China's Reform and Opening-up

Yan ZHANG （张晏）

China Center for Economic Studies
School of Economics
Fudan University

Part III. Feasible Systems and Feasible Strategies for China's Sustainable Developments

- Reconstruct the Central-local Relationship: Economic and Political Bases
- Market, Government, and Public Services Provision in China
- China and the World: Opening-door Policies and Globalization

Part III. Challenges to China's sustainable developments

Lecture 9. China and the World: Opening-door Policies and Globalization

Why China Has So Much FDI?

- "……interpreting the rising share of FDI, as a sign of good health is unwarranted……

  ——Hausmaan and Fernández-Arias(2000)

- "……Why more is actually less?......"

  ——Huang (2001)

- "……Could financial distortions be no impediment to economic growth after all?......"

  —— Guariglia & Poncet(2006)

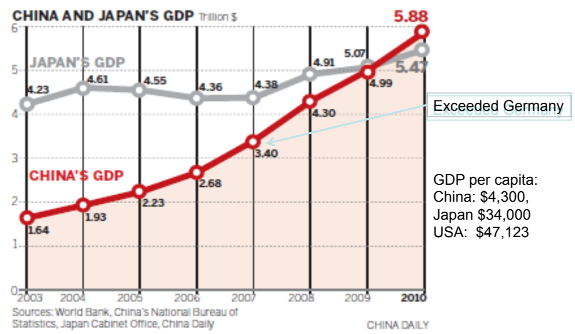
- "……It is possible, though, that researchers have been looking for FDI spillovers in the wrong place……"

  ——Javorcik, B. S.(2004)

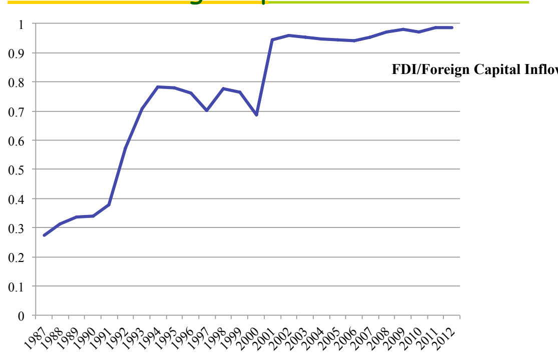
Outline

- ❖Stylized facts of FDI in China
- ❖Why China has so much FDI?
- ❖What effects does FDI have on China's economy?
- ❖Conclusion & discussion

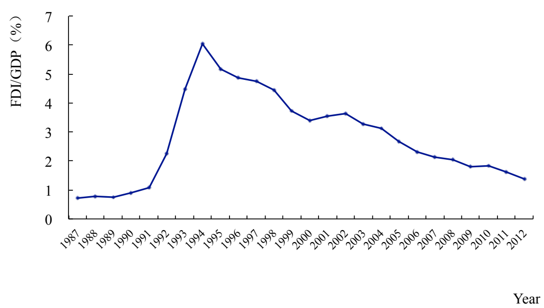
China overtook Japan as the world's second largest economy in 2010



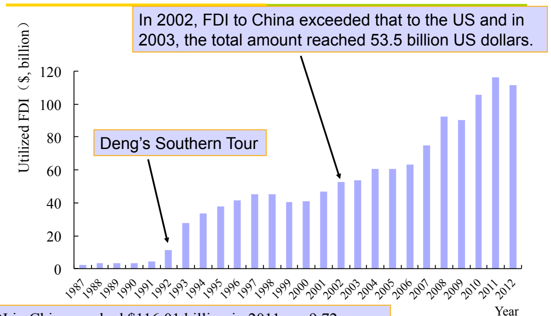
FDI is the dominating way of utilizing foreign capital in China



The Ratio of Utilized FDI to GDP



Inflow and Stock of FDI in China



FDI in China reached $116.01 billion in 2011, up 9.72 percent year-on-year. It decreased to $111.72 billion in 2012, then increased to &117.59 billion in 2013.

FDI in China in 2014

- ❖While global FDI decreased 8%, foreign direct investments in China hit a record high of $128 billion in 2014, an increase of 3% from 2013 and exceeding USA as the largest FDI receiver.
- ❖Meanwhile, China's ODI has grown 100-fold in recent years, from less than 1 billion US dollars in 2000 to nearly 108 billion in 2013. The number is expected to reach 120 billion dollars this year, outstripping FDI for the first time

FDI in China in 2014

- ❖The FDI increase was led by higher investment in the services sector together with increases in investment in the country's central and western regions. FDI in the services sector climbed by 28.6% and that in the central and western regions increased 27.6%.

FDI to Service Sector Increasing

- Foreign investment in the services sector rose by 14.15 percent year-on-year, and accounted for 52.3 percent of the country's actualized FDI for the year, according to the MOFCOM statistics. This was the first time it exceeded the 50 percent mark.
- Foreign investment in social welfare, electric machine repair, and entertainment services also saw rapid growth last year, increasing by 368.63 percent, 308.8 percent and 117.42 percent, respectively.

FDI into the Manufacturing Sector Decreasing

- In comparison, actualized FDI into the manufacturing sector saw a fall of 6.78 percent in 2013, with the industry receiving 38.7 percent of the total.

Utilized FDI Inflows by Sector (%)

	1999	2000	2001	2002	2003	2004	2005
Primary Sector	1.8	1.7	1.9	1.9	1.9	1.8	1.19
Manufacturing	56.1	63.5	65.9	69.8	69.0	70.9	70.37
Utilities	9.2	5.5	4.8	2.6	2.4	2.0	2.31
Construction	2.3	2.2	1.7	1.3	1.1	1.3	0.81
Transport and Telecom Services	3.8	2.5	1.9	1.7	1.6	2.2	3.00
Distribution Industries	2.4	2.1	2.5	1.8	2.1	1.3	1.68
Banking and Finance	0.2	0.2	0.1	0.2	0.4	0.4	0.36
Real Estate	13.9	11.4	11.0	10.7	9.8	9.4	8.98
Social Services	6.3	5.4	5.5	5.6	5.9	5.9	6.21
Media and Broadcasting	0.2	0.1	0.1	0.1	0.1	1.8	

Utilized FDI Inflows by Sector (%)

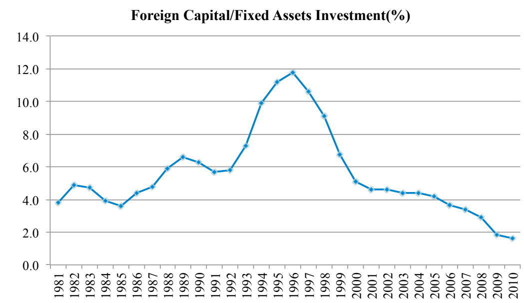
	2012	2011	2010	2009	2008	2007	2006
Primary Sector	1. 85	1. 73	1. 81	1. 59	1. 29	1. 24	0. 95
Manufacturing	43. 74	44. 91	46. 90	51. 95	54. 00	54. 66	63. 59
Utilities	1. 47	1. 83	2. 01	2. 35	1. 84	1. 43	2. 03
Construction	1. 06	0. 79	1. 38	0. 77	1. 18	0. 58	1. 09
Transport and Telecom Services	3. 11	2. 75	2. 12	2. 81	3. 09	2. 68	3. 15
Distribution Industries	3. 01	2. 33	2. 35	2. 50	3. 00	1. 99	1. 70
Banking and Finance	1. 90	1. 65	1. 06	0. 51	0. 62	0. 34	0. 47
Real Estate	21. 59	23. 17	22. 68	18. 66	20. 12	22. 86	13. 06

Utilized FDI Inflows by Sector (%)

Sectoral composition of Actual Utilized FDI in China during 1997-2009, unit: US $100 million. *Source*: Compute from NBS, *China Statistical Yearbook 1998-2009* and MOF
Invest in China.

	1997-2000	2001-2005	2006-2009
Primary	1.51%	1.74%	1.24%
Secondary	69.25%	74.30%	56.21%
Manufacturing	58.33%	69.36%	52.95%
Tertiary	26.33%	22.28%	42.56%
Real Estate	12.46%	10.00%	18.10%
Other	2.92%	1.69%	-
Total amount of Actual Utilized FDI	1751.16 (100%)	2740.81 (100%)	3354.17 (100

The Ratio of Foreign Capital in Fixed Assets Investment



Green-field investment is the main entry mode of FDI

Country	FDI inflow ($, billion)	A&M ($, billion)	A&M/FDI inflow(%)
Bulgaria	2.49	2.65	106.63
Brazil	18.17	6.06	33.33
Russia	11.67	3.86	33.10
India	5.34	0.80	14.96
China	60.63	5.03	8.30

- A Greenfield Investment is the investment in a manufacturing, office, or other physical company-related structure or group of structures in an area where no previous facilities exist.
- Greenfield Investing is usually offered as an alternative to another form of investment, such as mergers and acquisitions (A&M), joint ventures, or licensing agreements.

The Dual-track approach for FDI

❖ **Huang (2006) shows China's dualist nature to FIEs:**

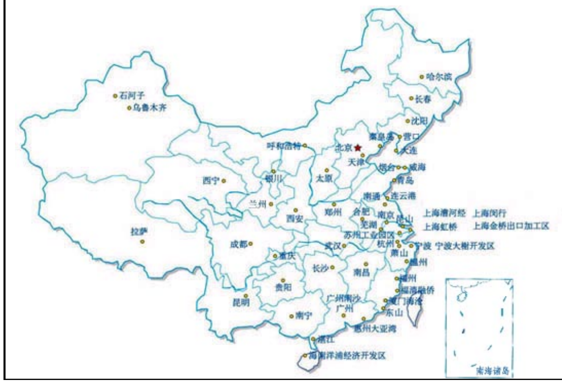
This paper shows that there is a dualist legal regime in China in that different bodies of laws and regulations apply to foreign-invested enterprises (FIEs) from those that apply to domestic firms. In general, the legal and regulatory treatments of FIEs are superior to those that pertain to domestic firms, especially domestic private firms. The dualist nature of China's legal regime is designed to insulate the economy from full effects of foreign direct investment (FDI) as well as to protect socialism.

❖ **The development of special economic zones and coastal regions:**

Huang (2006): The Dual-track approach

One of the most interesting aspects of China's legal system is its explicitly "dualist" nature. Certain laws and regulations apply to foreign business activities, and other laws and regulations apply only to domestic businesses. The dualist nature of the legal system even pertains to such basic issues as company incorporation, corporate governance, contract, and tax issues. The dualist nature of China's economic legislations is deeply rooted in the design and the approach of China's reform. As a design matter, China's reform has been primarily motivated to save, rather than dismantle, socialism. The separate legal regime designed for foreign-invested enterprises (FIEs) is simultaneously used to complement socialism as well as to insulate socialism from the full effects of foreign direct investment (FDI). China's reform approach matters as well. China has permitted and over time encouraged the emergence of nonstate firms by crafting new rules and policies while maintaining old rules and policies on the incumbents. Deng Xiaoping's famous formulation for Hong Kong—"one country, two systems"—can apply with equal force to the bifurcated treatments of foreign-owned and domestic firms in China.

Economic and Technological Development Zones



Export Processing Zone

Free Trade Zone

Big-three Economic Regions

tion, the Pearl River Delta (PRD), the Yangtze River Delta (YRD) and the Bohai Economic Rim (BER) are regarded as the “big-three” economic regions that have the lion’s share of foreign trade, investment and economic activities. Because of escalating production costs in PRD, the spatial path of FDI inflows had a noticeable change between Phase II and Phase III, when FDI started shifting from PRD to other coastal provinces, particularly the YRD and BER regions (Table 6 and Fig. 2).

Increasing Polarization of the Spatial Distribution of FDI

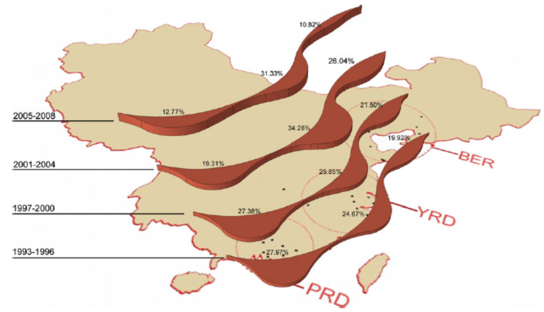


Fig. 2. Changing proportion of Actual Utilized FDI in major economic regions of China: 1993–2008.

FDI Inflows into China by Region (%)

	Average 1995-2003	Average 1995-1997	Average 2000-2003	2003
Henan	1.2	1.4	1.0	1.0
Anhui	0.8	1.2	0.7	0.7
Sichuan	1.0	1.0	1.0	0.8
Heilongjiang	1.0	1.4	0.7	0.6
Jilin	0.8	1.0	0.6	0.4
Shaanxi	0.8	1.0	0.7	0.6
Chongqing	0.6	0.9	0.5	0.5
Shanxi	0.5	0.4	0.5	0.4
Inner Mongolia	0.4	0.2	0.8	0.2
Yunnan	0.3	0.3	0.2	0.2
Quizhou	0.1	0.1	0.1	0.1
Gansu	0.1	0.2	0.1	...
Qinghai	...	...	0.1	...
Ningxia	...	...	0.1	...
Xinjiang	...	0.1	0.1	...

FDI Inflows into China by Region (%)

	Average 1995-2003	Average 1995-1997	Average 2000-2003	2003
Guangdong	25.1	27.0	22.3	14.6
Jiangsu	15.3	12.8	17.4	19.7
Shanghai	8.5	8.8	8.8	10.2
Fujian	8.7	9.9	7.2	4.9
Shandong	7.1	6.2	8.8	11.2
Beijing	3.9	3.4	3.8	4.1
Zhejiang	4.5	3.4	6.0	9.3
Tianjin	4.1	4.8	3.3	2.9
Liaoning	4.7	4.3	5.5	5.3
Hebei	2.0	2.0	1.6	1.8
Guangxi	1.4	1.8	0.9	0.8
Hubei	2.2	1.7	2.6	2.9
Hainan	1.4	2.1	1.0	0.8
Hunan	1.7	1.7	1.8	1.9
Jiangxi	1.2	0.8	1.6	3.0

Increasing Polarization of Spatial Distribution

The top 10 recipient provinces of Actual Utilized FDI in China during 1993–2008. *Source*: NBS, *China Statistical Yearbook 1994–2009*.

	1993–1996 (%)		1997–2000 (%)		2001–2004 (%)		2005–2008 (%)
Guangdong	27.97	Guangdong	27.38	Guangdong	19.31	Jiangsu	17.38
Jiangsu	12.19	Jiangsu	14.41	Jiangsu	17.21	Guangdong	14.14
Fujian	10.54	Fujian	9.31	Shandong	10.78	Shandong	8.55
Shanghai	8.93	Shanghai	8.11	Shanghai	9.56	Zhejiang	8.29
Shandong	6.98	Shandong	5.82	Zhejiang	7.52	Shanghai	7.15
Liaoning	4.21	Tianjin	4.43	Liaoning	6.65	Liaoning	6.87
Tianjin	3.73	Liaoning	4.40	Fujian	5.77	Tianjin	4.51
Zhejiang	3.55	Beijing	4.35	Beijing	3.87	Beijing	4.30
Beijing	3.35	Zhejiang	3.32	Tianjin	3.28	Fujian	3.48
Hainan	2.49	Hebei	2.49	Hubei	2.79	Hunan	2.67
Sub-total	83.94	Sub-total	84.04	Sub-total	86.73	Sub-total	77.35

The concentration of FDI occurred at provincial and regional le

Increasing Polarization of Spatial Distribution

Examples of high concentration of FDI in China at the city level in 2004 and 2008.
Source: NBS, *China Statistical Yearbook 2005, 2009, Guangdong, Zhejiang, Shanghai, Jiangsu and Liaoning Statistical Yearbook 2005, 2009.*

	2004 (%)	2008 (%)
Pearl River Delta FDI/Guangdong FDI	78.7	88.3
Jiangsu South FDI/Jiangsu FDI	75.8	66.9
Shenyang and Dalian FDI/Liaoning FDI	85.6	91.6
Qingdao, Yantai and Weihai FDI/Shandong FDI	76.3	51.1

Notes: Pearl River Delta includes Guangzhou, Shenzhen, Zhuhai, Dongguan, Zhongshan, Foshan, Huizhou (only includes Huizhou City, Huiyang, Huidong, Boluo), Jiangmen and Zhaoqing (only includes Zhaoqing City, Gaoyao and Sihui); Jiangsu South includes Nanjing, Suzhou, Wuxi, Changzhou and Zhenjiang.

The concentration of FDI also occurred at the city and county level.

New Trend after 2011: FDI to Western Regions Growing

- ❖FDI in China's western regions grew faster than that in the country's eastern and central areas last year, although eastern China remained the biggest destination for FDI, accounting for 83.27 percent of all foreign investment in China.
- ❖West China attracted $11.57 billion in FDI, up 28.24 percent year-on-year, compared with an increase of 7.51 percent in the east and 14.26 percent in central China.

FDI from Asian Nations Increasing

- ❖FDI from the United States declined 26.07 percent year-on-year to $3 billion in 2011, while investment from the EU dropped 3.65 percent to $6.35 billion.
- ❖Capital inflow from 10 Asian nations and regions, including Japan, Thailand and Singapore, climbed 13.99 percent to $100.52.

FDI Inflows by Source Country or Region (%)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 Sept.
Total	100	100	100	100	100	100	100	100	100	100	100
Hong Kong SAR	58.2	53.4	49.6	45.6	40.7	40.6	38.1	35.7	33.9	33.1	31.7
Virgin Islands	...	...	...	...	8.9	6.6	9.4	10.8	11.6	10.8	11.5
Japan	6.1	8.2	8.8	9.6	7.5	7.4	7.2	9.3	7.9	9.4	8.7
Korea	2.1	2.8	3.3	4.7	4.0	3.2	3.7	4.6	5.2	8.4	10.7
United States	7.4	8.2	8.2	7.2	8.6	10.5	10.8	9.5	10.3	7.8	6.9
European Union	...	...	...	...	...	11.1	11.0	8.9	7.0	7.3	7.3 [1]
Taiwan Province of China	10.0	8.4	8.3	7.3	6.4	6.4	5.6	6.4	7.5	6.3	5.4
Singapore	3.5	4.9	5.4	5.8	7.5	6.6	5.3	4.6	4.4	3.8	3.5
Australia	0.6	0.6	0.5	0.7	0.6	0.0	0.8	0.7	0.7	1.1	1.0
Western Samoa	...	...	...	...	0.3	0.5	0.7	1.1	1.7	1.8	2.0
Macao SAR	...	...	...	...	0.9	0.8	0.9	0.7	0.9	0.8	0.8 [1]
Others	12.0	13.4	16.0	19.3	14.7	6.5	6.7	7.9	8.9	9.2	10.4

Note: This table is based upon data for utilized (rather than contracted) FDI.

[1] Data for these two regions for 2004 are not yet available, so the same share has been assumed as in 2003.

FDI Inflows by Source Country or Region (%)

	2003	2004	2005	2006	2007	2008	2009	2010
Hong Kong	33.1%	31.3%	29.8%	32.1%	37.1%	44.4%	51.2%	57.3%
Japan	9.4%	9.0%	10.8%	7.3%	4.8%	4.0%	4.6%	3.9%
Singapore	3.8%	3.3%	3.7%	3.6%	4.3%	4.8%	4.0%	5.1%
Korea	8.4%	10.3%	8.6%	6.2%	4.9%	3.4%	3.0%	2.5%
Taiwan Province of China	6.3%	5.1%	3.6%	3.4%	2.4%	2.1%	2.1%	2.3%
European Countries	8.0%	7.9%	9.4%	9.1%	5.8%	5.9%	6.1%	5.6%
United States	7.8%	6.5%	5.1%	4.5%	3.5%	3.2%	2.8%	---
Australia	1.1%	1.1%	0.7%	0.9%	0.5%	0.4%	0.4%	---
Others	22.0%	25.4%	28.5%	33.0%	36.8%	31.8%	25.8%	23.2%

FDI Inflows by Source Country or Region (%)

The proportion of selected Actual Utilized FDI origins in China during 1993–2008. *Source*: Computed from NBS, *China Statistical Yearbook 1994–2009*.

Economies/year	1993–1996[a]	1997–2000	2001–2005	2006–2008
East Asian economies				
Hong Kong	55.28%	41.34%	32.55%	38.65%
Macau	1.51%	0.86%	0.86%	0.79%
Taiwan	9.30%	6.46%	5.69%	2.52%
Japan	7.31%	7.93%	9.33%	5.14%
Republic of Korea	2.58%	3.91%	7.58%	4.65%
Thailand	0.77%	0.44%	0.30%	0.16%
Singapore	4.08%	6.30%	3.92%	4.29%
Western economies				
Federal Republic of Germany	0.87%	2.41%	2.04%	1.57%
France	0.74%	1.70%	1.09%	0.62%
United Kingdom	2.21%	3.05%	1.62%	1.07%
Netherlands	0.31%	1.43%	1.43%	1.00%
United States of America	7.83%	9.16%	7.68%	3.90%
Canada	0.67%	0.73%	0.97%	0.59%
Some Free Port Economies				
Cayman Islands	N/A	0.86%	2.59%	3.39%
Virgin Islands	0.69%	7.13%	11.93%	19.01%
Samoan	N/A	0.46%	1.78%	2.72%
Other Economies	5.34%	5.14%	8.62%	5.76%
Total Amount (Unit: US$ 10,000)	14,165,756[a]	17,175,331	21,375,510	23,018,386

2 Why China Has So Much FDI?

- **Often Cited Arguments**
  - Low labor cost
  - Large population and market potential
  - Sound infrastructure
  - Healthy macroeconomic conditions
  - Politically stability

Review Points

- No agreed conclusion about how these factors mentioned above affect FDI.
- These variables are endogenous, which are determined by other factors.
- Ignoring the effects of institutional, geographic, cultural and historic factors, exiting researches are misleading to some extent.
- Maybe it's weak points not strong points of China that attract so much FDI inflow.

FDI Location by Source Country

ajor origins of Actual Utilized FDI in selected provinces in China during 2005–2008. *Source*: Computed from various issues of different provinces' *Statistical Yearbook 2006–2009*.

	National average	Guangdong	Zhejiang	Shanghai	Jiangsu	Shandong	Beijing	Liaoning
Hong Kong	36.80%	49.84%	43.16%	22.84%	30.87%	25.95%	24.26%	37.88%
Taiwan	2.74%	2.18%	2.72%	2.44%	4.26%	4.08%	N/A	2.29%
Japan	6.32%	4.44%	3.80%	12.12%	7.20%	6.47%	11.70%	8.62%
Republic of Korea	5.46%	0.81%	1.71%	1.25%	5.58%	31.65%	5.90%	13.22%
Singapore	4.16%	2.61%	2.23%	3.46%	5.99%	4.79%	3.09%	3.10%
Federal Republic of Germany	1.77%	0.41%	1.21%	5.85%	1.69%	0.98%	5.76%	0.97%
France	0.70%	0.54%	1.11%	1.28%	0.85%	0.41%	1.01%	0.10%
United Kingdom	1.18%	0.70%	1.09%	1.79%	1.06%	0.92%	0.63%	1.03%
Netherlands	1.15%	1.18%	0.67%	N/A	1.07%	0.63%	2.25%	0.39%
United States of America	4.14%	1.78%	5.42%	5.54%	4.75%	5.45%	3.74%	6.32%
Canada	0.63%	0.21%	0.74%	0.35%	0.89%	1.40%	0.15%	1.12%
Australia	0.59%	0.27%	0.96%	0.57%	0.70%	1.02%	0.12%	0.89%
Virgin Islands	18.17%	21.04%	18.11%	N/A	N/A	6.76%	19.34%	14.29%
Sub-total	83.82%	86.01%	82.93%	57.49%	64.91%	90.51%	78.10%	90.21%
Total amount of Actual FDI (STATE UNIT)	$29,050,845	$6316,800	$3704,511	$3196,100	$7762,685	$3818,228	$1922,573	$3069,227

Puzzles

- The large amount of FDI into China is puzzling given two facts about China's economy:

One is that the *savings rate is very high in China*; it is more than 40%. There is therefore no shortage of capital in China as in many other developing countries. If FDI is not needed to make up for the shortage of capital, why is it needed? What role does it play?

The second fact is that *the return to FDI is much higher than the return the Chinese government gets from investing China's foreign reserves in foreign government securities*. It is reported that the returns on US direct investment in China averaged 19.7 percent over the period 2000-2004 (Cooper, 2006). Given the large difference in the returns from FDI and from foreign government securities, why should the Chinese government invest in low yielding foreign government securities while allowing foreign investors enjoy high returns on FDI?

New Perspectives

- **Low Efficiency of Financial System (Bai, 2006)**

The domestic financial system is not efficient in allocating investment either through the capital market or through financial intermediation, and therefore the economy has to seek the help of foreign investors who know where to invest better. In a sense, this can be described as the *contracting out of investment allocation* by a country that does not have an adequate financial system.

The banking sector is strongly influenced by the legacy of central planning, the stock market is still very immature, and the corporate bond market is just emerging. None of them is very efficient in allocating investment. Furthermore, venture capital and private equity investment are still new and restricted by many unfavorable government regulations. Therefore, foreign investors are needed to help make investment choices.

New Perspectives

- **Policy Discrimination and Scarcity of Native Competitive Firms (Huang, 2003; Zhang, 2003)**

State-owned firms *have assets but have no capability*. On the contrary, private firms *have capability but have no assets*. As a whole, the native competitive firms are scarce in China. This situation provides opportunity for foreign companies to play a role in China's economy.

For China, FDI not only means capital, technology or management, but also means *effective organizations* to combine these factors together. In Zhang's words(2003), importing FDI actually means importing *firms*.

New Perspectives

- **Distortions on Financial and Goods Market (Naughton, 1999; Young, 2000; DFG, 2003, 2004, 2005; Lu et al., 2006)**

Because of fragmentation, China's domestic market is not so big as people often think. Under this surroundings, effects of scale of economy can't be realized. In view of these constraints, China's leaders consider exports as a way to *circumvent the internal fragmentation*. In order to make full use of abundant labor, China has to resort to international market to develop.

But China does not have so many firms which can produce competitive goods satisfying the international demand. Needless to say, this situation has something to do with the financial distortions. With FDI inflow and the firms it brings in, China *circumvents the internal financial distortions*.

New Perspectives

- **How to attract FDI?**
  - Potential high return assured by low labor cost !
- **How to keep foreign market open to Chinese exports?**
  - China provides an economic rent to foreign investors by limiting entry and that "the foreign investors then become a well-financed and effective lobby to counteract the resistance to the restructuring of the US labor force away from import substitutes!"
  - Official capital exports finance growth-oriented trade surpluses. In a single-minded emphasis on export growth has been supported by a virtually unlimited demand for US financial assets in the form of official reserves.

Direct Investment and Collateral($, billion)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Direct investment	3.5	10.6	33.7	65.5	99.4	137.4	179.1	220.2	257.2	294.7	332.0	378.8	425.7
50% Collateral of initial contract	1.7	3.6	11.6	15.9	16.9	19.0	20.8	20.6	18.5	18.7	18.7	23.4	23.5
100% Collateral capital gain	0.3	1.1	3.4	6.6	9.9	13.7	17.9	22.0	25.7	29.5	33.2	37.9	42.6
Total stock collateral	2.1	6.7	21.6	44.1	70.9	103.7	142.5	185.0	229.3	277.5	329.3	390.6	456.7
Stock of reserve assets	21.7	20.6	22.4	52.9	75.4	107.0	142.8	149.2	157.7	168.3	215.6	290.8	408.3

New Perspectives

- **Competition induced by fiscal decentralization**

(Wang et al. 2007; Zhang, 2006)

Political centralization and economic decentralization promote officials at different levels to drive their economy to grow. They usually compete each other for more FDI inflows. This kind of competition is not always good because they often "*race to the bottom*" not "race to top" and enter into a game of "*prison dilemma*".

In seeking for FDI, *tax incentives* are widely used. Forsyth (1972) provides support for the view that incentives may often not play a key role in influencing the decision to undertake a particular foreign investment. However, once other factors have provoked the decisions to set up production facilities in a broad area, then the more precise location decision may be strongly affected by such factors.

Tax exemption is like a dessert; it is good to have, but it does not help very much if the meal is not there.

New Perspectives

- **Round-tripping FDI (Xiao, 2004)**

  Round-tripping FDI is those Chinese capital which goes abroad first and come back later.

  Three stages of capital's journey: (1) the original creation of new capital in PRC, (2) the capital flight out of PRC and (3) the round tripping FDI back to PRC.

- Two types of round tripping: Rent-Seeking or Value-Seeking.

  Rent-seeking: tax advantages and fiscal incentives.
  Value-seeking: property rights protection/expectations on exchange control and exchange rate/competitiveness of HK and overseas financial services.

Round-tripping FDI to China: Estimated Amount and Ratio

Table 15. Round-Tripping FDI to PRC: Summary of Estimated Amount and Ratio

Region	FDI in 2000 (USD M)	Share of PRC's FDI in 2000	RT-Ratio: High	RT-Ratio Middle	RT-Ratio Low	RT-FDI: High (USD M)	RT-FDI: Middle (USD M)	RT-FDI: Low (USD M)
U.S.	4,384.00	10.8%	68.5%	61.8%	55.1%	3,003	2,709	2,416
Germany	1,041.00	2.6%	31.0%	22.4%	13.8%	323	233	144
Japan	2,916.00	7.2%	60.9%	51.7%	42.6%	1,776	1,508	1,242
Republic of Korea	1,490.00	3.7%	60.3%	48.8%	37.3%	898	727	556
Taipei,China Province	2,293.00	5.6%	70.2%	52.1%	34.0%	1,610	1,195	780
Singapore	2,172.00	5.3%	65.5%	59.9%	54.3%	1,423	1,301	1,179
Hong Kong, China SAR	15,400.00	37.8%	53.4%	39.9%	26.3%	8,224	6,145	4,050
Sub-total of the above 7	29,696.00	72.9%	58.1%	46.5%	34.9%	17,256	13,817	10,366
The rest	11,019.00	27.1%	31.0%	22.4%	13.8%	3,416	2,468	1,521
All Sources	40,715.00	100.0%	50.8%	40.0%	29.2%	20,672	16,286	11,887

Source: Previous tables and author's calculation.

Round-tripping FDI and Capital Flight($, Billion)

	1994	1995	1996	1997	1998	1999	2000	2001	Average
FDI	33.8	37.5	41.7	45.3	45.5	40.3	40.7	46.9	41.5
Capital Flight	39.4	47.9	50.4	85.6	115.6	102	90.4	24.2	69.5
RT-FDI	13.5	15	16.7	18.1	18.2	16.1	16.3	18.8	16.6
RTF/CF	34.3 %	31.3 %	33.1%	21.1%	15.7%	15.8 %	18.0%	77.3 %	23.9%

Siphoning off Effects

- Chantasasawat et al.(2004): FDI in China is positively related with FDI in ASEAN countries, but no relationship with FDI in Latin America.
- Marcereau (2005): Crowding-out effects limited to Singapore and Myanmar.
- Garcia-Herrero and Santabarbara (2005): Between 1984 and 2001, FDI in China has no impact on FDI in Latin America. However, between 1995 and 2001, China produced siphoning off effects on FDI in Mexico and Columbia.
- Eichengreen and Tong (2005): FDI in China is positively related with FDI in other Asian countries, negatively with OECD countries, but no relationship with Latin America and CEE.

In sum, for Asian neighbors,
The dragon does not crowd out the tigers! They are comrades not competitors!
Much Ado about Nothing!

New Perspectives

❖ **Geography and Culture Matter! (Gao, 2006)**

The total FDI stock would be lowered by about 45% if China's economic center were located in New Delhi, India, and would be lowered by about 70% if China's economic center were located in New Delhi and there were no cultural ties.

These rough estimates suggest that much of China's ability to attract FDI is due to its natural advantages, which is unlikely to be reproduced through FDI policy alone by other developing countries.

History Matters! (Zhang, 2006)

Phases	Central Gov Attitude	Local Gov Attitude	Foreign Attitude	Tension	Features of Institutions
Pre-1368 Era	Indifferent	Indifferent	Enthusiastic	Weak despite China's dominance	1. Tribute system 2. Strong regulations over trade
1368-1842	Reluctant	Positive	Aggressive	Strong due to China's dominance	1. Tribute system 2. Strong regulations
1842-1911	Reluctant/ Hostile	Positive	Aggressive, Exploitation	Strong due to foreign dominance	1. Opening by unequal treaties 2. Remain weak control beyond ports.
1911-1949	Hate-love mixture	Positive	Aggressive, Exploitation	Strong due to foreign dominance	1. Continue treaty port system 2. Remain weak control beyond ports.
1949-1978	Hostile	Hostile	Hostile	Strong due to hostility	1. Isolation 2. Self-reliance
1978 onwards	1. Friendly and in demand 2. Cautious about negative effects	Active	1. From hesitating to positive 2. Positive but criticizing	Strong due to Chinese high attractiveness and foreign tech. advance	1. Voluntary opening 2. Seek mutual benefit 3. Self-reliance

A New Framework Understanding FDI in China

❖ **Pre-reform conditions determined that China needs FDI.**

- ➢ Constraints faced with by the central Gov.:
  - ✓ Endowment structure determined China has comparative advantage in labor-intensive products (Lin, 2005).
  - ✓ Commodity market imperfections reduced the expected return from developing labor-intensive industry.
  - ✓ Financial market distortions heightened the cost of developing labor-intensive industry.
- ➢ Strategy adopted by the central Gov.:
  - ➢ By utilizing FDI, domestic financial distortions were circumvented.
  - ➢ Combining foreign capital and native labor together, China can produce and export competitive products. In this way, commodity market imperfections are evaded.

Understanding FDI in China: FD

❖ Fiscal decentralization triggers off competition at different level, which promotes FDI to flow in quickly.

- ➢ The objective of "Market-oriented Reform" results in "pushing effects" on FDI.
- ➢ The strategy of "Fiscal decentralization" produced "pulling effects" on FDI.

Understanding FDI in China: Natural Advantages

- China has natural advantage over other developing countries because of geographic and cultural proximity with South East Asian neighbors.
  - South East Asian neighbors quickly emerge as a source of capital export.
  - Geographic and cultural proximity make them choose China as an important location of capital outflow.

3. What Effects has FDI Produced on China's Economy?

- **Existing literatures about FDI's effects and influencing factors**
  - Focused on effects on China's economic growth and technological advancement.
  - Centered on discussing factors influencing these effects above. These factors include human capital, income level, infrastructure, financial development , opening degree, and so on.

Review points:

China has been undergoing huge transformation from planning economy to market-oriented economy. It's necessary to deal with the issue that what effects brought by FDI on shaping an efficient market.

FDI found and realized China's comparative advantage

- **FDI found and realized China's comparative advantage in global economy.**
  - That FDI does not speed up technical improvement tells us that China is not an outlier.

    Same conclusion are drawn from those researches on Morocco, Venezuela, and Turkey.
  - The so-called strategy "Swap Market for Technology" is misleading and untenable.

    Fragmented market gives FDI monopolistic position and entitles them to enjoy excessive profit, which inhibits their motive of innovation for more market share.

    In order to promote technology transfer and advancement, the government should release regulation and reduce the entry barrier for domestic private capital.

FDI found and realized China's comparative advantage

- By way of processing trade, FDI found and realized China's comparative advantage in international market.

  It is not "Swap Market for Technology" but "*Swap Less Integrated Domestic Market for More Integrated International Market*" that drives China and foreign investors into a "win-win" game.

Value Unit:USD100Millions

	Utilized FDI	Utilized FDI /GDP at Official Exchange Rate (%)	Contribution to Gross Industrial Output Value by FIEs (%)	Contribution to Exports by FIEs (%)	Contribution to Urban Employment by FIEs (%)	Contrituion to PRC's Total Industrial and Commercial Taxes by FIEs (%)
1985	4.65	0.6	--	1.20	0.05	--
1986	7.26	0.6	--	1.60	0.10	--
1987	8.45	0.7	--	2.50	0.20	--
1988	3.19	0.8	--	3.70	0.20	--
1989	3.39	0.8	--	9.10	0.30	--
1990	3.49	0.9	2.28	12.60	0.40	--
1991	4.37	1.1	5.29	16.75	1.00	--
1992	11.01	2.3	7.09	20.44	1.30	4.25
1993	27.52	4.6	9.15	27.51	1.60	5.71
1994	33.77	6.2	11.26	28.69	2.20	8.51
1995	37.52	5.4	14.31	31.51	2.70	10.96
1996	41.73	5.1	15.14	40.71	2.70	11.87
1997	45.26	5.0	18.57	41.00	2.70	13.16
1998	45.46	4.8	24.74	44.06	2.90	14.38
1999	40.32	4.0	27.75	45.47	2.80	15.99
2000	40.72	3.8	22.51	47.93	2.90	17.50
2001	46.88	4.0	28.05	50.06	2.80	19.01
2002	52.74	4.2	33.37	52.20	3.00	20.52

Source: Extracted from *China Foreign Economic Statistical Yearbook 1998 and 2002*

Commodity Trade($, Billion)

	2001				2005			
Rank	Country or Region	Export	Country or Region	Import	Country or Region	Export	Country or Region	Import
0	World	6183.0	World	6474.0	World	10393	World	10753
1	USA	729.1	USA	1179.2	DE	970.7	USA	1732.7
2	DE	571.6	DE	486.1	USA	904.3	DE	774.1
3	JP	403.5	JP	349.1	PRC	762.0	PRC	660.0
4	FR	323.4	UK	333.0	JP	595.8	JP	516.1
5	UK	272.7	FR	328.6	FR	459.2	UK	501.2
6	PRC	266.1	PRC	243.6	HO	401.2	FR	495.8
7	CA	259.9	IT	236.2	UK	377.9	IT	379.7
8	IT	244.5	CA	227.3	IT	366.8	HO	357.9
9	HO	230.9	HO	208.6	CA	359.6	BEL	320.4
10	HK	191.1	HK	202.0	BEL	329.6	CA	320.1

Commodity Trade, Year 2010($, Billion)

Rank	Exporters	Value	Share	Annual percentage change	Rank	Importers	Value	Share	Annual percentage change
1	China	1578	10.4	31	1	United States	1969	12.8	23
2	United States	1278	8.4	21	2	China	1395	9.1	39
3	Germany	1269	8.3	13	3	Germany	1067	6.9	15
4	Japan	770	5.1	33	4	Japan	694	4.5	26
5	Netherlands	573	3.8	15	5	France	606	3.9	8
6	France	521	3.4	7	6	United Kingdom	560	3.6	16
7	Korea, Republic of	466	3.1	28	7	Netherlands	517	3.4	17
8	Italy	448	2.9	10	8	Italy	484	3.1	17
9	Belgium	412	2.7	11	9	Hong Kong, China	442	2.9	25
10	United Kingdom	406	2.7	15	10	Korea, Republic of	425	2.8	32

FDI improves the allocation efficiency

- **FDI is like "a visible hand" which directs where resources should go.**
  - **Labor Market**
    - ✓Unskilled labor forces with little human capital flow to numerous private SMEs. The development level of these firms play as a visible hand to direct where low-end labors should go.
    - ✓Skilled labor forces with high human capital flow to large numbers of foreign invested enterprises. The development level of foreign firms are like a magnet to attract these high-end labors.

FDI improves the allocation efficiency

- **Financial Market**
  - ✓With state-owned enterprises being reduced further, state intervention in the bank system is decreased and the banks have to make decisions by themselves. In this situation, FDI can play an important part in getting the financial resources to the real sector.
  - ✓When not knowing how to do, banks have an alternative way out, that's simply "*following FDI*". This prediction is supported by our observations that "*Banks often go where FDI goes*". Those firms, industries and regions which host FDI are easier to get loan from the banks.
  - ✓Through reducing the informational asymmetry between financial sector and real sector, ***as well as introducing more competition***, FDI improves the efficiency of financial system.

FDI improves the allocation efficiency

- **Land Market**
  - ✓Under traditional economy, various government departments and SOEs stored large quality of land. With reform going on, opportunity cost resulting from such actions goes higher and higher.
  - ✓In order to attract more and more FDI, the local governments established many development zones, industrial parks or high-tech development zones. In this way, waste land has been reduced.

Discussion 1: Huang (2006)

Table 1
The average response scores given by foreign and domestic private firms on business environment in China, 2000

	Foreign firms	Domestic private firms
Business regulations: 1 = no obstacle; 4 = major obstacle	1.79	1.90
Labor regulations: 1 = no obstacle; 4 = major obstacle	1.62	1.70
General constraint—taxes and regulations: 1 = no obstacle; 4 = major obstacle	1.86	2.17
Confidence in judicial system today: 1 = fully agree; 6 = fully disagree	2.59	2.77
Quality of courts: 1 = very good; 6 = very bad	3.15	2.97
Changes in laws and regulations: 1 = completely predictable; 6 = completely unpredictable	3.37	3.15
Helpfulness of central government today: 1 = very helpful; 5 = very unhelpful	3.0	3.02
Helpfulness of local government today: 1 = very helpful; 5 = very unhelpful	2.76	2.62
General constraint—financing: 1 = no obstacle; 4 = major obstacle	2.93	3.48
General constraint—corruption: 1 = no obstacle; 4 = major obstacle	1.93	2.13

Source: World Bank business environment survey.

Discussion

- ❖ Topic 1: Huang (2006) found "In many important aspects, the legislative and regulatory framework developed for the Foreign-Invested Enterprises (FIEs) seems to be superior to that for domestic firms, especially domestic private firms. There is some preliminary evidence that this legislative and regulatory superiority has created a business environment that is more "friendly" to FIEs than to domestic private firms." How do you think about it?

Table 2
Tax and extra charges as a percentage of sales, 1995 (%)

	Manufacturing industries	Electronic industry	Machinery industry (excluding automobile industry)
FIEs	0.67	0.09	1.14 (0.12)
SOEs	0.86	0.33	0.77 (0.48)
Collective firms	1.07	0.71	0.61 (0.55)
Private firms	1.03	1.29	0.13 (0.13)

The main source for this table is Office of Third National Industrial Census, 1997, #1987.

Discussion 2: Ran, Voon & Li (2007)

(1) Is it true that the early reports on the positive effects of FDI on China are still valid today? In other words, does the legendary spillover still exist?
(2) Do local industries without foreign equity participation benefit from the FDI inflow?
(3) How does the increased foreign presence affect the productivity of different industries and provinces in China?

While point (1) essentially focuses on the efficiency impact of FDI, points (2) and (3) provide significant equity or income distribution considerations.

We provide herewith a brief summary of our findings. First, the traditional legendary spillover effect on China seems to continue but apparently not as strong as previously thought. Second, some local industries without foreign participation appear to lose while those with foreign participation gain from the inflow of FDI. Third, the effect of FDI in China varies across industries and provinces. Industries that benefit from the FDI inflow include sectors that are more capital-intensive, such as chemical, petroleum and nonferrous metal processing, transportation, and electronics. In terms of the distribution effect across provinces, relatively more developed provinces and municipal cities in the East like Guangdong, Jiangsu, Shanghai, and Shandong are beneficiaries while others, especially in central and western regions, lose from the FDI inflow.

Discussion

❖ Topic 2: How and Why has FDI influenced the interregional disparity in China?

Capital-weighted foreign equity participation in different regions across China from 2001 to 2003

FRA^C			FRA^C			FRA^C		
East	(2001/2002/2003)	Average	Mid	(2001/2002/2003)	Average	West	(2001/2002/2003)	Average
Hebei	0.0683/0.0733/0.0915	0.0777	Shanxi	0.0252/0.0266/0.0251	0.0257	Qinghai	0.0036/0.0036/0.0024	0.0032
Zhejiang	0.1032/0.1132/0.1025	0.1063	Jiangxi	0.0371/0.0230/0.0226	0.0276	Gansu	0.0072/0.0092/0.0081	0.0082
Guangxi	0.0994/0.1093/0.1183	0.1090	Henan	0.0296/0.0274/0.0321	0.0297	Xinjiang	0.0123/0.0078/0.0206	0.0135
Shandong	0.1289/0.1274/0.1306	0.1290	Neimenggu	0.0342/0.0344/0.0568	0.0418	Ningxia	0.0148/0.0182/0.0282	0.0204
Liaoning	0.1184/0.1188/0.1762	0.1378	Heilongjiang	0.0555/0.0532/0.0538	0.0542	Shannxi	0.0246/0.0272/0.0246	0.0288
Hainan	0.1567/0.1345/0.1406	0.1439	Hubei	0.0693/0.0621/0.0767	0.0694	Guizhou	0.0291/0.0298/0.0384	0.0324
Beijing	0.1974/0.2103/0.2155	0.2077	Hunan	0.0515/0.1030/0.0667	0.0737	Yunnan	0.0421/0.0373/0.0450	0.0414
Fujian	0.2062/0.2175/0.2474	0.2237	Anhui	0.0857/0.0953/0.0910	0.0907	Sichuan	0.0528/0.0678/0.0674	0.0627
Guangdong	0.2226/0.2397/0.2591	0.2405	Jilin	0.0872/0.0918/0.1062	0.0950	Chongqing	0.1199/0.1187/0.1138	0.1175
Jiangsu	0.2821/0.2975/0.3120	0.2984						
Shanghai	0.2639/0.3191/0.3882	0.3237						
Tianjing	0.3469/0.3858/0.3720	0.3683						

China and the World

❖ How will international economic recession influence China's reforms?

❖ How will China replace foreign demand for its goods with domestic markets?

❖ Will China catch up in 2020? If yes, what will be the necessary conditions?

Chinese Economy

❖ Special report: China's economy

❖ Like high-wheeling on a penny-farthing

❖ http://www.economist.com/blogs/analects/2012/05/special-report-chinas-economy

Institutional Crisis

- Losing faith:
  - http://www.economist.com/blogs/freeexchange/2012/06/regime-change
- Different from the 2008 crisis, a broad institutional crisis appears to be brewing.
  - Markets may be questioning the ability of policymakers around the world to manage the macro economy in a non-disastrous way.
  - Europe is the most obvious and dangerous flashpoint in this crisis, but it is by no means the only one.

Institutional Crisis

- Universal crisis
  - In America, confidence was seriously rattled by last year's debt-ceiling showdown, and it is frightening to think that an ever bigger fiscal confrontation looms ahead at year's end.
  - China's economy is weakening, and while it seems clear that the government has the tools to support it, the interaction of economic weakness and political transition in a place with such opaque political institutions breeds concern.
  - In India, the citizenry and markets are rethinking their view of the economy. It once appeared to be on a path toward steady reform and rapid catch-up growth, but the recent burst in output now looks a one-off, suggesting that there are big reform challenges—and political battles—ahead.

institutional crisis

- contributing to a distressing monetary feedback loop.
  - Europe provides the clearest example. The European Central Bank is clearly reluctant to extend its interventions in the economy without more progress and institution-building from the euro-zone's political leadership. But this reluctance deprives the euro-area economy of needed support, increasing the pressure on political institutions. It is possible that a similar, if less pronounced, dynamic is influencing the behaviour of the Federal Reserve.

Similarities

- It's easy to oversell comparisons between the present and the interwar years; the problem is simply that there aren't that many reasonably comparable macroeconomic eras.
- But there are clear parallels: significant sovereign indebtedness, difficult-to-address imbalances across an inflexible monetary regime, an economic system that had run well ahead of supporting political and fiscal institutions, central bankers seemingly at sea, and an absence of effective economic leadership. And a chief characteristic of this mess was a reinforcing cycle between economic weakness and pressure on inadequate political institutions.

Reform Revisited: Economic Decentralization & Political Centralization

- Definition:
  - Centralization
    - All resources are controlled by the government instead of the market, or by the higher level government instead of the local governments.
  - Decentralization
    - Devolution
      - Govt. vs. individuals
      - Central vs. local

Economic decentralization in China

- Economic decentralization:
  - Govt. vs. individuals
  - Central vs. local
- Incentives
  - Work harder
  - Hide wealth?
  - Local competition

Political Centralization in China

- Political centralization
  - official promotion systems in China
  - Election & Democracy
- Incentives
  - Yardstick competition for growth

Federalism Chinese Style

- Economic decentralization & political centralization
  - official promotion systems in China
  - Election & Democracy

Social Structure in China

- Relationship-based vs. contract-based
- Relatives vs. strangers

- Decreasing role?

Reform and Development

- Is such institutional structure efficient and sustainable?

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