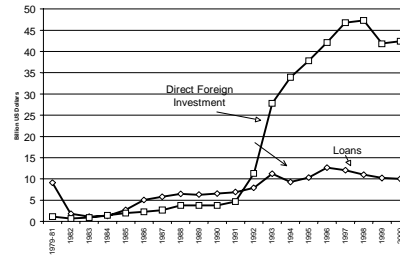


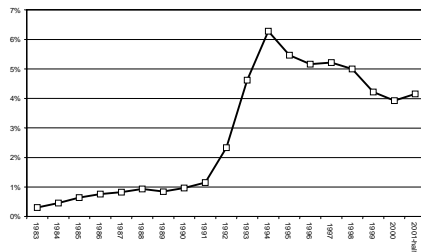
## Foreign Investment

- Forms of foreign investment
  - Loans
    - Short term
    - Long term
  - Portfolio investment (equity in market)
  - Foreign direct investment (FDI)
- Features of China's foreign investment
  - Mainly FDI
  - Among loans, few short term loans
  - Little portfolio investment (such as B-shares, QFII)

## Total Foreign Investment



## FDI as Share of GDP



## First Wave: 1978-80

- 1979: Guangdong and Fujian provinces “one step ahead”
- 1979: Joint venture laws (no limit on foreign shares)
- 1980: four special economic zones (Shenzhen, Zhuhai, Shantou, and Xiamen)

## Size of China's SEZs and Asian EPZs (km<sup>2</sup>)

	Initial 1980 Size	Size in 1990
Shenzhen	327.5	327.5
Zhuhai	6.8	121.0
Shantou	1.6	52.6
Xiamen	2.5	131.1
Kaohsiung, Taiwan		0.7
Penang, Malaysia		1.2
Batam Island, Indonesia		36.6
Bataan, Philippines		3.4

## Special Economic Zones (SEZ) vs. Export Processing Zones (EPZ)

- Similarities
  - Tax incentives for foreign investors (import duties and corporate income tax)
  - Administrative procedures simplified
- Differences
  - Special in many senses: market oriented while the rest of the country still under central planning
  - They are the windows to the outside
  - Domestic enterprises also invested heavily (all provinces and ministries made investment)
  - Laboratories for experiments with reforms

### Second Wave: 1984-87

- 1984: Shenzhen was proclaimed as a successful experiment after Deng Xiaoping's visit
- 1984: 14 coastal "open cities"
  - They set up "development zones" to offer similar terms as in special economic zones
- Coastal development strategy

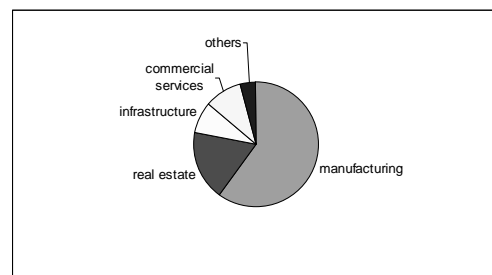
### Third Wave: 1992-93

- 1992: Pudong Special Zone in Shanghai
  - Most important among all special zones
  - Shanghai did not have much change between 1980 and 1990
  - But Shanghai completely changed since 1991
- SEZ like preferential policies apply to many other areas
- More development zones were established
- Competition among regions to attract foreign capital

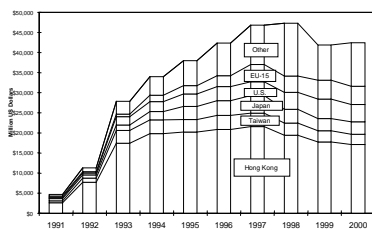
### Fourth Wave: 2001-present

- FDI declined after Asian financial crisis in 1997
- FDI picked up again since 2001: annual inflow around US\$ 50 billion
- WTO is an important factor
- But China has a combination of
  - a huge market
  - a competitive manufacturing sector
    - Cheap labor cost
    - Skilled workers (basic education)
    - Professionals (engineers)
    - Industrial base (processing capability)
    - Infrastructure (roads, telephone costs)
    - Reasonable land cost

### FDI: Sectors



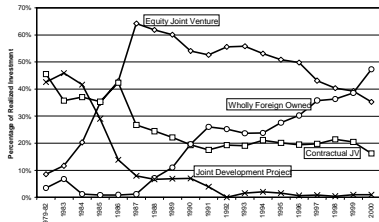
### FDI: Sources



### FDI: Sources

- Special role of Hong Kong
  - Some are Taiwan investment
  - Some are "round tripping" domestic investment
    - Take advantage of tax concessions
    - Foreign capital safer than domestic capital
- Taiwan, Japan, U.S., EU

### FDI: Ownership Structure



### FDI: Ownership Structure

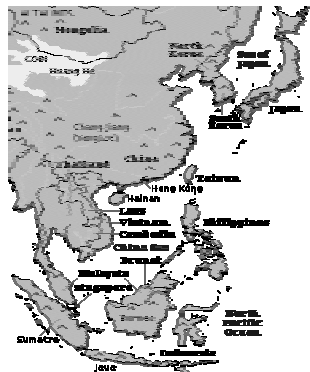
- Three forms foreign investment (*sanzi qiye*)
- Contractual Joint Venture
  - Not necessarily a legal entity, but a service contract
  - Examples: industrial processing contracts, hotels
- Equity Joint Venture
  - A legal entity, both Chinese and foreigners have stakes
  - A dominant form in late 1980s through late 1990s
- Wholly Foreign Owned
  - Becomes a dominant form in late 1990s

### FDI: Geography

- Guangdong is special (share of total FDI)
  - 1979-84: 80%
  - 1979-97: > 33%
  - 1998: 26%
- Coastal provinces accounting for 85% of total FDI
  - Guangdong, Fujian, Guangxi and Hainan
    - 1979-97: 45%
    - 1998: 39%
  - Shanghai, Jiangsu, and Zhejiang
    - 1979-97: 22%
    - 1998: 25%
  - Liaoning, Tianjin, Hebei, Beijing and Shandong
    - 1979-97: 18%
    - 1998: 22%

### FDI: Geography

- Changes in economic environments
  - Export oriented industrialization by Japan and East Asian newly industrialized economies (NIEs)
  - Reduction of transportation costs
  - Collapse of raw material prices
- China is located in the right neighborhood
  - Japan
  - Hong Kong, Singapore, Taiwan, South Korea
  - Malaysia, Thailand, Indonesia, the Philippines
- But geography can't explain everything



### FDI: Geography

- “Greater China” includes Hong Kong, Taiwan, and mainland China
- “China circle” includes coastal Hong Kong, Taiwan, and coastal China
- Intra-regional trade
- Main export markets: U.S. and other OECD countries

### Special Role of Hong Kong

- Hong Kong vs. Shanghai
  - Will Shanghai replace Hong Kong soon?
- Hong Kong's comparative advantage
  - Banking
  - Legal environment

### Special Role of Taiwan

- Special role of Taiwan
- Taiwan investment in mainland China soared after 2000
- Will Taiwan de-industrialize?
- Taiwan will shift to high margin services
  - R&D
  - Design