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China's economic restructuring through induced capital inflows

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ABSTRACT

Mao Zedong was China's "Great Helmsman" between 1949 and 1976. Corollary to his vision for China, all major social, economic and political decisions bore his personal imprimatur. Mao advocated self sufficiency and isolated China's economy from the rest of the world. By the time of his demise in 1976, the mold had been cast. China's economy had only negligible interaction with the rest of the world's economies.

Once Mao was out of the picture, Deng Xiaoping and his colleagues who had been previously disgraced and removed from public office by Mao, were promptly back to center stage. Deng succeeded Mao as China's paramount leader in 1978. Economic restructuring and modernization began. Deng's approach to systemic transformation in China combined tight political controls with liberalizing economic policies.

Attracting foreign investment and liberalizing foreign trade became two major engines of structural reform and economic development for China. After nearly three decades of reform, China has already become the third largest economy in the world. Its immense population has been providing low-cost labor for the market-hungry foreign investors. Though nearly 40% of China's GDP still originates from the state sector, the country remains a favorite site for global manufacturing relocations. China's economy has been achieving nearly double-digit annual growth rate for years.

This paper researches original documents, official data, select laws/decrees and current writings for analyzing China's unique experience with inducing foreign capital inflows since 1979. It also analyzes the likely consequences of its foreign-economic-relations policy on the rest of the world's economies.

Keywords: China, Economic, Capital Inflows, Foreign Investment

INTRODUCTION

After the Communist takeover in China in 1949, Mao closed China's economy to the West until the early 1970s.[1] The U.S.-led embargo fortified Mao's distrust of the West. As a result, China initially confined its external economic relationship to exchanges with economies of the former Council for Mutual Economic Association (CMEA) members. Foreign inflow came in the form of long-term credit extended by Moscow. China relied primarily on the former USSR for credits and technical assistance. However, the ideological rift and open quarrel between Mao and Khrushchev in 1960 brought an abrupt withdrawal of all Soviet assistance to China.[2] The USSR recalled all it technical experts and invalidated treaties on economic cooperation with China. As a result, Mao insisted on self-reliance further isolating China from the rest of the world. The self-imposed isolationism left China increasingly behind the developed West and the rapidly growing economies of the Pacific Rim.[3] As reforms began in the late 1970s and early 1980s, Deng Xiaoping assumed a two-pronged approach: mobilizing within, liberalizing without. Liberalizing foreign investment and foreign trade became the cornerstone of reform for the external sector.

BACKGROUND

Mao's China was plagued by political upheavals and economic turbulence.[4] By the late 1970's and the early 1980s, Japan's ascendance as a new economic superpower could no longer be overlooked. China's smaller neighboring economies were also poised for developmental takeoff. Developed economies were continually growing and adapting to a rapidly changing world economic structure. All open economies benefitted from economic integration and globalization. China, however, remained on the sidelines.

In the mid 1970s, economic opportunities for an open-door policy abounded. The mature markets of the west were slowing while the developing economies in Southeast Asia were accelerating. Foreign capital sought investment opportunities, and foreign technical experts and technologies searched for international hire and buyers. China needed the capital and technologies of foreign investors.

An open-door policy would facilitate more than advanced foreign technologies. It would reduce China's need for foreign borrowing, mitigate its need for imports, conserve and enhance foreign reserves, increase domestic productivity, expand taxable revenue, improve employment opportunities, raise the quality of domestic labor and management, and promote China's standing abroad. With dozens of urban centers dotting thousands of coastal miles, China's potential as competitive market could attract the much-needed foreign capital and advanced technologies.

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[1] "U.S. China Relations Since 1949" http://afe.easia.columbia.edu/special/china1950_us_china.htm. 6-14-2010.

[2] Oleg Hoeffding, "Sino-Soviet Economic Relations 1959-1962," The Annals of the American Academy of Political and Social Science Vol. 349, No. 1, 94-105 (1963).

[3] Selected works, articles and writings authorized and approved by Mao are found in Bruno Shaw Selected Works of Mao Tse-Tung. (New York: Harper Collins, 1970).

[4] Marcus E. Ethridge and Howard Handelman, Politics in a Changing World 5th Edition (Boston: Wadsworth, 2010) 427-428.

Deng recognized China's productive potential and its need for foreign capital infusion. He understood that systemic and structural reform in an economy of a billion subjects was politically, economically, and socially complex.[5]

Foreign investment reform began after Deng's open-door policy received formal approbation from the Party's third session of the Eleventh Congress in December 1978.[6] He emphasized the imperative of socialists construction suited to China's unique characteristics.

REFORM APPROACH

In the 1960s limited foreign capital and technologies began trickling in from France, Germany, Britain, and Japan. Exchanges between China and the United States resumed on a limited scale in the 1970s.[7]

Political tension eased after Mao's demise. Tentative airing of 'novel' ideas also began budding forth. Capitalizing on more relaxed political atmosphere after Mao, the leadership in Guangdong province petitioned the central administration in April of 1979 for greater autonomy in its economic relations with neighboring economies. More specifically, it requested that Shenzen, Zhuhai and Shan Tou be designated as export-destined centers for value-added activities. The targets for such exports would include not only neighboring Hong Kong but nearby Asian markets. Hong Kong also served as a ready conduit for channeling exports to distant shores. The petition received Deng's unequivocal endorsement.[8]

Deng specified select coastal locations as the conduit for capital and technological inflows. China has designated five special economic zones (SEZs), fourteen coastal open cities, six open economic regions, and numerous economic and technological development areas. The long-term objective progressed from economic zones dotted along the coast, to lengthened economic lines fronting overseas economies, and then drawing the development impetus inward to provinces in the interior.[9]

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[5] Hsing Hsu, ed., Chronicle of a Decade of Reform: 1978-1987 (十年改革大事记：1978-1987) (Beijing: Hsing Hua Press, 1988) 334-348.

[6] Xue, Muqiao. 1982. Almanac of China's Economy 1981: With Economic Statistics for 1949-1980. (New York and Hong Kong: Modern Cultural Company In Association with Eurasia Press, 1982) 92.

[7] National Security advisor Henry Kissinger secretly visited China In July 1971 followed by President Nixon's 1972 visit and the eventual signing of the Shanghai Communiqué (also known as the open-door policy). See Robert Dallek, Nixon and Kissinger: Partners in Power. (New York: Harper Collins, 2007).

[8] The central administration deliberated the petition. The fruit from the deliberation was a document titled "Select Provisions Governing Stepped-up Foreign Trade Endeavors for Enhanced Foreign Earnings." See Shin Su and Xin Zhonguo and Jingji Shi, Select Provisions Governing Stepped-up Foreign Trade Endeavors for Enhanced Foreign Earnings (Chinese Communist Party School Publication, 2007) 567.See Robert Dallek, Nixon and Kissenger: Partners in Power. (New York: Harper Collins, 2007).

[9] "An Evaluation of Economic Development Policy of the Chinese Communists" (中共经济发展策略之评估) Economic Construction Institute, Economic Research Division (ed.) 1990: 284-288.

China designated Shenzen as its first SEZ in March of 1980, followed by Zhuhai and Shantou as the second and third SEZs in August of that year. Two months later, Xiamen, which is along the coast of Fujian Province, was named the fourth SEZ. In April of 1988, the island of Hainan was conferred the status of an independent province and the whole province became China's fifth SEZ. [10]

Till then, SEZs were unique to China. It was an experiment to introduce pivotal free-market elements into what was still a socialist system. SEZs enjoyed the privileges of more liberal policies than the rest of the country. Though under the umbrella of a socialist system where the state sector still dominates, a SEZ concurrently permits economic activities based on market principles and therefore differs from a traditional free-trade zone. The principal source of financial and human resources needed for development originates from abroad. Goods and services produced from the induced foreign inflow earned convertible currencies through exports. Market-based economic activities also competed with state enterprises within the designated zones and created forwarded linkages benefitting local economies. Experience gained from experimenting with SEZs within a planned economy provided useful knowledge to policy designers regarding priorities, pace, and overall scope of reform.

The SEZs were not simply export-destined processing centers. They served as special links and windows to external economies, inducing foreign capital and technological inflows. Between 1979 and 1982, 949 agreements with foreign investors were reached within the designated SEZs. Out of the agreements, 922 foreign direct investments (FDI) were made, totaling $6.01 billion. FDI in 1983 alone reached $1.73 billion, accounting for 470 additional investments. For hard-currency-starved China, the beginning of open-door policy promised bountiful dividends.[11]

After an on-site tour of the SEZs in February 1984, Deng was duly convinced of the merits of an open door policy, he took the next step in opening up China to the outside world. In April 1984, 14 coastal cities stretching from Dalian in the northeast to Beihai in the southwest were declared as open to foreign direct investments.[12]

The newly designated fourteen open cities (hereafter, OCs) formed a north-south line, or front-line, facing the Pacific Ocean. In varying degrees, these coastal cities had the experience of external economic relations before 1949, primarily as ports handling foreign trade. All were better endowed with infrastructural conveniences not available in most of China's interior municipalities. Many of them had been trade centers in the past. The intent was that by opening up these coastal cities to foreign capital and technological inflows, the foreign injections would be able to revive the long dormant commercial spirit of the past. Policies governing external economic relations within the open cities were not as liberal as those in the SEZs. Neither were the local administrations granted as much autonomy as in SEZs. The primary focus of opening these coastal cities was to attract foreign capital and technologies and to stimulate and promote

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[10] "Fifty Years of The People's Republic of China" (新中国五十年). China's National Bureau of Statistics (国家统计局). Beijing: China Statistics Press (中国统计局出版社). 1999: 57.

[11] "An Appraisal of Development Strategy of the Chinese Communist's Economy," Research Division for Institute of Economic Development, 1990: 284, 288.

[12] The fourteen open cities were: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai.

foreign trade. The focus also was to modernize and invigorate local state enterprises, stimulate export growth, and develop tertiary industries.[13]

In order to further expand and accelerate foreign inflows, China designated six economic development regions (EDRs) in the delta areas of China's major water-ways: the Pearl River deltas, the Southern Fujian, Xiamen, Zhanghou, and Quanzhou delta region, the Yangtze River deltas, the Shandong Peninsulas, the Beihaiwan region north of the Yellow River, and Liaodong Peninsulas bordering North Korea. EDRs were perfectly situated as bases for disseminating and transmitting infused capital and technologies to China's interior provinces. Each of the six EDRs has geographic as well as developmental advantages, supplementing and fortifying SEZ and OC functions, and providing a broader variety and a wider range of investment opportunities in larger territories for prospective foreign capital.[14]

Beginning in late 1984, the government designated thirteen additional coastal districts as economic and technological development areas (ETDAs). [15] Twelve of the fourteen OCs were also named ETDAs. To date, thirty-two such areas have been singled out as open, attracting foreign capital as a catalyst for economic and technological development. Finally, a number of free-trade zones have been established within circumscribed districts of select coastal cities (Shanghai, Shenzhen, Tianjin, Dalian, Fuzhou, Guangzhou, and Zhangjiagan) for import-export promotion.

In brief, China's opening up to external economies comprised primarily of three categories: SEZs, Open Cities, and Open regions. After the first dozens years of opening up to the outside world, the total number of agreements reached for using foreign capital was 29,693, totaling $68.1 billion. Appreciating the value of productively utilizing foreign capital, China also began borrowing as early as 1979. By the end of 1990, China had also borrowed a total of $45.9 billion from external sources that included international financial institutions, foreign governments, foreign commercial banks and financial institutions.[16]

FOREIGN INVESTMENT INCENTIVES

The primary economic incentives granted to foreign investors were tax reductions, tax exemptions, and tax refunds. The normal income tax payable on earnings from a foreign investment was reduced from 30 to 15 percent if the investment was made in one of the SEZs or ETDAs engaging in production-oriented activities. The reduced rate also applied to foreign investments if one of the three following conditions existed: (1) the investment was made in one of the OCs, provided its initial capitalization exceeded U.S. $30 million; (2) the venture was engaged either in advanced technology or in science-centered activities; or (3) the investment made was on the state-specified high priority development list. Depending on reform objectives and the development emphasis, the state also periodically sanctioned some of the lower-level administrations to grant tax incentives to prospective foreign capital. Local administrations such

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[13]"An Appraisal of Development Strategy of the Chinese Communist's Economy," Research Division for Institute of Economic Development, 1990: 291.

[14] Hong Wang, China's Exports Since 1979 (New York: St. Martin's Press. 1993) 107-109.

[15] Joseph C.H. Chai (ed.). The Economic Development of Modern China: Reforms and Opening Up Since 1979. Volume 3 (UK.USA.: Edward Elgar Publishing lnc. 2000) 451.

[16]China, State Statistical Bureau, People's Republic of China, China's Statistical Yearbook 1996 (Beijing: China Statistical Publishing House, 1996) 629.

as provinces, autonomous regions, or municipalities could then exempt favored foreign capital ventures within their jurisdictions from local taxes. In general, a two-year tax exempt period was granted to foreign capital in designated areas, commencing with the first year the operation realized a profit. It was followed by a three-year, 50 percent tax reduction period. The reduction could be from the usual 30 to 15 percent, or from the 15 percent levied on a foreign investment in a SEZ or ETDA to 7.5 percent.[17]

Upon the expiration of tax-privilege years, an export-oriented foreign investment venture in a state-designated area could continue its claim of a 50 percent reduction on income tax. The primary condition was that 70 percent or more of the concern's product was destined for export. A foreign capital venture could also extend its initial 50 percent income-tax reduction by three additional years, if the appropriate state ministry certified that its operation met the high-tech specifications or if its operation resulted in new products and/or new processes needed by the domestic market.

The tax privileges were also available to limited Chinese investors if the investment was a Chinese-foreign joint venture. The conditions for claiming tax privileges by a Chinese partner were similar to foreign investors: a minimum of ten-year operation, location in one of the state-designated areas, engagement in high-tech or export-oriented product activities, or investment in one of the state-emphasized sectors or sub sectors. The duration of the tax privilege enjoyed by a Chinese partner in a joint capital venture was two years. Foreign investors could further secure a 40 percent tax refund from the amount of income tax paid if its share of profit was reinvested in the existing operation, or if the profit was used to start a new investment venture in one of the state-designated areas.

In addition, the state guaranteed non-appropriation of foreign assets without just cause or without due compensation. After paying the taxes due, earnings by foreign capital could be freely remitted to the parent company or country of origin. The general provisions of economic incentives granted to either direct or joint-venture capital from abroad, including capital inflow from the province of Taiwan, pertained to tax privileges prior to the Tien-An-men Square incident of June 4, 1989. Growth in foreign capital inflow slowed after the student-led democracy movement. China introduced new stimulus packages thereafter to revive the momentum of foreign capital inflows.

LEGAL PROVISIONS

Laws and constitution had little relevancy in practice while Mao was alive. This was particularly apparent during the tumultuous years of the "Great Cultural Revolution" in the late 1960s. Deng himself was a victim of the lawless years of the 'Great Cultural Revolution.' When reform began, Deng insisted on the imperative of legal reform. Deng decentralized China's economic system, yet remained a socialist, at least in theory. A pivotal instrument in socialist construction was the utilization of all available resources, including those from non-socialist economies. Deng's address to Party leaders on March 30, 1979, made the following observation:

> Capitalism already has a history of hundreds of years. The advanced science and technology developed by people in different countries under the Capitalist system, and

[17] Raphael Shen, China's Economic Reform: An Experiment in Pragmatic Socialism (London: Praeger Publishers, 2000) 101-102.

> the useful knowledge and experience accumulated [by them] are what we must inherit and learn from. We need methodically, and on a selective basis, induce advanced techniques and what is useful to us from Capitalist countries. But we must neither imitate nor bring in the Capitalist system.[18]

Law and order were perceived as a prerequisite for sustained economic reform and development. When reform began, the People's Congress authorized the State Council to issue provisional regulations, decrees and guidelines pertaining to foreign economic relations. Between 1979 and the end of 1986, more than half of the laws enacted by the People's Congress and more than half of the directives and decrees issued by the State Council pertained to economic relations. Among them were laws and regulations pertaining to the encouragement and protection of foreign investments.[19]

China's laws governing foreign economic relations must also be compatible with accepted international laws, regulations, and practices. Foreign economic laws and regulations are thus premised on the notion of mutual respect and mutual gain on equitable terms.

Administrative authorities of different levels have, to date, enacted or issued more than three hundred laws and guidelines concerning foreign economic relations. The three most significant laws enacted by the state are: Equity Joint Venture Law (August 7, 1979; amended on April 4, 1990); Foreign Capital Enterprise Law (April 12, 1986); and Chinese-Foreign Cooperative Ventures Law (April 13, 1988).[20] The more distinct characteristics of each of the three are briefly highlighted in the ensuing discussion. Supplementing the Equity Joint Venture and Foreign Capital Enterprise laws, the State Council issued two Decisions. One of the Decisions was issued on October 11, 1986, inviting and encouraging investment of foreign capital. The other Decision specifically aims at prospective investors from Taiwan and was decreed on June 25, 1988.

Equity Joint Venture Law

Joint Venture Enterprise Law was adopted on July 1st, 1979 by the Second Session of the Fifth People's Congress and promulgated on July 8th that same year. The principal elements of the law are as follows:

- For broadening the PRCs international cooperation and technical exchanges, China authorizes cooperation between foreign concerns or foreign economic entities/individuals and their Chinese counterparts, when establishing equity joint-venture enterprises (JVs) in Chinese territories (Article 1).[21]
- All authorized foreign interests must abide by and receive protection from China's legal

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[18]Hsing Hsu, ed., Chronicle of a Decade of Reform: 1978-1987 (Beijing: Hsing Hua Press, 1988) 334.

[19]Dominique T.C. Wang, ed., China's Foreign Economic and Trade Laws (Taipei: National Taiwan University Law School Press, 1996) 2, 7.

[20]Dominique T.C. Wang (王泰铨) （ed.) (中华民国 85 年), China's Foreign Economic and Trade Law (中共对外经济贸易法). (Taiwan: Wu-nan Book Company Ltd.(五南图书出版公司). 1996: 58-71, 527-552, 637-653.

[21] Legislative Committee, ed., A Handbook of PRC's Laws Pertaining to Foreign Economic Activities (Beijing, Legislative Press, 1991) 149-169.

provisions. When a prospective JV submits an application to the appropriate authority, together with the JVs bylaws, agreements, and other cogent provisions, the authority must act on the application within a three-month period approving or denying the application. Upon approval, the JV registers as a limited liability legal entity and may begin operation (Articles 2-4).[22]

- The registered share of capital from the foreign participant(s) must be 20 percent or more, reaping profits or sharing losses in proportion to its registered share of capitalization. Foreign capital may come in the form of cash, material supplies, or patent rights, while the Chinese partner, with prior agreement, may enter the use of its land and/or structured properties as a share of the JV capital. Foreign-invested technology and capital, however, must be advanced in nature and must be in fact suited to China's development needs. Deliberate attempts at falsely representing the nature of the foreign share of capital, upon discovery, are subject to financial penalties (Article 5).[23]
- Profits are subject to taxation, although the foreign share may apply for income tax exemption for the first two or three years of its profitable operation. If the foreign share of profit is reinvested within China's territories, it may apply for a tax rebate on a given percentage of its income taxes already paid (Article 7).[24]
- A JV is encouraged to market its product(s) abroad, either directly by the JV itself or through one of the state's foreign trade organizations, although the product(s) may also be sold on the domestic market (Article 9).[25]
- The foreign investor, in accordance with foreign currency control laws and regulations, has the right of exchanging its earnings from the domestic market into a convertible currency for remittance abroad (Article 10).[26]
- The rights and privilege of remitting earnings abroad applies to a JV's foreign employees as well (Article 11). [27]
- Upon the expiration of a joint venture agreement, the parties may apply to the appropriate authority extending the agreement's validity for a specified period of time (Article 12).[28]

On September 20th, 1983, the State Council issued detailed Directives governing the implementation of the Joint Venture Enterprise Law.[29] Of the 105 Directives, a select few merit highlighting as follows:[30]

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[22] Ibid.
[23] Ibid.
[24] Ibid.
[25] Ibid.
[26] Ibid.
[27] Dominique T.C. Wang (王泰铨) (ed.), 最近中华人民共和国法律、法规汇编. (Taipei: Hanlu Book Company Ltd (翰芦图书出版有限公司). 2002: 461-483.
[28] The law was amended on April 4th by the Third Session of the Seventh People's Congress. The second revision of the law took place during the Fourth Session of the Ninth People's Congress on March 15, 2001. Other than rendering a longer article of the law into two individual shorter ones, no substantive elements of the initial law have been altered.
[29] For detailed articles of the State Council's decree, consult the People's Republic of China Implementation Rules Governing Chinese-Foreign Capital Joint Ventures, dated September 20, 1983. An original text of the decree may be found in Legislative Committee, ed., A Handbook of PRC's Laws Pertaining to Foreign Economic Activities (Beijing, Legislative Press, 1991)

- Technology transferred for use by JVs (in China) should be advanced in nature. The products resulting from employing the induced technology should be either socially or economically beneficial (to the host country) or are competitive on international markets (Directive no. 41).
- Unless otherwise stipulated, the party transferring the technology may not restrict the recipient partner in terms of geographic regions, quantity or pricing of products exported by the JV. In addition, upon the expiration of the technology-transference agreement, the technology recipient partner may continue availing itself of the technique or technology (Directive no. 43, sub sections 2 and 4).
- In accordance with tax laws, the equipments and machineries and their parts that are not available from domestic sources may be imported. Such imports may receive tax reduction or exemption privileges. Similarly, raw materials, machinery parts and packaging supplies that are needed for producing export-destined goods may be accorded similar privileges.
- When needed, JVs may apply for convertible or domestic currency credits from either domestic financial institutions or from banks in Hong Kong and Macao.

Viewed as a whole, the JV law and its corresponding operational Directives accentuate two major points: China welcomes foreign capital in the form of JVs, and it actively and demonstrably seeks advanced technologies and modern techniques.

The earnestness in seeking advanced technology-imports is made patently clear in the favorable provisions made for diverse forms of capitalization. The favorable conditions provided are manifestly evident especially under article four of the JV law and in Directives number 22 through 25, inclusive, as issued by the State Council. China wanted advanced technologies.

Instead of all-cash investment, the foreign capital partner could apply advanced technologies or patented techniques as a part of its total contribution to a joint capital venture. It is made even more transparent by the language of subsection four of Directive 43 which obliges the foreign capital partner to grant the domestic partner continual rights to utilize the imported technology even after the technology-transfer agreement have run its course.

Foreign Capital Enterprise Law

By the mid 1980's, China's leaders were duly convinced of the valuable contributions which foreign capital and technology could make in the country's effort at systemic restructuring. However, the bulk of capital and technology inflow came through neighboring Asian economies. At this time, China was ready for the next step. On April 12, 1986, the Fourth Session of the Sixth People's Congress adopted the PRC's Foreign Capital Enterprise Law. The Foreign Capital Enterprise LTV (FCEL) was aimed at larger foreign investors interested in sole ownership within

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149-169. Of interest is an amendment to Article 2 of the original JV law, which guarantees non-appropriation of the foreign share of the JV. Under special circumstances, if appropriation or nationalization becomes necessary, due compensation must be given to the foreign interest. "National People's Congress, Revision of the <PRC, Sino-Foreign Equity Joint Venture Law> Decision." New Law Digest, Volume IV, CLP, May 7, 1990: 36.

[30]Minor modifications of no substantive consequence were introduced into the Directives on January 15, 1986, December 21, 1987 and July 22, 2001.

China's territories. JV operations in general were smaller in scope, the FCEL more specifically targeted larger foreign investors, especially the multi-national corporations of developed economies. A foreign capital enterprise (FCE) differs from other enterprises in China in that all capital investment originates from a foreign source. The FCEL stipulates that all or most of the output from a foreign concern be export-bound (Article 3). The interest of all FCEs is protected by the laws, while all must abide by the laws as well (Article 4). The State Council determines which types of FCE activities are prohibited or circumscribed. The foreign interest is protected from appropriation by the state. In extraordinary instances where necessity justifies appropriation, the state guarantees due compensation to the FCE (Article 5). All things being equal, a FCE should secure the needed factors from China's domestic market first; although it may procure the same from international markets as well (Article 15). As with the JVs, a FCE enjoys tax exemption, reduction, and rebate privileges as articulated by provisions of the law (Article 17).

Stipulated in Articles 3 and 15, respectively, the FCEL encourages FCE purchases of inputs from China's domestic market, while it requires most output to be targeted for export. This benefits China since purchasing domestic inputs earns convertible currencies, while marketing domestically produced outputs abroad translates into increased taxable revenue from a FCE. This is why the law requires that an FCE files its business plan(s) with its supervising authority in China prior to its operation (Kwei, 1988: 454).

On December 12, 1990, the Ministry of Foreign Economic Relations mandated that an FCE must fulfill one of the following two requirements.[31] Either an FCE must adopt advanced technology and equipment, develop new products, demonstrate energy and factor efficiency, and produce products capable of substituting for China's needed imports; or an FCE's year-end export value must be equal to or exceed 50 percent of its total value product, achieving a balance or surplus in its transactions involving convertible currencies (Article 3, 1 and 2). The implementation also details stipulated areas where FCE activities are prohibited or circumscribed. Among prohibited activities are broadcasting, publications, television, telecommunication, insurance, and domestic commerce (Article 4). Among restricted activities are public services, transportation, real estate, and investment trusts (Article 5). Articles 43 through 49 in Chapter Six of the implementation rules detail the guidelines for a FCE's factor. purchasing and product-marketing activities. Chapters Seven and Eight of this decree correspondingly deal with taxation and foreign currency regulations applicable to a FCE.

Chinese-Foreign Cooperative Joint-Venture Law

To provide greater latitude than that of the JV law for the expansion of foreign capital and advance technology inflows, the Seventh People's Congress adopted the Cooperative Joint Venture law (CJV) on April 13, 1988.[32] Unlike an equity JV, there is no upper or lower limits to the foreign share of capital in a CJV. Respective contributions of the two cooperative parties may be freely agreed upon by the partners prior to registration (Article 2). It is the agreement that determines the respective shares of losses and liabilities, revenue and profit, and administrative responsibilities. In an equity JV, the parties share the liquidated assets proportionate to their

[31] Bureau of Legislative System, Executive Administration ed., A Compendium of PRC's Executive Laws: 1979-1992 (Beijing: Hsing Hua Press, 1993) 1478-1487.

[32] Legislative Committee, ed., A Handbook of PRC's Laws Pertaining to Foreign Economic Activities (Beijing, Legislative Press, 1991) 170-174.

respective shares of capital contribution to the venture upon the expiration of their cooperation. In a CJV, however, all fixed assets belong to the Chinese partner at the end of the joint effort, although the foreign interest, in accord with a signed agreement, may withdraw a stipulated share of the asset-equivalent prior to the venture's expiration date.[33] Moreover, all or part of the responsibilities may be contracted to a third party. The CJV allows for broader economic activity. Thus, a foreign interest may seek a cooperating partner in China for ventures in hotels and restaurants, food and apparel industries, housing and construction activities, education, and health care services.

Although the law was not enacted until April of 1988, by the end of 1987 the authorities had already approved 5,139 applications from would-be CJVs, with stipulated capitalization valued at U.S. $12.1 billion.[34]

Two Decisions Concerning the Encouragement of Foreign Investment

The State Council's Decision of October 11, 1986 and the State Council's Decision of June 25, 1988 also have special significance. The pronouncement titled "Decision Concerning the Encouragement of Foreign Investment" recapitulates the privileges and advantages granted to foreign interests as stipulated in the JV and FCE laws, including obtaining short-term credits from the Bank of China on a priority basis, exemptions of withholding taxes on profits remitted abroad, and the extended reduction of income taxes if 70 percent or more of a venture's value product is export bound (Articles 6-8).[35]

The State Council's Decision of June 25, 1988 is also of special significance. Its target is the prospective investment capital from Taiwan.[36] The Decision of June 25 stipulates that Taiwan capital may invest in every province, autonomous region, municipality, and designated economic zone on China's mainland territories. This means that Taiwan interest has the same rights and privileges as a domestic economic entity. All rights and privileges of an investment from Taiwan are protected under the laws, including the rights of inheritance and property-rights transference (Article 7). The administrative responsibilities of venture capital from Taiwan may be discharged either by the Taiwan investor, or they may be delegated to the investors' associate in China (Article 17). Taiwan investors may petition local authority to form an association of Taiwan investors for consultation and support (Article 18).

PROGRESS

China needed advanced technology, modern techniques, and investment capital. Despite

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[33]Chinese Communist Party School, ed., Practical Economic Laws (Beijing: Chinese Press, 1994) 225-226.

[34]Yun Li, Chang, ed., Foundations of Commercial Legislation (Shanghai: Science and Propagation Press, 1989) 290.

[35]Bureau of Legislative System, Executive Administration, ed., A Compendium of PRC's Executive Laws: 1979-1992 (Beijing: Hsing Hua Press, 1993) 832.

[36]The twenty-two articles of the decree titled The State Council's Decision Encouraging Investment by Compatriots from Taiwan, may be found in many state documents, including Bureau of Legislative System, Executive Administration ed., A Compendium of PRC's Executive Laws: 1979-1992 (Beijing, Hsin Hua Press, 1993).

the language of the JV law—the provisions were less liberal than they appeared. For example, foreign investors had limited access to the domestic market. As a result, their interest in pursuing China's vast market potential was severely curtailed. Furthermore, corrupt officials expecting or intimating bribery, the lack of an enforceable civil code, absence of a company law, time limits imposed on JVs achieving a balance or surplus in foreign exchanges, and prohibiting foreign investors from acting as chairperson of the board all contributed to the relatively slow inflow of capital in the early 1980s.

On the other hand, although China's reform measures were tentative and experimental at the beginning, China has steadily and progressively removed covert restrictions, lifting institutional impediments to foreign investors and adjusting to evolving conditions.

The primary forces attracting inflows were cost efficiency in the form of relatively inexpensive labor and complementary factors, tax and duty privileges, and abundant investment opportunities; that is, low-cost manufacturing and assembly operations promising rapid returns.[37] Table 1 below provides a succinct overview of foreign capital inflows for select years into China since reform began.

Data in upper portion of Table 1, at the end of this article, presents the number of projects and their corresponding values for the given years.[38] The total amount of contracted foreign investment is comprised of foreign loans, direct foreign investment and other foreign investments. The lower portion of the table presents data on the total amount of foreign investment realized or actually utilized. A select few observations are briefly outlined below:

- For a five-year period between 1979 and 1984, there were a combined total of 3,841 projects amounting to $28.1 billion. The main source of the contracted foreign capital originated from the 'foreign loan' sector.
- The portion of contracted direct foreign investment (DFI) during that same five-year period accounted for 34.7 percent of total, whereas the portion of realized DFI for the same period was a meager 22.6 percent.
- Contracted foreign investment in 1988 was $16.0 billion, which was a 31.8 percent increase over the previous year's $12.1 billion. However, the same category of contracted foreign investment suffered a 21.3 percent decrease during the following year. The most likely cause of the abrupt decline in contracted foreign investment in 1989 was that it was also the year of student unrest and the 'Tien-An-Men Square incident.'
- There was a modest increase of 5.4 percent in contracted foreign investment in 1990. However, the 1990's contracted foreign investment was still 24.5 percent below that of 1988.
- With restored social calm and enhanced economic incentives, growth in direct foreign investment resumed in 1991. Amendments in 1990 to the JV law extended a guarantee of non-expropriation of JV assets by the state (Article 1), permitted a foreign investor to Chair the board of a JV (Article 3), granted to the foreign partner the privilege of opening a foreign currency account with a bank other than the Bank of China (Article 5), and allowed an extension of the time limit on cooperative ventures (Article 6).[18]
- A year later the government granted additional tax privileges to foreign capital enterprises and contractual ventures if the investments were made in priority domains as

[37] Joint Economic Committee, Congress of the United States (1991) 830.

[38] National Bureau of Statistics of China (ed.). China Statistical Yearbook, 2009. (Beijing: China Statistics Press, September 2009).

identified by the state. As seen in the Table, the contracted direct foreign investment increased by 77.8 percent from 1990 to 1991, and realized inflow grew by 24.3 percent.

- With the passage of time, foreign investors were sufficiently reassured that the Chinese government was determined to maintain social calm, whatever the cost. For foreign investors, this meant the safety and security of their investments. Contracted foreign investment surged from 1991's $19.6 billion to the following year's $69.4 billion, a 254.6 percent increase.
- The fastest growth category in inducing foreign capital was in DFI. The latest single-year data available for it was for 2006. When comparing 2006's contracted DFI of $193.7 billion with that of 1985's $6.3 billion, it showed a phenomenal 2,959 percent increase in a 21 year period. The increase in corresponding number of projects for the same two years under comparison was also an impressive 1,250 percent. The conclusion that may be deduced was that larger and larger DFIs were making their way into China's vast investment markets.
- During the five-year period of 1979-1984, foreign capital realized was $18.2 billion. It was a humble beginning when compared with 2008's single-year realized foreign investment totaling $95.3 billion.
- The combined amount of contracted foreign investment for the three decades of open door policy between 1979 and 2008 was $1.66 trillion. Combining 2005's $192.6 billion of contracted foreign investment with that of 2006's $198.2 billion, the two-year period's contracted foreign investment total was $390.8 billion. That is, the sum of the two latest years contracted foreign investment data that have been made available accounts for nearly 24 percent of the total contracted foreign investment for the thirty-year period from 1979 through 2008. The data demonstrate plainly of China's impressive accomplishments in the domain of attracting foreign capital inflows through its reform policies that began three decades ago.

A CLOSING OBSERVATION

The success story of China's foreign investment policy is self evident. With improved capital inflows and resulting increases in foreign earnings, the government has been able to improve both the infrastructural support systems as well as needed services to foreign investments.

On another front, the scope of foreign investment keeps widening over time. Initial foreign investments concentrated mostly in manufacturing and construction industries. With improved investment environment for foreign capital, investments from abroad have systematically branched into service industries that include communication, transport and financial services.

It is through foreign injections that the entrepreneurial spirit in China has been awakened, fortified and energized. Foreign capital inflows have also helped create jobs, increase government revenues, fuel the growth of the export sector, raise the general living standards and empowered the general public to dreams of sustained economic well being.

FDI in China has been the catalyst for China's rapid growth and rapid increase in its ability to expand its export sector. The resulting accumulation of foreign reserve has thereby empowered China to seek investment opportunities from abroad. From 2002 through 2007, China's direct investment abroad increased from $2.5 billion to $18.8 billion, a seven fold

increase. In 2002, China ranked number 26 in the world in terms of investment volume abroad. Five years later, China climbed to number 13 in that category. Among the developing nations, China has ranked number one in terms of DI made abroad.[39]

China continues to take steps to attract foreign investors. There have been efforts made to attract more DFI north and west into China's interior provinces and regions. Some of the steps include granting select provincial governments the authority to formulate their own incentive packages for foreign projects. To introduce increased competition with domestic banking operations, China has also been granting a broader range of services offered by foreign banks. In addition, the Chinese currency was made fully convertible on China's current account as of December 1, 1996, complying with one of the International Monetary Fund's (IMF) Articles of Agreement.

On the reverse side, China also seems to be sending negative signals to foreign investors. For instance, component localization schedules, a key element of the automobile industry policy, has become a standard aspect of foreign-funded electronics and machinery project approvals. Furthermore, foreign investments must also pay into five mandatory funds—medical, unemployment insurance, accident and disability, pension and maternity—as their domestic counterparts. Combined with rising labor costs, incremental expenditures imposed on foreign investments may be perceived as seriously compromising the investment milieu for foreign capital.

In brief, China's foreign investment policy has helped propel China onto the world stage. This proves China is more than just a success story in terms of systemic restructuring and economic development. After thirty years of reform, China has become a dominant force in the world scene and has proven to be a key player in affairs of the world economy. However, since joining the World Trade Organization (WTO), the special privileges granted to foreign investors before would now have to be gradually phased out. Tariffs are the sole leverage with limited flexibility that still exists for China to deploy. China, therefore, must shift from granting privileges to significantly improved investment environment so that it can continue to compete for foreign capital that still thirsts for investment opportunities abroad.

Table 1: Utilization of Foreign Capital (unit USD, 100 million)[40]

Year	Total		Foreign Loans		Direct Foreign Investments		Other Foreign Investments
	Number of Projects	Value	Number of Projects	Value	Number of Projects	Value	
Total Amount of Contracted Foreign Investment							
1979-1984	3841	281.26	117	169.78	3724	97.50	13.98
1985	3145	102.69	72	35.34	3073	63.33	4.02
1986	1551	122.33	53	84.07	1498	33.30	4.96

[39] Yieu Wei Tai. "Rapid Growth in Our Country's Direct Investment Abroad." <http://www.sinotf.com/GB/Tradedata/1141/2008-5-12/225938AFGBD.htm>.

[40] National Bureau of Statistics of China (ed.). China Statistical Yearbook, 2009. (Beijing: China Statistics Press, September 2009).

1987	2289	121.36	56	78.17	2233	37.09	6.10
1988	6063	160.04	118	98.13	5945	52.97	8.94
1989	5909	114.79	130	51.85	5779	56.00	6.94
1990	7371	120.86	98	50.99	7273	65.96	3.91
1991	13086	195.83	108	71.61	12978	119.77	4.45
1992	48858	694.39	94	107.03	48764	581.24	6.12
1993	83595	1232.73	158	113.06	83437	1114.36	5.31
1994	47646	937.56	97	106.68	47549	826.80	4.08
1995	37184	1032.05	173	112.88	37011	912.82	6.35
1996	24673	816.10	117	79.62	24556	732.76	3.71
1997	21138	610.58	137	58.72	21001	510.03	41.82
1998	19850	632.01	51	83.85	19799	521.02	27.14
1999	17022	520.09	104	83.60	16918	412.23	24.26
2000	22347	711.30			22347	623.80	87.50
2001	26140	719.76			26140	691.95	27.81
2002	34171	847.51			34171	827.68	19.82
2003	41081	1169.01			41081	1150.69	18.32
2004	43664	1565.88			43664	1534.79	31.09
2005	44001	1925.93			44001	1890.65	35.28
2006	41473	1982.16			41473	1937.27	44.89
2007	37871				37871		
2008	27514				27514		
Total Amount of Foreign Investment Actually Utilized							
1979-1984		181.87		130.41		41.04	10.42
1985		47.60		25.06		19.56	2.98
1986		76.28		50.14		22.44	3.70
1987		84.52		58.05		23.14	3.33
1988		102.26		64.87		31.94	5.45
1989		100.60		62.86		33.92	3.81
1990		102.89		65.34		34.87	2.68
1991		115.54		68.88		43.66	3.00
1992		192.03		79.11		110.08	2.84
1993		389.60		111.89		275.15	2.56
1994		432.13		92.67		337.67	1.79
1995		481.33		103.27		375.21	2.85
1996		548.05		126.69		417.26	4.10
1997		644.08		120.21		452.57	71.30
1998		585.57		110.00		454.63	20.94
1999		526.59		102.12		403.19	21.28
2000		593.56		100.00		407.15	86.41
2001		496.72				468.78	27.94
2002		550.11				527.43	22.68
2003		561.40				535.05	26.35
2004		640.72				606.30	34.42

2005		638.05				603.25	34.80
2006		670.76				630.21	40.55
2007		783.39	1471.57			747.68	35.72
2008		952.53				923.95	28.58

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