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**RECENT DEVELOPMENTS IN FOREIGN
DIRECT INVESTMENT IN CHINA**

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Recent Developments in Foreign Direct Investment in China

by

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April 1996

Abstract

The growth of foreign direct investment (FDI) in China has been very impressive during the past 16 years. Since 1993 China has become the second largest FDI recipient in the world and the single largest host country among the developing countries. However, in terms of the regional, sectoral, industrial and source country distribution of FDI inflows into China, several issues are worth studying. This paper finds that, first, the regional distribution of FDI inflows into China has been very uneven and mainly concentrated in the East region, which may reinforce the regional disparity between the East and West regions in terms of economic development. Second, among the economic sectors, industry and real estate sectors are the major FDI recipients. Agriculture and infrastructure sectors have received very little FDI inflows though the Chinese government has made a lot of effort to attract FDI inflows into these sectors. Third, FDI inflows into China are mainly concentrated in labour intensive manufacturing industries, which reveals that taking advantage of China's cheap labour is the main motive for foreign investors in China. Fourth, FDI inflows into China have been dominated by NIEs, especially by Hong Kong. This paper discusses several factors for the domination of NIEs' investments in China. Finally, this paper discusses the recent policy and regulation changes towards FDI and the corresponding implications.

Recent Developments in Foreign Direct Investment in China

The growth of foreign direct investment (FDI) in China is one of the most dramatic consequences of China's change in economic policy from the planned economy towards the market economy. The total accumulated amount of foreign direct investment at current prices rose from the initial \$0.109 billion in 1979 to reach \$95.67 billion in 1994, at an annual growth rate of 57.12 percent.¹ In 1991, China ranked only thirteenth in the world and third among the developing countries in terms of FDI inflows.² Since 1993 China has become the second largest FDI recipient in the world (following the United States) and the single largest host country among the developing countries.³ Together with its continuous rapid economic growth and the expansion of international trade, foreign direct investment has increasingly exposed and integrated the Chinese economy into the world economy during the last 16 years.

1. The growth trend of FDI inflow into China

As shown in Table 1 and Figure 1, the growth of the inflow of realised foreign direct investment into China can be divided into three phases: 1979-83, 1984-91, and 1992-94.

¹ Calculated from the State Statistical Bureau, *Zhongguo Tongji Nianjian 1994*, [Statistical Yearbook of China 1994], (Beijing, Zhongguo Tongji Chubanshe, 1994), p.527.

² United Nations, *World Investment Report*, 1995, p.394.

³ United Nations, *World Investment Report*, 1994, p.68.

³ United Nations, *World Investment Report*, 1994 and 1995, p.68 and p.54, respectively.

In the early period of 1979-83, China was not successful in attracting foreign direct investment into China. The inflow of realised foreign direct investment was only \$109 million in 1979 and \$636 million in 1983.

In 1984 the inflow of realised foreign direct investment into China doubled the figure of 1983, reaching \$1,258 million, indicating a new phase in attracting foreign direct investment into China. During the second period from 1984-91, the inflow of realised foreign direct investment grew steadily and reached \$4,366 million in 1991.

Table 1. Realised FDI inflow, China 1979-94

(US\$ million at current prices)

Year	FDI
1979	109
1980	195
1981	375
1982	440
1983	636
1984	1258
1985	1661
1986	1874
1987	2314
1988	3139
1989	3393
1990	3487
1991	4366
1992	11156
1993	27515
1994	33800

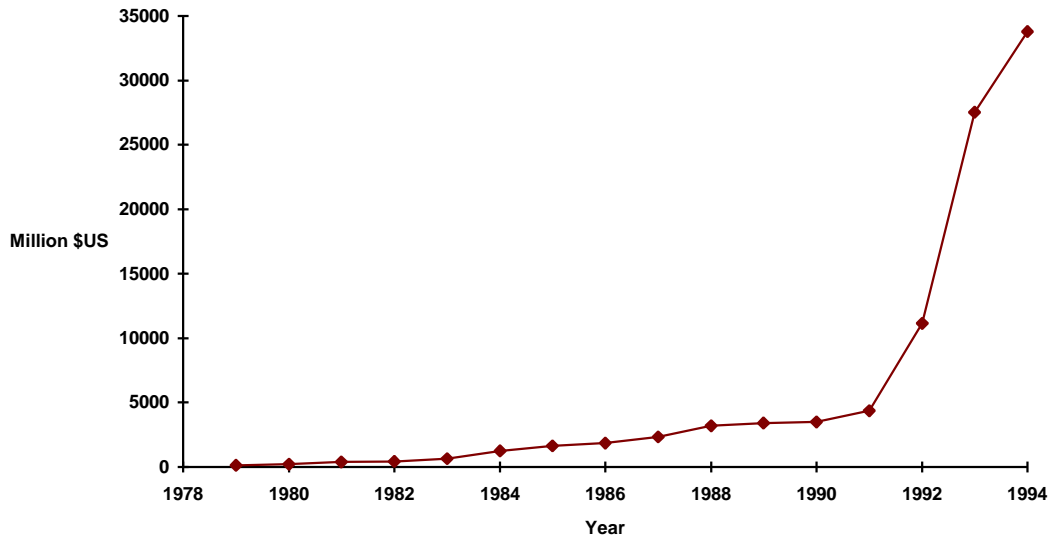
Source:

Data for 1979-82 are from Chung Chen, Lawrence Chang and Yimin Zhang. 1995. The Role of Foreign Direct Investment In China's Post-1978 Economic Development. World Development. Vol. 23, No. 4, pp.691-703.

Data for 1983-93 are from State Statistical Bureau, Zhongguo Tongji Nianjian 1994 [Statistical Yearbook of China 1994], (Beijing, Zhongguo Tongji Chubanshe, 1994), p.527.

Data for 1994 is from the United Nations, World Investment Report, 1995, Annex table 1.

Figure 1 Realised FDI inflow into China



Source: Table 1.

In early 1992 Deng Xiaoping took a tour to the southern coastal economically opened areas. The Chinese government reaffirmed the open-door policy and called for massive foreign direct investment in China. Consequently, in 1992 the inflow of realised foreign direct investment in China reached \$11,156 million, doubling the figure of 1991, and in 1993 the inflow of realised foreign direct investment doubled the figure of 1992, reaching \$27,515 million. This figure was even higher than the total inflow of realised foreign direct investment into China from 1979 to 1991. In 1994, the inflow of realised foreign direct investment reached \$33,800 million, more than three times as much as that in 1992.

2. China's FDI inflow in perspective

2-1. China's FDI inflow from a global perspective

What has been the position of China in the world FDI inflows since China started to attract foreign direct investment into its domestic economy during the past 16 years? As shown in Table 2 and Figure 2, compared with the global FDI inflows, China's shares in total world FDI inflows and in FDI inflows into all developing countries have been around 2% and 10% respectively from 1982 - 1991 with minor annual fluctuations. However, in 1992 China's shares both in the world total FDI inflows and in the inflows into all developing countries increased dramatically, reaching 6.5% and 20.5% respectively. As a result, China became the largest developing-country recipient of FDI inflows in 1992. Further, in 1993, FDI inflows into China were \$27.5 billion, accounting for more than 13% of world total FDI inflows and more than one-third of foreign direct investment flows into all developing countries. In 1994, the growth rate of FDI inflows into China declined compared with that of 1992 and 1993. However, China still attracted \$33.8 billion of FDI inflow, its share in the world total FDI inflows increased to 15% and its share in the developing countries' flow further increased up to 40%. Growth rates and shares of these amounts are unprecedented.

Table 2. China's share in FDI inflow in the world (1982-94)

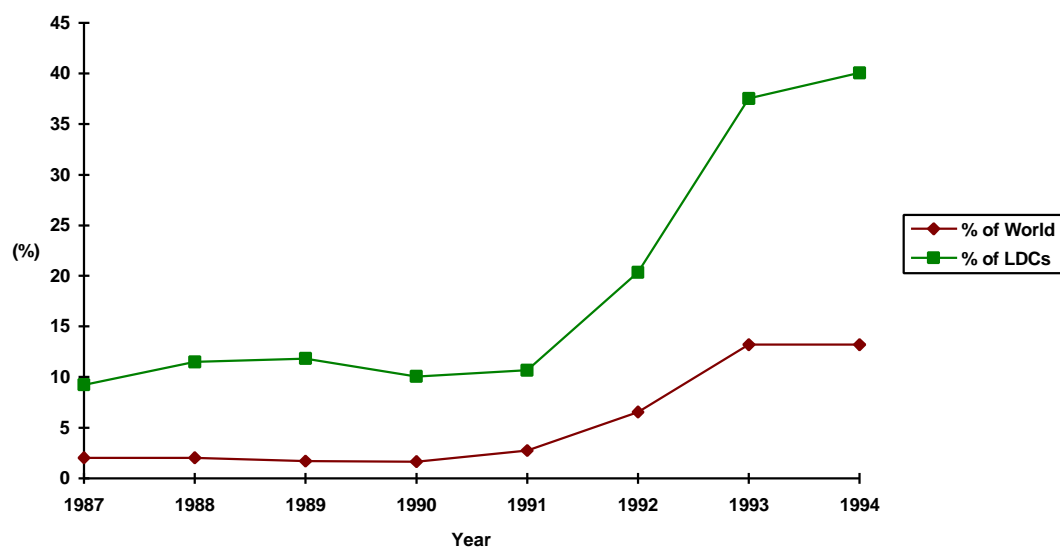
Year	1982-87 (annual average)	1988	1989	1990	1991	1992	1993	1994
China (million \$US)	1362	3194	3393	3487	4366	11156	27515	33800
All Countries (million \$US)	67526	159101	200612	211425	158428	170398	208388	225692
China's share in the World (%)	2.02	2.01	1.69	1.65	2.76	6.55	13.20	15.00
All LDCs (million \$US)	14752	27772	28622	34689	40889	54750	73350	84441
China's share in all LDCs (%)	9.23	11.51	11.85	10.05	10.68	20.38	37.51	40.03

Source:

Data for 1982-1987 annual average and 1988 are from the United Nations, World Investment Report, 1994, Annex table 1.

Data for 1989-1994 are from the United Nations, World Investment Report, 1995, Annex table 1.

Figure 2 China's share in FDI inflow in the world



Source: Table 2.

2-2. China's position in FDI inflows in Asia ⁴

As the world most dynamic and fast growing economies, East, South and South-East Asia have attracted a massive amount of FDI since the 1980s, particularly after 1986. Figure 3 shows that after having experienced several years of fluctuations and a declining trend since 1981, FDI inflows into East, South and South-East Asia started to increase rapidly after 1986. The rapid increase of FDI inflows into this region was first mainly attributed to the big increase in FDI inflows into NIEs from 1986 to 1988, then accompanied by the rapid increase in FDI inflows into ASEAN since 1989, and finally led by the dramatic increase of FDI inflows into China since 1992. Starting from 1992 FDI inflows into Asia have been dominated by China.

In accordance with this trend of FDI inflows into East, South and South-East Asia, China's share in total FDI inflows into this region has changed dramatically. Figure 4 presents the changing pattern of China's share in the total FDI inflows into this region. From 1980 to 1985 China's share increased steadily from 6% up to a record high of 37%. However, as FDI inflows into NIEs and ASEAN started to surge in 1986 and 1989 respectively, China's share began to decline continuously from 1986 to 1991. In 1992, FDI inflows into China increased dramatically and exceeded the inflow into both NIEs and ASEAN, and China's share in the total FDI inflows into this region recovered to 35%. In 1993, FDI inflows into China doubled the figure of

⁴ Refers to East, South and South-East Asian developing countries including Afghanistan, Bangladesh, Brunei, Cambodia, China, Hong Kong, India, Indonesia, South Korea, North Korea, Lao, Macao, Malaysia, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, and Viet Nam.

1992, and, as a result, China's share in FDI inflows into the East, South and South-East region reached 56%. In 1994, China still accounted for 57% of the total FDI inflows into this region.

Table 3. China's share in FDI inflow in Asia and selected countries

Year	China (million \$)	Asia (million \$)	China's share in Asia (%)	NIEs ⁵ (million \$)	China as % of NIEs	ASEAN ⁶ (million \$)	China as % of ASEAN
1980	195	3232	6.03	1667	11.70	1250	15.60
1981	375	5545	6.76	2950	12.71	1730	21.68
1982	440	4870	9.03	2350	18.72	1830	24.04
1983	636	4276	13.46	1970	32.28	1960	32.45
1984	1258	5038	24.97	2250	55.91	1380	91.16
1985	1661	4541	36.58	1450	114.55	1150	144.43
1986	1874	6484	28.91	3250	57.66	1000	187.40
1987	2314	11571	20.00	7417	31.20	1140	202.98
1988	3194	14980	21.32	8112	39.37	2400	133.08
1989	3393	15537	21.84	6326	53.64	4125	82.25
1990	3487	19893	17.53	9348	37.30	5869	59.41
1991	4366	20805	20.99	7813	55.88	7494	58.26
1992	11156	31569	35.34	10210	109.27	9076	122.92
1993	27515	48463	56.78	9929	277.12	8925	308.29
1994	33800	59093	57.20	12041	280.71	10200	331.37

Source:

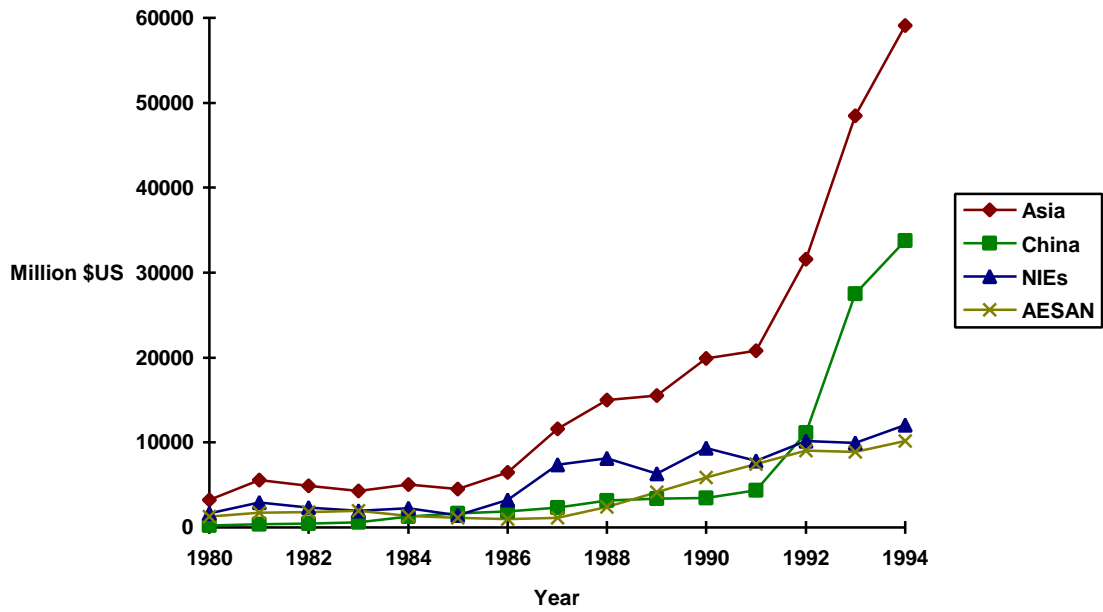
Data for 1980-1988 are from the United Nations, World Investment Report, 1994, Annex table 1 and p.67 respectively.

Data for 1989-1994 are from the United Nations, World Investment Report, 1995, Annex table 1.

⁵ Including Hong Kong, Korea, Singapore, and Taiwan.

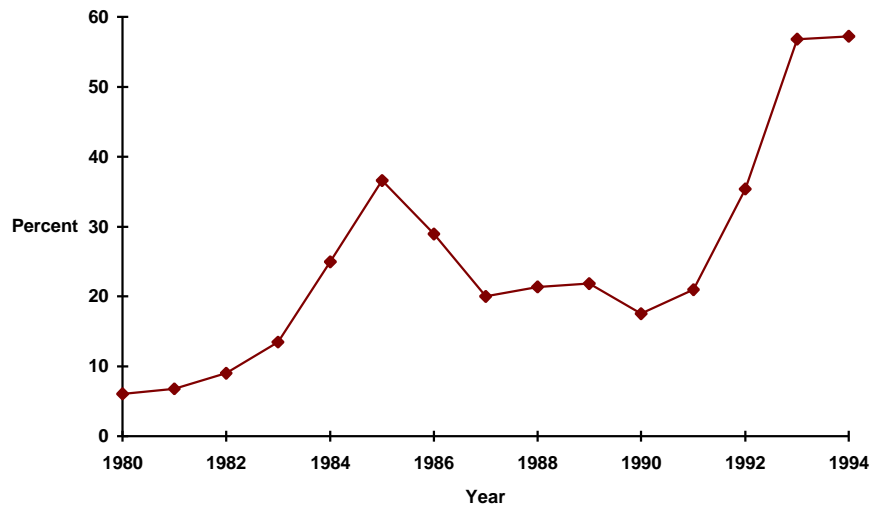
⁶ Including Indonesia, Malaysia and Thailand.

Figure 3 FDI inflow in Asia, China, NIEs and ASEAN



Source: Table 3.

Figure 4 China's share in FDI inflows in Asia



Source: Table 3.

3. Regional distribution of FDI inflow into China

The regional distribution of FDI inflow into China has been very uneven. First, as shown in Table 4 and Figure 5, in terms of the realised FDI stock accumulated since 1983, the figures highlight the importance of the 11 Eastern coastal provinces as the main recipients of foreign direct investment in China. The percentage shares in the national total of realised FDI stock were 85% for the 11 Eastern coastal provinces,⁷ 13% for the 10 central provinces,⁸ and only 2% for the 9 west and less developed provinces.⁹ Among the 11 Eastern coastal provinces, Guangdong's performance in attracting FDI has been very impressive. Its share of accumulated FDI stock since 1983 was one third of the national total, far exceeding all other provinces including Fujian, Shanghai and Jiangsu which each possessed around 10% of the national FDI stock.

Second, in terms of the growth trend of FDI inflows during the period from 1983 to 1993, as shown in Figure 6, the three provincial groups have experienced different patterns. For the 11 Eastern coastal provinces, the inflow of FDI has been increasing steadily with an impressive growth rate, particularly during 1992 and 1993. For the other two provincial groups, the inflows of FDI have fluctuated, especially for the western less developed provinces.

⁷ These 11 economically opened coastal provinces are: Tianjin, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Guangxi, and Hainan.

⁸ These 10 central and middle developed provinces are: Beijing, Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, and Sichuan.

⁹ These 9 west and less developed provinces are: Inner Mongolia (Neimenggu), Guizhou, Yunnan, Tibet (Yizang), Shaanxi, Gansu, Qinghai, Ningxia, and Xinjiang.

Within the East region, there is a shift of FDI inflows from South East towards North East provinces. Guangdong's share in FDI inflows has declined steadily as FDI inflows into Jiangsu, Shanghai, Zhejiang, Shandong and Hebei provinces have increased. The wide distribution of FDI inflows is illustrated in Figures 7-A and 7-B.

Table 4. Provincial distribution of FDI in China (current prices)

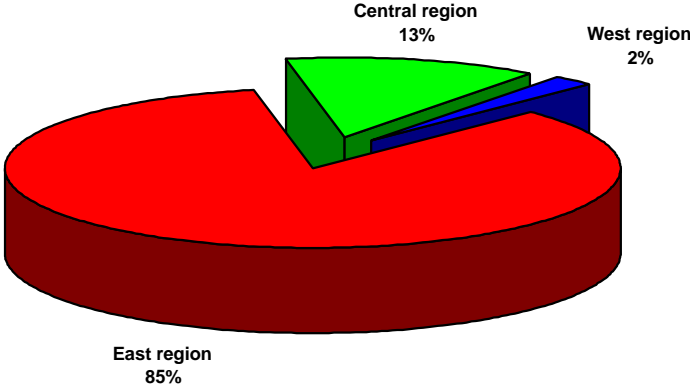
Provinces	Year 1983 - 1993		Year 1983 - 1991		Year 1992 - 1993	
	FDI stock (million US\$)	Share (%)	FDI stock (million US\$)	Share (%)	FDI stock (million US\$)	Share (%)
Beijing	2819.44	4.78	1802.65	8.68	1016.79	2.66
Tianjin	1148.62	1.95	517.16	2.49	631.46	1.65
Hebei	709.53	1.20	199.90	0.96	509.63	1.33
Shanxi	169.37	0.29	29.10	0.14	140.27	0.37
Inner Mongolia (Neimenggu)	132.02	0.22	41.56	0.20	90.46	0.24
Liaoning	2851.29	4.83	1055.74	5.09	1795.55	4.69
Jilin	455.93	0.77	105.32	0.51	350.61	0.92
Heilongjiang	524.80	0.89	220.31	1.06	304.49	0.80
Shanghai	5153.09	8.73	1499.23	7.22	3653.86	9.55
Jiangsu	5095.34	8.63	788.39	3.80	4306.95	11.26
Zhejiang	1608.76	2.73	337.23	1.62	1271.53	3.32
Anhui	414.65	0.70	102.35	0.49	312.30	0.82
Fujian	5878.98	9.96	1587.89	7.65	4291.09	11.21
Jiangxi	384.72	0.65	76.83	0.37	307.89	0.80
Shandong	3706.13	6.28	828.58	3.99	2877.55	7.52
Henan	550.24	0.93	192.17	0.93	358.07	0.94
Hubei	919.38	1.56	175.72	0.85	743.66	1.94
Hunan	690.55	1.17	120.38	0.58	570.17	1.49
Guangdong	20657.37	35.00	9400.50	45.29	11256.87	29.42
Guangxi	1362.04	2.31	295.47	1.42	1066.57	2.79
Hainan	1651.80	2.80	492.15	2.37	1159.65	3.03
Sichuan	953.77	1.62	270.22	1.30	683.55	1.79
Guizhou	132.65	0.23	69.92	0.34	62.73	0.16
Yunnan	164.77	0.28	39.00	0.19	125.77	0.33
Tibet (Yizang)	0.03	0.00	0.03	0.00	0.00	0.00
Shaanxi	702.45	1.19	422.62	2.04	279.83	0.73
Gansu	35.55	0.06	23.25	0.11	12.30	0.03
Qinghai	7.57	0.01	3.65	0.02	3.92	0.01
Ningxia	17.84	0.03	2.42	0.01	15.42	0.04
Xinjiang	119.51	0.20	56.30	0.27	63.21	0.17
By Regions						
East	49822.95	84.42	17002.24	81.92	32820.71	85.78
Central	7882.85	13.36	3095.05	14.91	4787.80	12.51
West	1312.39	2.22	658.75	3.17	653.64	1.71
Total	59018.19	100.00	20756.04	100.00	38262.15	100.00

Source:

Data for 1983 - 1991 are calculated from the State Statistical Bureau, Zhongguo Duiwai Jingji Tongji Daquan 1979 - 1991, [China Foreign Economic Statistics 1979 - 1991], (Beijing, Published by China Statistical Information & Consultancy Service Centre, 1992), pp.353-355.

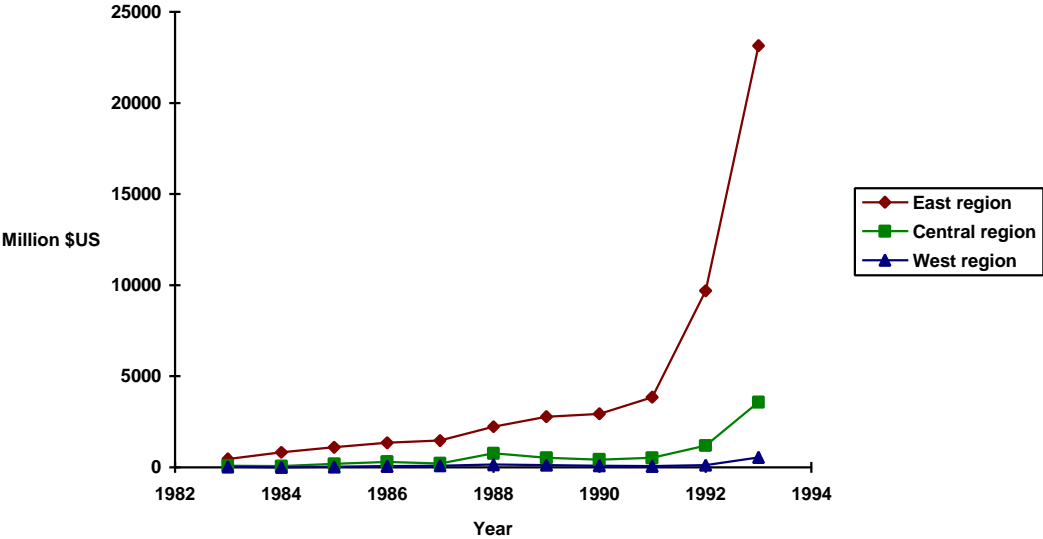
Data for 1992 - 1993 are calculated from the State Statistical Bureau, Zhongguo Duiwai Jingji Tongji Nianjian 1994, [China Foreign Economic Statistical Yearbook 1994], (Beijing, China Statistical Publishing House, 1995), p.286.

Figure 5 Realised FDI stock by host regions in China (83-93)



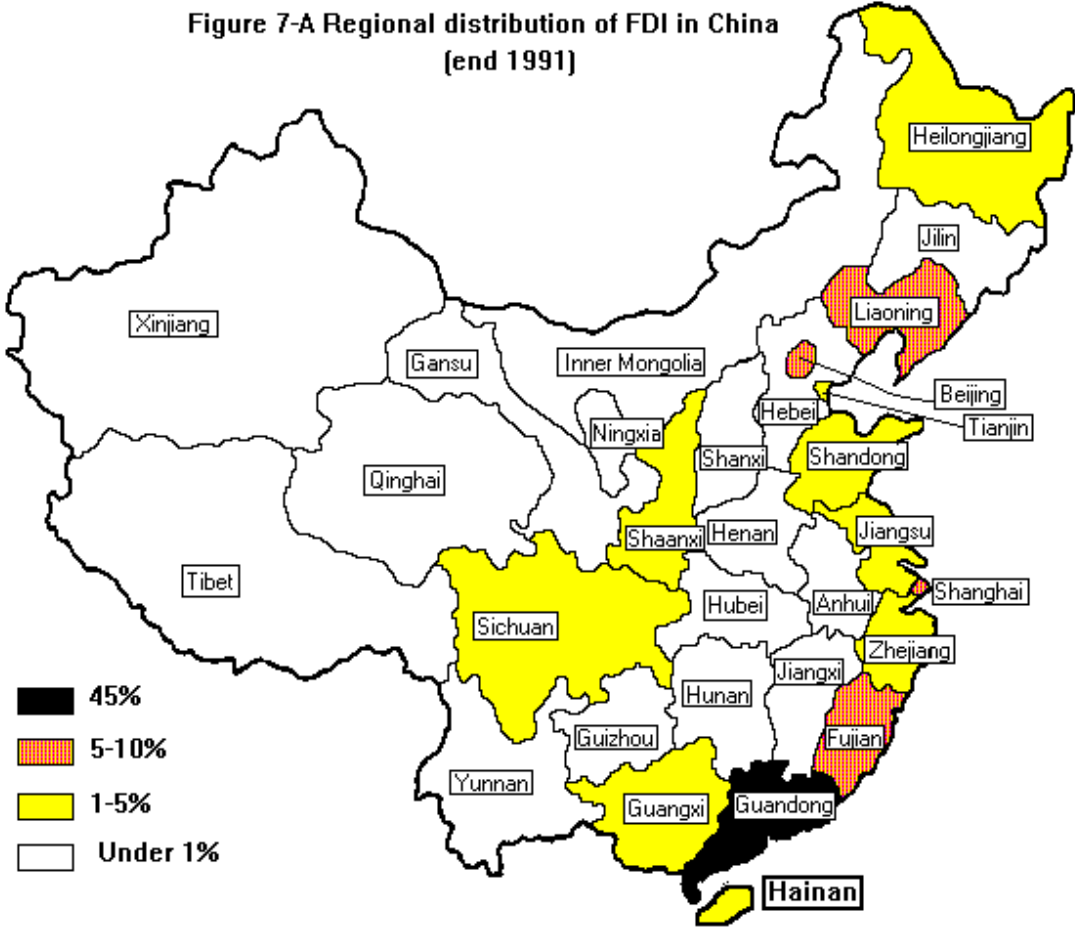
Source: Table 4.

Figure 6 Regional inflow of FDI in China (83-93)



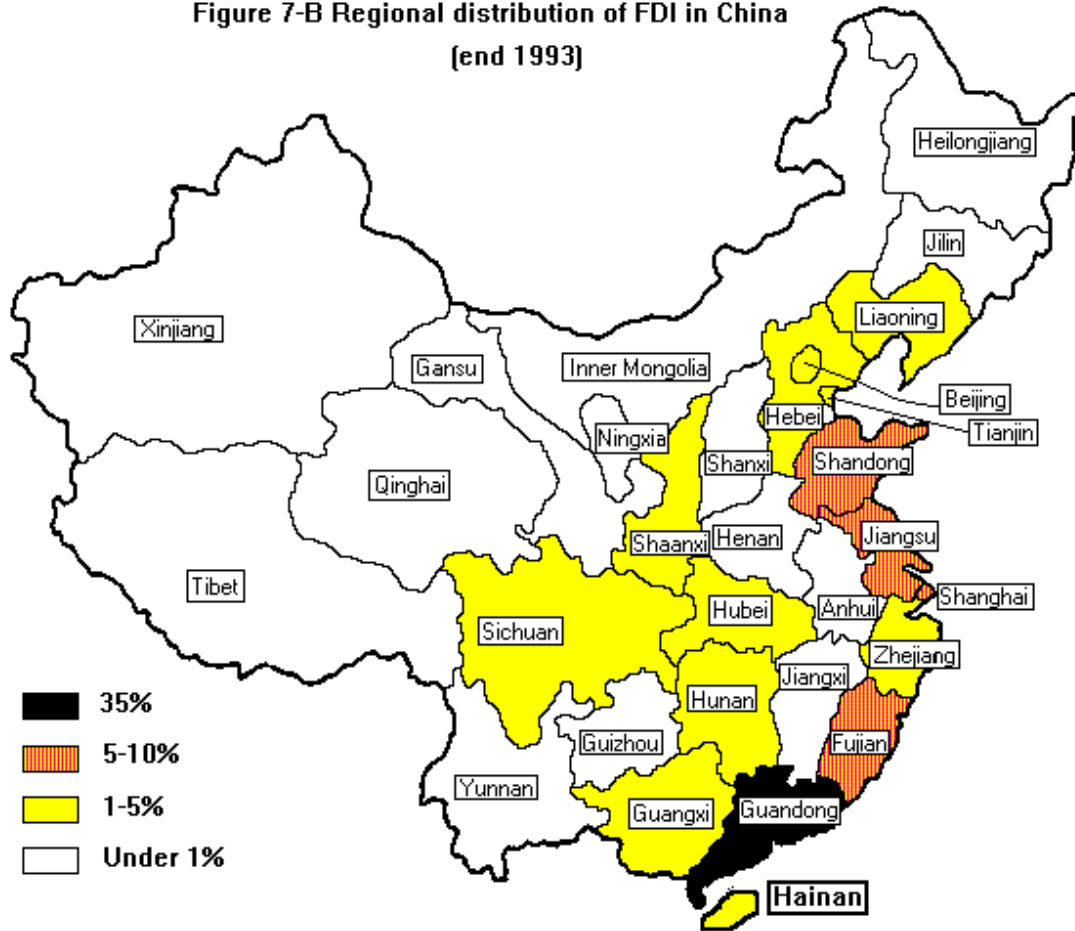
Source: Table 4.

Figure 7-A Regional distribution of FDI in China (end 1991)



Source: Table 4.

Figure 7-B Regional distribution of FDI in China
(end 1993)



Source: Table 4.

4. Sectoral distribution of FDI inflow into China

From 1983 to 1993, as Table 5 and Figure 8 show, the sectoral distribution of FDI inflows into China has been dominated by the industry and real estate sectors. On the contracted base, in terms of the accumulated FDI stock at the year end of 1993, the shares of the FDI stock of the industry were 54% and of the real estate sector were 32%. Their combined share was 86% of total FDI inflows into China. For the other sectors, their shares of FDI inflows in national total were very small, 5% for transportation and telecommunications, 3% for commerce, 2% for health, education and sciences, 1% for agriculture and 3% for other sectors.

In terms of the annual FDI inflows, the changes in sectoral distribution of FDI inflows into China have also been dominated by the share changes between the industry and the real estate sectors. In the early stage of FDI inflow into China, because of the undeveloped real estate market in China combined with some restricting regulations, the real estate sector attracted a very small amount of FDI inflows. In 1983, the real estate sector attracted only 5% of the total national FDI inflows in contrast to 67% in the industry sector. From 1984 to 1987, the FDI inflow into the real estate sector increased very rapidly. It attracted more than one third of the annual total FDI inflows into China during this period reaching a record of 49% in 1986. During the same period, the share of annual FDI inflow into the industry sector declined and reached a record low of 22% in 1984. In 1988, fighting against high inflation, the Chinese government introduced tighter macroeconomic control policies. As a result, the real estate sector contracted very sharply. From 1988 to 1991, the shares of annual FDI inflow into the real estate sector were less than 10%. The industry sector shares were more than 80% of annual total FDI inflows into China from 1988 to 1991. Starting from 1992, with another economic boom in China, the

real estate sector regained its momentum in attracting FDI and its share of FDI inflows increased from 12% in 1991 up to 31% in 1992 and 40% in 1993. The industry share decreased from 81% in 1991 to 57% in 1992 and 46% in 1993. Despite the share changes between industry and real estate sectors, their combined share of FDI inflows has been around 80% of the national total with annual minor fluctuations.

Table 5. Sectoral distribution of FDI inflow into China (contracted base) (%)

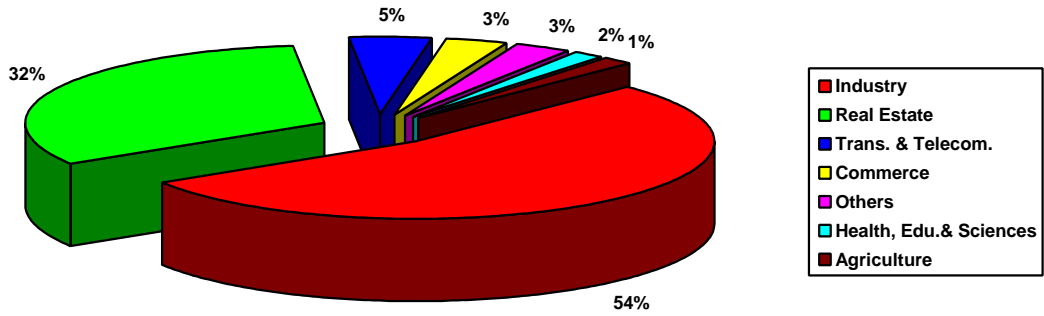
Year	Agriculture	Industry	Trans. & Telecom.	Commerce	Real Estate	Health, Edu. & Sciences	Others
1983	0.93	66.89	6.08	2.05	4.95	19.10	0
1984	2.74	21.97	5.63	3.83	33.46	32.37	0
1985	1.99	37.65	3.76	8.31	35.85	0.99	11.45
1986	3.13	37.07	2.58	3.01	48.56	1.72	3.92
1987	3.98	52.34	1.65	0.68	34.06	0.61	6.69
1988	4.08	77.61	3.39	1.04	8.56	0.92	4.39
1989	2.10	84.47	1.89	1.07	8.32	0.74	1.40
1990	1.98	85.07	3.11	1.53	6.48	1.07	0.76
1991	1.82	80.95	1.88	1.41	12.11	1.12	0.71
1992	1.26	56.53	5.76	2.46	30.78	0.94	2.27
1993	1.09	46.12	4.82	4.11	39.09	1.36	3.40
Total	1.45	53.65	4.62	3.28	32.20	1.73	3.07

Source:

Data for 1983 - 1991 are calculated from the State Statistical Bureau, *Zhongguo Duiwai Jingji Tongji Daquan 1979 - 1991*, [China Foreign Economic Statistics 1979 - 1991], (Beijing, Published by China Statistical Information & Consultancy Service Centre, 1992), pp.314-316.

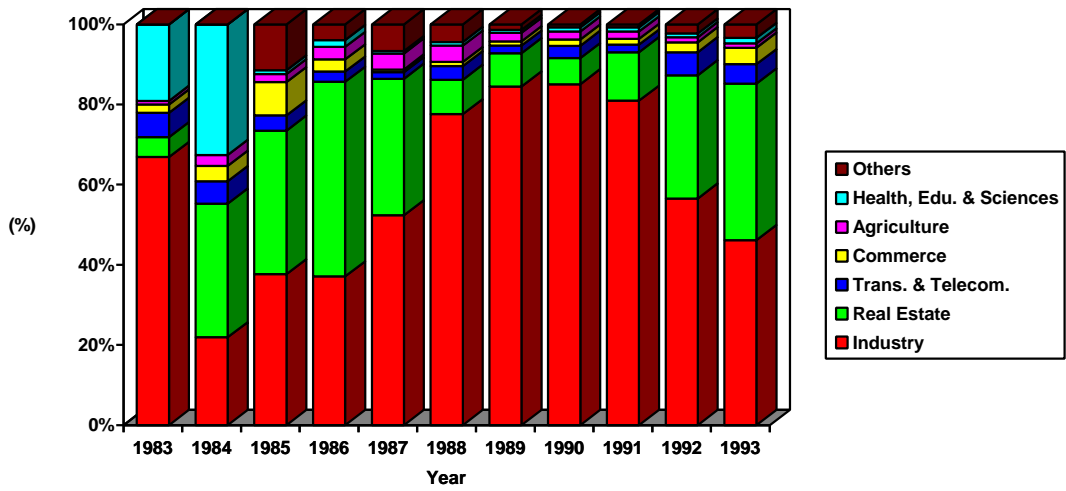
Data for 1992 - 1993 are calculated from the State Statistical Bureau, *Zhongguo Duiwai Jingji Tongji Nianjian 1994*, [China Foreign Economic Statistical Yearbook 1994], (Beijing, China Statistical Publishing House, 1995), p.263.

Figure 8 Composition of FDI stock in China by Sectors (from 1983-1993)



Source: Table 5.

Figure 9 Changes in the composition of FDI inflow into China by sectors (1983-1993)



Source: Table 5.

5. Industrial distribution of FDI in China

Since the industry sector is the main recipient of FDI inflows in China, its structural distribution has special significance. Unfortunately, the data for industrial distribution of all FDI in China are not available. However, for the purpose of a general understanding of the industrial distribution of foreign direct investment in China, we can use data of China's 3000 largest foreign-funded enterprises¹⁰. Foreign-Funded Enterprises (FFE) are the Equity Joint Ventures, Contractual Joint Ventures and Wholly Foreign-Owned Enterprises. Though the information is biased towards the large enterprises which are more capital intensive compared with small enterprises, it does give us a general picture of the industrial distribution of foreign direct investment in China since 1979.

Among the 3000 largest FFEs, there are 2033 manufacturing enterprises which were first classified into 30 industries according to the Chinese industrial classification, and then were classified into three groups - namely labour intensive, capital intensive, and human & capital intensive (hi-tech industry) industries.¹¹

To avoid problems associated with differences in valuations by the date of the investments, we use the number of enterprises instead of the reported value of the capital invested.

¹⁰ Huang Zhengshen, Xie Wenxia and Chen Xianjing. 1994. *China 3000 Largest Foreign-Funded Enterprises, 1994*. China Reform Publishing House. Beijing.

As Table 6 and Figure 10 show, foreign direct investment in China is mainly concentrated in labour intensive manufacturing industries. Taking advantage of China's cheap labour is the main motive of foreign investors in China.

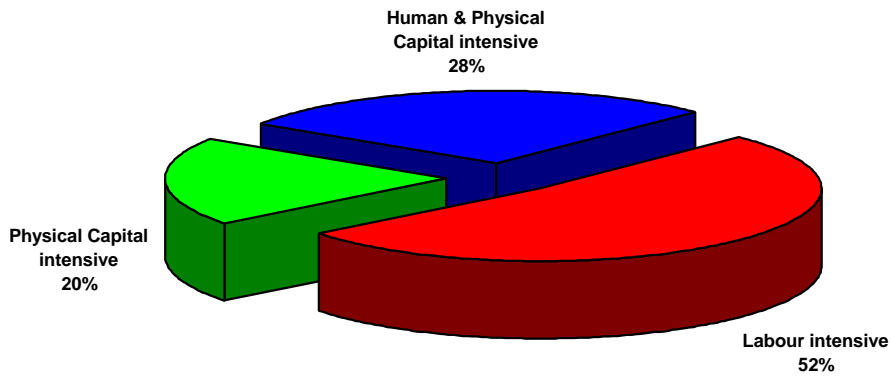
Table 6. Industrial distribution of the largest FFEs in China (end 1993)

Industry	(%)	Industry	(%)	Industry	(%)
Textile	12.60	Electricity	3.79	Leather & Fur products	1.18
Building Materials	8.95	Chemical fibre	3.44	Feed	1.13
Electronics	8.51	Ferrous metal	3.05	Rubber products	1.13
Chemical	6.20	Nonferrous metal	2.85	Timber	1.08
Plastic products	6.00	Beverage	2.36	Instruments & Meters	0.98
Machinery	5.36	Paper & paper products	2.16	Furniture	0.64
Electrical machinery	5.36	Pharmaceutical	2.12	Handicrafts	0.59
Food	5.16	Garments & Shoes	1.72	Petroleum refinery	0.49
Communication & Transport equip.	5.12	Printing	1.38	Tobacco	0.30
Metal products	4.77	Cultural, Edu. & Sports	1.38	Coke & Gas	0.20

Source: *China 3000 Largest Foreign Funded-Enterprises, 1994*. China Reform Publishing House. Beijing.

¹¹ Details for the classification of industries into labour intensive, capital intensive, and human & capital intensive categories are in Zhang Xiaohu. 1993. *Economic liberalisation, dualism and the international trade pattern of China: theory and evidence*, Ph.D thesis, Adelaide University.

**Figure 10 Industrial distribution of FFEs in China
(end 1993)**



Source: Table 6.

6. The distribution of source countries of FDI in China

Since 1979 more than 100 countries have invested in China but who are the major foreign investors? As shown in Table 7, from the period of 1984 to 1993, Hong Kong, Taiwan, Singapore and South Korea (NIEs) have been the major investors, accounting for 73.9% of the total accumulated FDI inflows into China. Among NIEs, Hong Kong accounts for 62.1% of the total accumulated FDI inflows, followed by Taiwan (8.01%), Macao (1.56%), Singapore (1.44%) and South Korea (0.81%). Among the developed countries, the United States and Japan are the important

investors in China, each accounting for 8.34% and 8.15% of the total accumulated FDI inflows into China, while the combined share of the other developed countries was only 4.91%. No other single developed countries has invested more than 1% in China, including the Western European countries even though they are the main source countries in international foreign direct investment. Developing countries' investments in China are very small, 0.31% for other Asian countries, 0.17% for Eastern European countries, 0.17% for Latin American countries, and 0.07% for African countries.

In the two periods of 1984-89 and 1990-93, the shares of investment in China from various source countries changed greatly. The share of investment of the NIEs increased substantially from 61.7% to 77.8%, which was mainly the result of the investment from Taiwan and South Korea. In the period of 1990-93, the share of Taiwan's investment stock in mainland China has exceeded that of the United States and of Japan. Taiwan is now the second most important investor in China.

Another significant contribution was by the ASEAN countries. Their share increased from 0.5% in 1984-89 up to 1.5% in 1990-93. By contrast, the shares of the investment stock in China for all developed countries declined. The Japanese share declined from 13% to 6.62%, the United States' share declined from 11.9% to 7.23%, and the Western European countries' share declined from 6.63% to 3.03%.

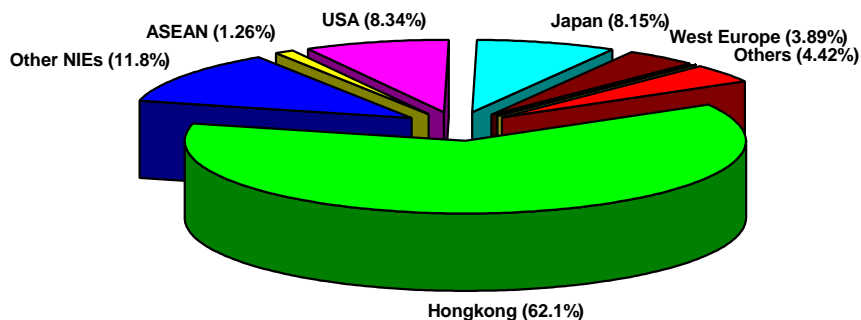
Table 7. Realised FDI in China by source countries (current prices)

Source Countries	Year 1984-93		Year 1984-89		Year 1990-93	
	US\$ (million)	(%)	US\$ (million)	(%)	US\$ (million)	(%)
NIEs	45024	73.9	8961	61.7	36063	77.8
Hong Kong	37823	62.1	8724	60.1	29099	62.7
Macao	950	1.56	79	0.54	872	1.88
Taiwan	4878	8.01	0	0	4878	10.5
Singapore	880	1.44	159	1.09	721	1.55
South Korea	493	0.81	0	0	493	1.06
USA	5076	8.34	1723	11.9	3353	7.23
Japan	4963	8.15	1894	13	3070	6.62
West Europe	2369	3.89	963	6.63	1406	3.03
UK	579	0.95	272	1.87	308	0.66
Germany	528	0.87	158	1.09	370	0.8
France	356	0.59	139	0.96	217	0.47
Italy	297	0.49	144	0.99	153	0.33
Netherlands	176	0.29	41	0.28	135	0.29
Switzerland	101	0.17	17	0.12	84	0.18
Norway	67	0.11	52	0.36	15	0.03
Belgium	66	0.11	28	0.19	38	0.08
Denmark	65	0.11	38	0.26	26	0.06
Austria	36	0.06	24	0.16	13	0.03
Sweden	30	0.05	13	0.09	18	0.04
Finland	30	0.05	28	0.19	2	0.0
Spain	26	0.04	7	0.05	20	0.04
Other DCs	620	1.02	199	1.37	420	0.91
Australia	332	0.54	147	1.01	185	0.4
Canada	259	0.43	45	0.31	214	0.46
New Zealand	29	0.05	7	0.05	22	0.05
ASEAN	770	1.26	73	0.5	697	1.5
Thailand	395	0.65	52	0.36	343	0.74
Philippines	162	0.27	15	0.11	146	0.32
Malaysia	122	0.2	3	0.02	119	0.26
Indonesia	91	0.15	2	0.02	89	0.19
Other Asia	189	0.31	5	0.04	184	0.4
East Europe	103	0.17	27	0.19	76	0.16
Latin America	105	0.17	11	0.08	93	0.2
Africa	45	0.07	4	0.02	42	0.09
Others	1631	2.68	658	4.53	973	2.1
Total	60894	100	14519	100	46376	100

Source: Calculated from the various issues of the Editorial Board of the Almanac of China's Foreign Economic Relations and Trade, Zhongguo Duiwai Jingji Maoyi Nianjian [Almanac of China's Foreign Economic Relations and Trade], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe).

Foreign direct investment in China by country of origin, on one hand, shows significant diversification in terms of the total number of investing countries. On the other hand, it also reveals great concentration in terms of the magnitudes made by the source countries and the changes in the shares of investment stock made by various source countries for the two periods of 1984-89 and 1990-93 suggest that the concentration of FDI in China will tend to increase.

Figure 11 Realised FDI stock by source countries in China (1984-1993)



Source: Table 7.

Since the NIEs' investments, particularly Hong Kong's investment, have been the largest part of the story of foreign direct investment in China, it is worth looking at the NIEs' investment in a little more detail. The remarkable intensity of the NIEs' investment in China is explained both by the factors which led to the rapid emergence

of NIEs as source countries of foreign direct investment, and by specific developments in China.

Two factors are important explanators of the rapid growth of the NIEs' foreign direct investment. Firstly, rapid rising real wages in the NIEs rendered many labour-intensive industries uncompetitive, and foreign investment was seen as a means of utilising accumulated managerial and technical expertise in these industries. Secondly, the NIEs are upgrading their technology and restructuring their economies as they accumulate human and physical capital relatively rapidly compared with other countries. FDI is an efficient means to transfer their labour-intensive industries abroad to earn a return on their accumulated assets in these activities.

Perhaps even more important in explaining the upsurge was the remarkable coincidence in timing of China's economic reform and the NIEs' economic restructuring. A "gold rush" mentality developed among NIE investors towards China's reforms. This occurred precisely as NIE firms were eagerly seeking out overseas investment opportunities.

The rapid increase in foreign direct investment in China from ASEAN countries (Thailand, Philippines, Malaysia, Indonesia) in the late 1980s and early 1990s resembled the early pattern of NIEs investments in most respects. In general, the changing domestic economic structures and the extensive overseas Chinese

business networks ¹² have led to and facilitated the companies of ASEAN countries to venture in China.

Investments from developed countries are somewhat different from that of NIEs and other developing countries. This is because, first, the technological gap between the developed countries and China is relatively large and the transfer of technology is hampered to a certain extent by the appropriateness of technology. Second the firms of developed countries usually possess more advanced technology and production techniques. Since the legal network for protecting property rights in China is poor, the firms from the developed countries possessing advanced technology and production techniques are reluctant to invest in China. Third the developed countries, especially Western European countries have little direct contact with China, therefore their firms also are very prudent in setting up ventures in China. As a result, the magnitudes of investment from developed countries are very small compared with their total investments in the world. For example, from 1990 to 1993, the total FDI outflows from the Western European countries accounted for 55% of the world total FDI outflows, however, in the same period the inflows of FDI from the Western European countries into China were only 3% of China's total FDI inflows. ¹³

¹² For more detailed analysis on overseas Chinese business networks see: East Asia Analytical Unit (1995), "Overseas Chinese Business Networks In Asia". (Canberra, EAAU, Department of Foreign Affairs and Trade, Australia).

¹³ Calculated from the United Nations, World Investment Report, 1995, Annex table 2.

7. The investment patterns of the major investors

Since the various source countries investing in China are different in many aspects such as economic and technological development levels, production structure, government policies (especially international trade policies), relative distance, historical relations and ties, and resource endowments, we expect that the investment patterns of various source countries are also different.

To analyse the investment patterns of various source countries we again use the data of the 3000 largest Foreign Funded Enterprises.

For comparison, we grouped the source countries into NIEs (Hong Kong, Taiwan, Singapore, South Korea), ASEAN (Thailand, Philippines, Malaysia, Indonesia), WECs (Western European Countries), Japan, and the United States.

Table 8 presents the relative sector investment intensity of source countries in the three manufacturing sectors. These indicators show the share of that sector in the total inflows from this source, compared with that sector's share in total inflows from all sources.¹⁴

¹⁴ The relative sector investment intensity is defined as follows:

$$RII_{ij} = \left(\frac{\frac{I_{ij}}{I_{i*}}}{\frac{I_{*j}}{I_{**}}} \right) \times 100$$

Where RII_{ij} = relative sector investment intensity of source country i in industry j

I_{ij} = investment from source country i in industry j

* = across all industries or all source countries

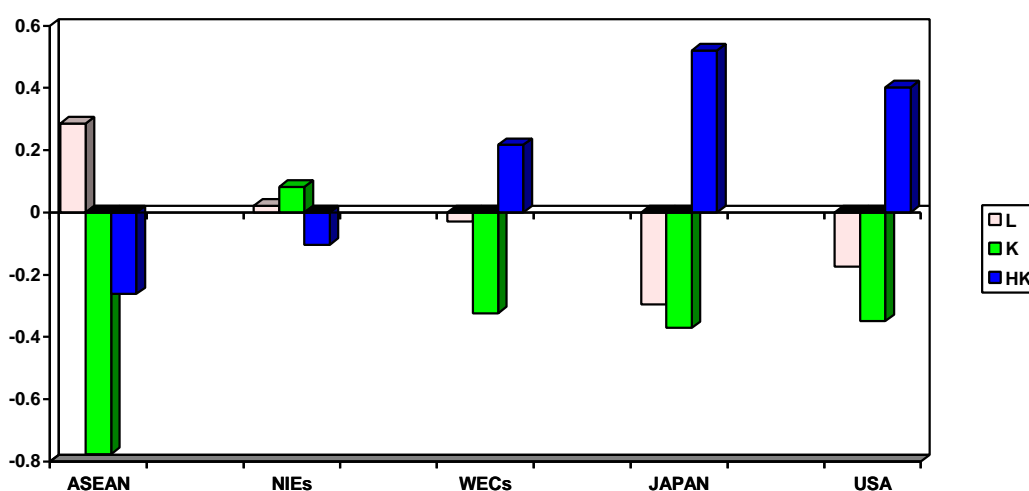
The calculations are based on the number of enterprises and not on the value of investments.

Table 8. Relative sector investment intensity in China by source countries (%)

Sectors	ASEAN	NIEs	WECs	Japan	USA
Labour Intensive	133	102	97	74	84
Capital Intensive	46	109	72	69	71
Human Capital Intensive	77	90	124	168	150

Figure 12 is the logarithmic measures of the relative sector investment intensity of the major source countries.¹⁵

Figure 12 Relative sector investment intensity of source countries (logarithmic measure)



The table and the figure illustrate several points. First, following the evolution of the economic and technological development level of various source countries, the

¹⁵ The logarithmic transformation is defined as:

$$LRII_{ij} = \ln (RII_{ij})$$

where $LRII_{ij}$ = the logarithmic measure of the relative sector investment intensity of source country i in industry j .

relative sector investment intensity changes from labour intensive industry (L) to capital intensive industry (K) and to human capital intensive industry (HK), indicating the investment sequence as countries change their proportion of factor endowments and their economic and technological structures. Second, among the major foreign investors, ASEAN countries are at the lowest level of economic and technological development, their investment are mainly concentrated in the labour intensive industries. NIEs' economic and technological development level is in between the ASEAN countries and the developed countries. They are more capital rich compared with the ASEAN countries but less endowed with human capital and technology. Therefore, their investment patterns in China are mainly concentrated in labour as well as capital intensive industries, which are in between the investment patterns of ASEAN countries and the developed countries. The investment patterns of the developed countries of WECs, Japan and the United States reflect their comparative advantage in human capital and technology intensive sectors. Third, since the investment from ASEAN and NIEs are mainly in labour intensive sectors, in which China has a comparative advantage, we could say that the investments of ASEAN and the NIEs in China are mainly export oriented. Since the investments from the developed countries are mainly in human capital and technology intensive sectors, in which China has a comparative disadvantage, the investments of developed countries in China are mainly domestic market oriented.

8. Policy changes towards FDI in China

8-1. An overview of the development of FDI policies in China

For historical and ideological reasons, FDI in China was highly restricted prior to the economic reforms of 1979. In order to achieve the objectives of industrialisation and economic development, China opened its door to the world economy at the end of 1978. Since 1979, the FDI regime has been liberalised gradually, and a series of policies towards foreign direct investment has been adopted in China, aiming at attracting a high level of foreign direct investment, to accelerate the transfer of technology, as well as to provide foreign exchange.

At the second session of the Fifth National People's Congress in July 1979, the "Law of the People's Republic of China on Joint Venture Using Chinese and Foreign Investment" was passed, granting foreign direct investment a legal status in China.¹⁶ This law was further clarified by its 1983 Implementing Regulations.

By 1980, four Special Economic Zones (SEZs), Shenzhen, Zhuhai, Xiamen and Shantou, had been established in Guangdong and Fujian Provinces along the south-eastern coastal area.¹⁷

¹⁶ The Editorial Board of the Almanac of China's Foreign Economic Relations and Trade, *Zhongguo Duiwai Jingji Maoyi Nianjian 1984* [Almanac of China's Foreign Economic Relations and Trade 1984], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe, 1984), pp.III-21-III-22.

¹⁷ The Editorial Board of the Almanac of China's Foreign Economic Relations and Trade, *Zhongguo Duiwai Jingji Maoyi Nianjian 1984* [Almanac of China's Foreign Economic Relations and Trade 1984], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe, 1984), p.I-15.

In 1984, the concept of SEZs was extended to another fourteen coastal cities and Hainan Island.¹⁸

In 1985, three “development triangles” --- the Yangzi River delta, the Pearl River delta, and the Min Nan Region --- were also opened to foreign investors.

In 1986, new provisions were established for the encouragement of foreign direct investment, of which the more important ones included: reducing fees for labour and land use; establishing a limited foreign currency exchange market for joint ventures; extending the maximum duration of a joint-venture agreement beyond 50 years; and permitting wholly foreign-owned enterprises.¹⁹

In April 1988, Hainan Island became a province and China’s fifth --- and the largest --- SEZ. Also adopted in 1988 was a “Cooperative Joint Ventures Law”.²⁰

In 1990, amendments to the joint venture law were passed, greatly improving investment climate in China. The stipulation that the chairman of the board of a joint venture should be appointed by Chinese investors, for example, was abolished. Also

¹⁸ The fourteen coastal cities are: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai. See the Editorial Board of the Almanac of China’s Foreign Economic Relations and Trade, *Zhongguo Duiwai Jingji Maoyi Nianjian 1984* [Almanac of China’s Foreign Economic Relations and Trade 1984], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe, 1984), p.I-16.

¹⁹ Fung, Vigor, 1986. China seeks ways for joint ventures to convert their yuan earnings into foreign exchange. *Asian Wall Street Journal Weekly*. January 6, 1986.

²⁰ The Editorial Board of the Almanac of China’s Foreign Economic Relations and Trade, *Zhongguo Duiwai Jingji Maoyi Nianjian 1988/89* [Almanac of China’s Foreign Economic Relations and Trade 1988/89], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe, 1988/89), pp.102-103.

significant was the provision of protection from nationalisation.²¹ In 1990, the concept of SEZs was extended to the Shanghai Pudong New Development Area, which is about the size of Singapore.

In 1992, some service industries, such as aviation, telecommunication, banking and retail trade, and 52 cities and areas became open to foreign investors.²²

8-2. Recent policy changes on FDI and implications

In recent years, the Chinese government has implemented several policies on FDI inflows. The most important policy change is the introduction of national treatment for foreign firms. In November 1993, combined with China's efforts to get into the World Trade Organisation, China decided to introduce national treatment for foreign affiliates, in order first to establish a level-playing field for both domestic and foreign firms, and second to meet the requirement of WTO regulations. While this may improve the regulatory framework in the longer term, it reduces the degree of preferential treatment of foreign investors, which may discourage the foreign investors in the short term.

²¹The Editorial Board of the Almanac of China's Foreign Economic Relations and Trade, Zhongguo Duiwai Jingji Maoyi Nianjian 1991[Almanac of China's Foreign Economic Relations and Trade 1991], (Beijing, Zhongguo Duiwai Jingji Maoyi Chubanshe, 1991), pp.100-101.

²² United Nations, World Investment Report, 1994. p.68.

China is now becoming more cautious in terms of appraising FDI projects and more careful in terms of monitoring the fulfilment of contractual FDI commitments. First, according to the requirement of the Equity Joint Venture Law, a feasibility study for an equity joint venture is required for review and approval by all relevant government organisations.²³

Second, Chinese policy-makers have recently implemented measures that will serve to reduce two problems related to inward FDI: over-valuation and round-tripping.

In general, about 70% of FDI inflows into China are equipment and technology.²⁴ To translate the amount of these investments into cash tends to overvalue the amount of FDI. The motives behind over-valuation include a larger share of dividends for the foreign investors than for the Chinese partners, resulting from the higher equity share of foreign investors compared with their local partners; lower taxes arising from larger capital expenditures and depreciation credits; and more management control. Over-valuation reduces the potential contribution of FDI to the development of the Chinese economy. It lowers tax revenues for the Government as well as the share of revenues accruing to the local partners in joint ventures. For dealing with the problem of over-valuation, the State Administration for Import and Export Inspection and the Ministry of Finance jointly promulgated the “Administrative Procedures for Appraising Foreign Invested Property” in early 1994

²³ Asia Update, No.6, December 1995

²⁴ United Nations, World Investment Report, 1995, p.59.

and began to monitor more closely the fulfilment of contractual commitments with respect to the actual value and quality of equipment in FDI projects.

Round-tripping involves the circular flow of capital out of China (in most cases to foreign affiliates of Chinese transnational corporations) and the subsequent “re-investment” of this “foreign” capital in China for the purpose of benefiting from fiscal entitlements accorded to foreign investors. By round-tripping, Chinese investors avoid the regulatory regime governing domestic investment by channelling capital through foreign affiliates and thereby bringing this capital under the more favourable regime governing foreign investment. One estimate made by Harrold and Lall suggested that round-tripping inward FDI accounted for 25% of China’s FDI inflows in 1992.²⁵ Policy reform aimed at equalising the treatment of domestic and foreign capital has substantially reduced the incentive for round-tripping, in particular the ongoing reduction of tax incentives for FDI and, more generally, the gradual movement towards a national treatment-based regulatory regime governing investment.²⁶

Regarding the uneven regional and biased industrial distribution of FDI inflows, in June 1995, the Chinese government issued the “Provisional Regulations on Guiding Foreign Investment”.²⁷ According to the regulations, China now is encouraging first a greater geographic dispersion of FDI inflows within China and, second, more FDI inflows into targeted economic sectors and industries, such as

²⁵ Harrold, Peter and Rajiv Lall (1993). “China reform and development in 1992-93”, World Bank Discussion Paper No. 215, (Washington, D.C.: The World Bank), p.24.

²⁶ United Nations, World Investment Report, 1995. p.59.

²⁷ SWB, 29 June 95. Chinese Regulations.

agriculture, resource exploitation, infrastructure, export oriented and high technology industries, which means that China has become more selective in terms of the type of FDI that it seeks.

8-3. Current FDI regulation

Foreign exchange control

China's exchange controls are among the strictest in the Asia/Pacific region. An extensive array of legislation governs the inflow and outflow of capital, goods and services generated or owned by foreign funded enterprises (FFE).

All foreign funded enterprises in China are required to balance their own foreign exchange. This regulation is implemented through requiring FFEs to open a *Renminbi* deposit account and a separate foreign exchange deposit account with either the Bank of China or another bank approved by the State Administration for Exchange Control (SAEC). All foreign exchange receipts and disbursements must flow through the foreign exchange account. Because the *Renminbi* is not convertible into foreign exchange, this rule effectively requires FFEs to generate all foreign exchange needed for the remittance of dividends, expenditures and other distributions. As a result, balancing foreign exchange expenditure and income is a critical operating issue for most FFEs in China.

FFE receiving foreign exchange loans from banks or enterprises located outside of China must report the transactions to the SAEC, although no specific approval is required. The authorities closely monitor the foreign exchange activity of FFEs via a range of reporting requirements, including an annual budget of foreign exchange receipts and expenditures for the coming year. The SAEC also has the power to inspect a FFE's foreign exchange books to verify income and expenditure.

Since FFEs are required to balance their own foreign exchange bank account, foreign investors have the following options to fuel their bank accounts, all of which require prior authorisation:

1. earning hard currency through exports;
2. producing an “import substitute” that may be sold locally for foreign exchange;
3. designating the Chinese Joint Venture partner as the sales and service representative for the foreign partner’s products imported from abroad, and then paying it hard currency commissions;
4. swapping Renminbi earnings at officially designated swap centres;
5. borrowing from abroad, or having the foreign parent supply temporary credits to the venture to make up the shortfall;
6. purchasing locally made goods not produced by the FFE and selling them abroad.

Remittance of dividends, profits, interest and principal in foreign exchange is permitted only to the extent that the company has sufficient funds in its foreign exchange deposit account. In principle, Renminbi funds may not be converted into foreign exchange for the purpose of making such a remittance. In practice, FFEs, which use swap markets to exchange Renminbi for foreign exchange for authorised

purposes (such as acquisition of technology and equipment from abroad), may use surplus foreign exchange obtained through this means for remitting dividends, profits, interest and principal abroad. Transfer of royalties and fees arising from approved agreements is permitted.

Repatriation of capital in foreign exchange is permitted only to the extent that the company possesses sufficient funds in its foreign exchange deposit account. Foreign exchange proceeds arising from the liquidation of a FFE are remittable subject to the approval of the SAEC.

Trade regulations

Import controls: The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) is the main regulatory body governing the current import-licensing system. China uses this system to restrict imports of consumer and luxury goods in order to conserve foreign exchange for other items.

China's import regulations divide goods into three categories: contraband goods, which may not be imported; restricted goods, which require an import licence, and general goods, which do not require an import licence unless brought in by entities not specifically authorised to engage in that import.

For FFEs' imports of equipment and materials as part of the investment, licences are issued for goods imported according to the investment contract. Exemption from import licences also applies to commodities that FFEs import for

incorporation in “export-oriented” production. Exempt commodities include mechanical equipment, vehicles for use in productive activities, raw materials, fuel, parts, components, elements and accessories.

Export control: China currently places taxes on a handful of exports, largely as a means of keeping state control over the trade of these products and stabilising revenue from these commodities in which China dominates world trade (such as raw silk).

China’s system of export licensing, administered by the MOFTEC, applies to domestic enterprises as well as FFEs.

National treatment

With the implementation of national treatment, FFEs and domestic enterprises will be given equal treatment in China. As a pioneer, Shenzhen will implement the national treatment policy in 1996. According to the regulations worked out by the Shenzhen government, preferential policies given to FFEs will no longer be offered. However, some original limitations on foreign investment will be lifted, such as that in the financial and insurance sectors.

Tax reduction and exemption

China will adjust its tax reduction and exemption measures in line with WTO regulations. With the reduction of import tariffs, China would make corresponding adjustments to tax reduction and exemption measures, including the tariff exemption policy for the import of equipment by FFEs. A transition period would be introduced for those FFEs that were already operational or approved for operation. In any event, however, FFEs would still continue to enjoy preferential income tax treatment. The concessionary rates of 24% in coastal cities and 15% in special economic regions together with a two year exemption period followed by a three year reduction period would continue to apply. Moreover, foreign investors would remain entitled to preferential treatment in the high technology and agricultural sectors.

9. Conclusion

During the past 16 years, China has been particularly successful in attracting FDI not only among the developing countries but also in the world. Since 1993 China has become the second largest FDI recipient in the world and the single largest host country among the developing countries.

However, China's attractiveness to foreign investors has intensified competition for FDI in the developing countries, particularly in Asia. The levels of FDI flows to China and their growth rate during the 1990s were substantially higher

than those to any other country in Asia, while a number of countries in Asia experienced a decline of inflows. Is there a shift of FDI towards China from other potential host countries? Since the possibility for investors to shift actual or potential FDI from one host country to another depends largely on the type of FDI as well as the sector or industry concerned, to answer this question, we should distinguish different types of FDI and take different sectors or industries into consideration.

First, *market-seeking FDI*, a significant portion of FDI in Asia, is unlikely to shift as long as there are profitable opportunities for production in a host country's market. The growing market size in many countries in Asia has generated a consumption boom for goods and services. Furthermore, the services sector is attracting more and more FDI flows, especially in the NIEs. Given the non-tradability of most services, markets can only be reached by FDI which, therefore, is difficult to divert.

Second, *natural resource-seeking FDI*, an important portion of FDI in several countries in Asia, is also largely location-specific and hard to shift.

Third, *export-oriented manufacturing FDI* is mainly based on cost considerations, therefore, it is most likely to shift from the high labour cost countries to the low labour cost countries. Indeed, it appears that transnational corporations' activities are gradually being restructured in Asia, with export-oriented labour-intensive manufacturing activity gradually shifting from the more advanced economies to the less advanced ones, including China.

In general, with the possible exception of export-oriented FDI, the success of China in attracting FDI flows is less likely to be achieved at the expense of other countries in Asia. In fact, among other factors, the main reasons for China's success in attracting FDI inflows are its market-oriented economic reform, rapid and sustained economic growth and development, and low labour cost.

Looking ahead, given the size of its economy and its rapid growth and natural and human resource endowments, China will most likely continue to maintain its position as one of the largest FDI host countries in the world, at least in the short-run. However, the rate of FDI growth and the structure of FDI inflows will depend largely on China's future political stability, the consistency of its economic policies and its macro-economic management capacities, as well as the extent to which China will succeed in its transformation into a market economy and its integration into the world economy.

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