

T.C.
İstanbul Üniversitesi
Sosyal Bilimler Enstitüsü
İngilizce İktisat Ana Bilim Dalı

Yüksek Lisans Tezi

**FOREIGN DIRECT INVESTMENT:
APPLICATIONS IN CHINA**

N. Duygu FINDIK
2504030003

Tez Danışmanı: Prof. Dr. Nihal TUNCER
İstanbul 2006

ABSTRACT

China is a world giant with her approximately 1.3 billions of people and with a deep-rooted history which have had great contributions on her social, cultural and economic life. With the establishment of the open door strategy, the last two decades have changed and added novel and unique aspects to the country's profile. Foreign direct investment (FDI) as a 19th century phenomena, has been an important yield of the economic reforms for China. The early applications were conducted by the Western Europe and the United States of America (USA), while, today, this way of economic activity is very popular in the whole world. FDI stands as one of the most profitable factors for the world economies, especially for the highly mobilized industries in which the investors are eager to benefit from the comparative advantage and/or the market volume of another country. This study tries to make an interpretation for the trends and the position of the FDI in China which is a very attractive country for the foreign investors throughout the world and has huge share of the investments. Moreover, the study discusses FDI as an outcome of the reforms for the Chinese economy and examines whether the structure of the country has been changing as a whole or there is anything left unchanged and protected in China. FDI is studied through and applied to China there of with all its definition, types, measurements theoretically and main applications.

ÖZ

Çin, 1,3 milyarlık nüfusu ve sosyal, kültürel ve ekonomik anlamda yaşantısına büyük katkıları bulunmuş köklü tarihiyle bir dünya devidir. 1980'lerin başında kapılarını dünyaya açmasıyla, son 25 yılda ülkenin görünümü oldukça değişmiş ve ülkenin kendine özgü görünümüne bir takım yeni öğeler eklenmiştir. Bir 19'uncu yüzyıl fenomeni olan doğrudan yabancı yatırım (FDI), Çin'in ekonomik reformlarının önemli bir getirisi olarak karşımızdadır. Doğrudan yabancı yatırım için ilk uygulamalar Batı Avrupa ülkeleri ve Amerika Birleşik Devletleri (ABD) tarafından yapılmış olmakla beraber, özellikle 1980'ler sonrasında oldukça popüler bir ekonomik faaliyet olarak kendini göstermektedir. Bugün, doğrudan yabancı yatırım, tüm dünya ekonomileri, özellikle de yüksek oranda mobilize olmuş sanayiler ve yatırım yapılacak ülkenin karşılaştırmalı avantajı ile piyasa hacminden fayda sağlamaya çalışan yatırımcılar için karlı bir ekonomik faktördür. Bu çalışma, doğrudan yabancı yatırımın, bu konuda tüm dünyayı cezbeden ve yine yatırımların büyük bir payına sahip Çin'deki trendleri ve durumu ile ilgili bir yorum getirmeye çalışmaktadır. Doğrudan yabancı yatırım, tanım ve türlerinden ölçüm ve temel uygulamalarına kadar incelenmiş, bulgular Çin'e uyarlanmıştır. Çalışma, ayrıca, doğrudan yabancı yatırımı Çin'deki reformların büyük bir getirisi olarak görmekte ve bu yatırımların, ülkeyi yapısal olarak toptan bir değişimin içine mi soktuğu yoksa bir takım ülkeye özgü yönlerin kendini halen korumakta mı olduğu konularını incelemektedir.

PREFACE

The main purpose of this study is to bring an interpretation on China's contemporary position in the world by examining the opening up policies of 1980s in the context of the FDI which is a naïve consequence of those reforms established in last two decades. and the famous Great Wall representing the unchanged features of China based on uniqueness of her history and culture.

This study tries to examine the effects of the economic reform era. In this context, a brief historical background and some contemporary features of the country are discussed. Since FDI is one of the most important outcomes of the economic change; the development, motives, types, measurements and the applications in the world is detailed in the second part of this thesis. The study of the theory formed up for FDI is followed by a nearly one-to-one application to in the third part.

I would like to express my gratitude to my thesis advisor Prof. Dr. Nihal TUNCER for her helpful advice and deep knowledge with which she has not hesitated supervising me. I also thank to Dr. Türkan TURAN for her help in reaching to a lot of noteworthy sources and her contributions about the content of the study. I am also grateful to my friends in Istanbul University, Faculty of Economics department for intelligent discussions, sharp criticisms and useful comments on my thesis.

Finally, I should thank my father for introducing new perspectives to my education life and supporting me in any means during hard times and my mother and sister for always being in the right place to help me. I also present my eternal thanks to Melih ERİTEN, new member of my family, for his insightful contributions on this thesis.

ISTANBUL UNIVERSITY
FACULTY OF ECONOMICS

September 30th, 2006

N. Duygu FINDIK

CONTENTS

ABSTRACT.....	iii
ÖZ	iii
PREFACE.....	iv
CONTENTS.....	v
LIST OF FIGURES.....	x
LIST OF TABLES.....	xii
LIST OF MAPS.....	xiii
LIST OF ABBREVIATIONS.....	xii
INTRODUCTION.....	1
1. A BRIEF HISTORY OF CHINA AND SOME CONTEMPORARY FEATURES.....	6
1.1.A Brief History.....	6
1.1.1. The Ancient Times and the Period of Dynasties.....	6
1.1.2. Republican Revolution: 1900– 1949.....	8
1.1.3. The Mao Era and the Communist Revolution.....	9
1.1.3.1. Civil War and the Korean War.....	9
1.1.3.2. Rearrangement Efforts and the Hundred Flowers Campaign, 1949-1956.....	10
1.1.3.3. The Great Leap Forward and the Uncertainty Period.....	11
1.1.3.4. The Cultural Revolution: 1966–1976 and Mao’s Death.....	11
1.1.4. Deng Xiaoping: 1976-1989 and the Modern China.....	12

1.2. China: Contemporary Features.....	15
1.2.1. Geographical Characteristics.....	16
1.2.2. Demography.....	17
1.2.3. Economic Characteristics.....	20
1.2.3.1. Agricultural Reform in China.....	21
1.2.3.2. Industrial Restructuring.....	23
1.2.3.3. Growing Energy Need.....	27
1.2.3.4. Widening Gap between the Hinterland and the Coastal China.....	31
1.2.3.5. Environmental Factors.....	35
2. FDI IN THE WORLD: HISTORY, CLASSIFICATION AND MEASUREMENT.....	37
2.1. Definition.....	37
2.2. Components and Driving Factors of FDI.....	38
2.3. Historical Development of FDI.....	40
2.3.1. Beginnings.....	40
2.3.2. Growing Economies and the Stock of FDI.....	41
2.3.3. The After War Period.....	44
2.4. The Present.....	47
2.4.1. The Rise of FDI.....	47
2.4.2. The Boom after 1995.....	48

2.5. Classification and Explanation of FDI.....	48
2.5.1. Motives for FDI.....	48
2.5.2. Types of FDI.....	49
2.5.2.1. Types by the Potential Return.....	50
2.5.2.2. Types by the Features of the Investments' Own.....	51
2.6. The Decision – Making Process in FDI.....	53
2.6.1. The Decision to Invest or Not to Invest.....	53
2.6.2. When, Where and How to Invest.....	56
2.7. Methods of Measuring FDI Performance and Potential.....	57
2.7.1. The Inward FDI Performance Index.....	57
2.7.2. The Inward FDI Potential Index.....	58
2.7.3. The Outward FDI Performance Index.....	61
2.8. FDI in the World: Projects, Flows, Stocks.....	62
2.8.1. Contracted and Actualized FDI.....	62
2.8.2. FDI Flows.....	65
2.8.3. FDI Stocks.....	72
3. FDI IN CHINA.....	78
3.1. Introduction.....	78
3.2. Historical Background.....	79
3.2.1. 1949 – 1978.....	79
3.2.2. 1989 – today.....	79

3.3. Driving Factors.....	80
3.3.1. Governmental Policies.....	80
3.3.2. WTO.....	84
3.4. Classification and Explanation of FDI.....	84
3.4.1. Vertical and Horizontal Motives.....	84
3.4.2. Types of FDI.....	85
3.4.2.1. Types by Potential Return.....	85
3.4.2.2. Types Specific to the Investment.....	86
3.5. The Decision – Making Process in FDI.....	87
3.5.1. The Decision to Invest or Not to Invest.....	87
3.6. Characteristics of FDI in China.....	92
3.6.1. Sectoral Distribution of FDI.....	92
3.6.2. Regional Distribution of FDI.....	95
3.6.3. FDI Distribution of according to Donor Country.....	97
3.6.4. Distribution among Different Types of FDI.....	100
3.7. Methods of Measuring the FDI Performance in and the Potential for China.....	102
3.7.1. The Inward FDI Performance Index.....	104
3.7.2. The Inward FDI Potential Index.....	104
3.7.3. The Outward FDI Performance Index.....	105
3.8. FDI in China: Projects, Flows, Stocks.....	107

3.8.1. Contracted and Actualized FDI.....	107
3.8.2. FDI Flows.....	110
3.8.3. FDI Stocks.....	112
3.9. Impacts of FDI in the Chinese Economy.....	113
3.9.1. The Impacts of FDI on China’s International Trade.....	113
3.9.2. Domestic Effects.....	118
CONCLUSION.....	123
REFERENCES.....	128

LIST OF FIGURES

Figure 1. Population of China from AD1 to Today.....	18
Figure 2. Population of China between 1949 and 2006.....	20
Figure 3. Industrial Output Trends between 1952 and 2004.....	25
Figure 4. Raw Coal Output.....	26
Figure 5. Generated Energy.....	28
Figure 6. Composition of Energy Production in China (1985-2003).....	30
Figure 7. FDI Stock in UK and France from 1850 to 1914.....	42
Figure 8. FDI Distribution in 1914.....	43
Figure 9. FDI Stock of Chief Economies after World War II.....	46
Figure 10. A Distributional Display of Number of FDI Projects by Region in 2004.....	64
Figure 11. Number of FDI Projects in the World by Sectors.....	65
Figure 12. FDI Inflows of Top 25 Countries in 2004.....	67
Figure 13. FDI Flows between 1980 and 2004.....	69
Figure 14. FDI Inflows and Outflows in Main Regions (2004).....	71
Figure 15. Sectoral Distribution of the FDI Stocks in the World: A Comparison between the 1989-1991 and 2001-2003 Averages.....	72
Figure 16. Top 25 Countries of FDI Inward Stock by 2004.....	74
Figure 17. FDI Inward and Outward Stocks of Some Regions in 2004.....	75
Figure 18. Sectoral Distribution of the FDI Stocks in the World: A Comparison between the 1989-1991 and 2001-2003 Averages.....	76
Figure 19. FDI Stock (referencing the inward stock) between 1980 and 2004.....	77
Figure 20. GDP Growth Rate for China.....	90

Figure 21. Sectoral Distribution in China between 2001 and 2004.....	93
Figure 22. Distribution of the Used FDI in China among Different Sectors in 2004.....	94
Figure 23. Regional Distribution of FDI in China in 2004.....	96
Figure 24. Top Foreign Investors in China by 2005.....	99
Figure 25. Composition of FDI types (Distribution among Different Types of FDI).....	102
Figure 26. Contracted and Utilized FDI Inflows in China from 1984 to 2004.....	108
Figure 27. FDI Inflows and Outflows in China.....	111
Figure 28. FDI Inward and Outward Stock in China.....	112

LIST OF TABLES

Table 2.1 Inward FDI Performance Matrix.....	59
Table 2.2 FDI Performance and FDI Potential.....	60
Table 3.1 The Inward FDI Performance Index Results between 2002 and 2004.....	103
Table 3.2 The Inward FDI Potential Index Results between 2002 and 2004.....	105
Table 3.3 The Outward FDI Performance Index Results between 2002 and 2004.....	106
Table 3.4 Distribution of the Contracted and Used FDI Data among FDI Types.....	109

LIST OF MAPS

Map 1. The Qin Dynasty.....	6
Map 2. China within the Region.....	16
Map 3. China; Display of the Provinces.....	32

LIST OF ABBREVIATIONS

- APEC: Asia-Pacific Economic Corporation
BP: British Petroleum
CCP: Chinese Communist Party
CEPII: Centre d'Études Prospectives et d'Informations Internationales
CIS: Commonwealth of Independent States
CJVs: Cooperative Joint Ventures
EJVs: Equity Joint Ventures
ETDZ: Economic and Technological Development Zones
EU: European Union
FDI: Foreign Direct Investment
FIE: Foreign Invested Enterprises
FISVs: Foreign-Invested Shareholding Ventures
GDP: Gross Domestic Product
HRS: Household Responsibility System
IMF: International Money Fund
INDi: Inward FDI Performance Index
JV: Joint Venture
M&As: Mergers and Acquisitions
MNC: Multinational Company
MNEs: Multinational Enterprises
ONDi: Outward FDI Performance Index
PRC: People's Republic of China
R&D: Research and Development
SARS: Severe Acute Respiratory Syndrome
SEPA: State Environmental Protection Administration

SEZ: Special Economic Zones

SOE: State Owned Enterprises

TNC: Transnational Corporations

TNK: Tyumen Oil Company

UK: United Kingdom

UN: United Nations

UNCTAD: United Nations Conference on Trade and Development

US: United States

USD: United States Dollars

WFOEs: Wholly Foreign-Owned Enterprises

WTO: World trade Organization

“Against whom is the Great Wall of China supposed to protect us from? Against the people of the North.. I come from the southeast of China. No northern tribe can threaten us there. We read about them in the books of the ancients; the cruelties which they commit in accordance with their nature make us heave deep sighs in our peaceful bowers; in the faithful representations of the artists we see these faces of the damned, their gaping mouths, their jaws furnished with great pointed teeth, their screwed-up eyes that already seem to be leering at the prey which their fangs will crush and rend to pieces. When our children misbehave we show them these pictures, and at once they fling themselves sobbing into our arms. But that is all that we know about these northerners; we have never set eyes on them, and if we remain in our villages we shall never set eyes on them, even if they should spur their wild horses and keep charging straight towards us; the land is too vast and will never let them through to us, they will ride on until they vanish in the empty air.”¹

INTRODUCTION

Chinese culture is highly examined by scholars and its development is of certain interest. Generally accepted own-developed, isolated culture framework is still valid despite the fact that China had many interactions prior to the construction of the Great Wall of China.

This study is about the foreign direct investment (FDI), a 19th century phenomena and its image in the People’s Republic of China (PRC) as an open economy since the early 1980s. The early implementations of FDI are closely related to the Industrial Revolution. Western Europe can be stated as the first region to conduct FDI interactions by opening plants in foreign countries, in order to take the comparative advantage of the international trade. The increasing interaction between the countries accelerated the contagion of FDI throughout the world. Today, we can say that FDI is one of the greatest sources of the international trade with its approximately 900 billion dollars volume.

¹ KAFKA, Franz (1992). *The Great Wall of China*, Penguin, p. 9-10.

The degree of the openness is one of the most important indicators for the FDI to flourish in a country. When we make a very brief analysis from the early stages of 20th century, the story of FDI is quite interesting. As seen in the FDI stock data, the dominance of the Western Europe is obvious. For a newly opened economy, FDI is one of the most considerable measures of the development. China, now, stands at the core of the world FDI by her favorable offerings such as low levels of the labor costs and the governmental regulations encouraging the FDI.

The passage from the Kafka's book is considerable. China started to build the Great Wall by the period of Qin Dynasty in 208 BC and the construction lasted in the period of Ming Dynasty in the 1600s. The common belief was to protect the country from the outsiders. Even this affords has worked or not, the wall still exists and is one of the most interesting features of China. In this study, I would like to ask the question of whether The Wall still has its psychological or physical power on people both within and outside China or it is just a fascinating world wonder for the touristic tours.

The main purpose of this study is twofold: First, the historical development, classification, formation and implementation of FDI and, secondly, the application of those elements on China. FDI is one of the most important sources of the world trade and China is a giant with its more than 1 billion of population and far open-doors to the foreigners since the early 80s. This study will try to answer the questions about FDI in China, a natural consequence of opening and its further consequences on the country's profile. We will try to find out whether China is still attempting to protect herself from the outsiders by an existing wall or FDI as many new economic factors destroyed it. In order to comprehend the FDI and China better, some detailed information about the country's past and today and the FDI are given before the application of FDI on China is conducted.

In Chapter 1, a brief history and some fundamental and contemporary features of China are explained. In the Chinese History part, the post Republican Revolution period is detailed more intensively as the Republican Era, Mao Era and

the changes after the 80s. Since the historical background is quite important in order to understand a country's present, some noteworthy political and economic events are dealt in this chapter. In "Some Contemporary Features of China" part, the basic features which are extremely important for defining social and economic context in China are explained and an overall present situation is presented. Those features are "Some Geographical Characteristics", "Demography", "Agricultural Transformation", "Industrial Restructuring", "Growing Energy Need", "Widening Gap between Coastal Areas and Hinterland", and "Some Environmental Factors". Those features have been shaping Modern China and are very important for our present interpretations. They are the indicators of the social, economic and cultural positions of the country. The investment side of the picture is what we are examining and for a forethoughtful investor considering business interactions in a country with peculiarities, such as China, to deal with those features is a crucial necessity. For example, while the widening gap between the coastal area and the hinterland is directly related with the regional distribution of the FDI, the industrial development has been being affected by the growing needs of the investments. Moreover, the agricultural sector with a huge amount of peasantry is one of the strongest characteristics of the country.

Chapter 2 presents more detailed information about the FDI from its early beginnings to the actual world trends of today. The components and driving factors of the FDI and a short historical background which explains the developments and trends are presented in the first parts of this chapter. Classification of FDI by vertical and horizontal motives is used in determining the motive of an investment. Types of FDI can be classified by the potential return or by the features of the investment's own. Chapter 2 examines those headlines and constructs some relationships between them. The behavior of the FDI changes among the different countries and those relationships became very important in interpreting the actualized or the potential investment. For example, the labour-intensive economies are more likely to attract vertical and resource seeking investments whereas, for the capital-intensive developed countries the horizontal and market-seeking foreign investments are more popular. However, for the foreign investor to make a decision

about the nature of the investment, there are some fundamental factors, namely, the country risk, unit-labour cost, host market size and the gravity factors pointing out the characteristics of the country in which the investment is to be conducted. Those factors can also be thought as the factors affecting the FDI. In this chapter, the peculiarities of those factors, rather than the effectiveness rates are discussed. In spite of the relatively low labour costs of many developing countries, since the country risk is high depending on the low credit ratio or the some industrial failures, the FDI flows may be lower than the relatively higher labour cost countries. A very important phenomenon in measuring the FDI for a country is the FDI indexes. Those indexes are, The Inward FDI Performance Index, The Inward FDI Potential Index and The Outward FDI Performance Index and used in calculating the position of a country within the world. The last part of this chapter is about the FDI projects, FDI flows and FDI stocks around the world in regional, sectoral or overall terms. This part indicates the main trends with figures and makes some interpretations about the China's FDI volumes. Moreover, the aim of this chapter is to prepare a strong base in order to apply the definitions and the facts to a single country; China.

Chapter 3 is completely about China and the meaning of the FDI in this country. This chapter uses the headlines of the previous Chapter –Chapter2- and gives information about their view in China. As mentioned many times, China is a unique country with special characteristics some of which we will try to understand. However, starting with the development and the present trends of FDI provides us a vision to comprehend each case about our subject. 20th century was an amazing century in which a lot of important events were occurred. The hundreds of century dynasty period ended and Republican Revolution was made. China has met with republic at first time in her history and witnessed crucial changes in her social, economic, political and cultural life. The Mao Era, coming then, was a unique regime in which the country faced of plenty of reforms. However, in 1980s completely different policies were applied; the country liberalized by the new reforms of Deng Xiaoping. By opening the economy outside, the international trade became one of the most important subjects for the government and the trend of FDI has been very high since the early 80s. By the accession to the World Trade

Organization WTO, China has witnessed a lot of essential changes in her legislation and economy. Even after the accession, China still tries to adapt herself to the annual declarations of the WTO. Moreover, this chapter mentions the regional, sectoral distribution of the FDI in the light of the China's own characteristics. The diversification of the investments among the types as wholly foreign owned or contractual FDI is also detailed in this chapter. The measurement of the FDI is adapted to China by indicating the trends and the rankings for the inward and outward indexes among the other countries. The FDI projects, FDI inflows and FDI stocks are also detailed for China. For the three elements, the improvements and the trends of the FDI were examined for China. Lastly, the impacts of FDI in the international trade of China and the domestic impacts were mentioned.

1 A BRIEF HISTORY OF CHINA AND SOME CONTEMPORARY FEATURES

1.1 A Brief History

1.1.1 The Ancient Times and the Period of Dynasties

Chinese history starts from six hundred thousand years ago and those dates are classified as *Lower Paleolithic age*. Homo Sapiens was found around 35000 BC and in Neolithic times, the social scene changed vastly. People settled in villages, engaged in agriculture, hunting and fishing. Masses buried in individual tombs were found near those villages. Different types of pottery shows how colorful was those times' art. When we look at Chinese records to find out the ancestors of rulers in China, we see the Three Sovereigns and then the Five Rulers. Invention of fire, farming and silk, and building of houses are attributed to those kings.¹

Map 1. The Qin Dynasty



Source: Minnesota State University Mankato, *Maps of China*, (online) <http://www.mnsu.edu/emuseum/prehistory/china/map/map.html>, September 22nd, 2006.

¹ MORTON, Scott W. (2004). *China: Its History and Culture*, Blacklick, Ohio, US: McGraw Hill Companies, pp. 11-14.

From approximately 1800s BC to 1700 AD, the dynasties were prevailed in the mainland China. The early ages of this period was reflecting the Mesopotamian culture when the living style and the warrior rulers were investigated. China was given her name from a ruler of this period; Qin, because Qin is pronounced as “cheen”. Practical and cruel legalism, a well-organized army that was possessing cavalry, iron weapons, and commanded by strong leaders were the most important peculiarities of this dynasty.²

China was a warrior country which had interactions with warrior countries as Mongols and Turks and the other neighbors, and collapsed many times. Although those separations, she achieved to be unified again.³

The Qing Dynasty prevailed about 300 years and its power remained until 19th century in which the republicans became strong danger for the dynasty. By the collapse of the Qing dynasty in 1912, over 2000 years of imperial China ended and an extended period of instability began, not just at the national level but also in many areas of social life. The collapse of the doubts about the future arisen from criticisms of the cultural, economic and political environment led to additional instabilities. China's turbulent history since the overthrow of the Qing may be understood at least in part as an attempt to understand and recover significant aspects of historic Chinese culture and integrate them with influential new ideas that have emerged within the last century. The Qing dynasty is the source of much of this magnificent culture and country of our contemporary world.⁴

² WRIGHT, David C. (2001). *History of China*, Westport, CT, US: Greenwood Publishing Group, Incorporated, p. 45.

³ MORTON, Scott W. (2004). *Op.cit.*, pp. 45, 46, 101, 115.

⁴ *Ibid.*, pp. 137-148.

1.1.2 Republican Revolution: 1900– 1949

A revolutionary leader, Sun Yat-sen was the father of the republic. He was educated in West, became a Christian and received a medical training in Hong Kong.⁵ In 1894, he founded the Revive China Society which was a revolutionary secret society having branches abroad as well as in China. The Meiji era in Japan had then been experiencing the childhood stages of western modernization. Chinese scholars, writers and hence students were very much in radius of effect of Japanese modernization and the intellectual writers emphasized the Social Darwinism, the struggle for existence and survival of the fittest of individuals and nations in their works. In the presence of such an intellectual progress, Sun had formulated “Three People’s Principles: People’s Nationalism, People’s Democracy and People’s Livelihood”. Sun’s writings were opposing both Dynasties and foreign imperialism.⁶

The Republican Revolution was started by a military revolt and Sun Yat-Sen became the first president of the Chinese Republic on March 12, 1912. However, the new army downed him and a chaotic period as started by a militaristic leadership in the next three years.⁷

In 1919, a very important event called the May of Fourth Movement occurred in China.⁸ That movement was barely noticed by the rest of the world, however, its effects on China and other countries lasted for 20th century. What Sun Yat-sen achieved in the 1920s was to found a revolutionary base in Southern China in order to unify the shattered country. However, after his death in 1925, one of the opposition leaders, Chiang Kai-shek gained control of Nationalist Party and brought south and central China under a military regime known as the Northern Expedition

⁵ COHEN, Warren. (1997) *China: Understanding Its Past*, Honolulu, HI, US: University of Hawaii Pres, p. 148.

⁶ MORTON, Scott W. (2004). *Op.cit.*, pp. 176, 177.

⁷ WRIGHT, David C. (2001). *Op.cit.*, pp. 121, 122.

⁸ This movement, on the very bases, was a response to the consequences of World War I in China. The Treaty of Versailles was the initial target of protestors whereas China’s internal politics were criticized more. Liberal Western thought fed Chinese intellectuals, who would soon establish the distinct political frontiers: the left and the right in China. Ongoing disputes among these two thought would dominate the direction of the Chinese history up to now. See, *ibid.*, pp. 123, 124.

and he also began to chase the Communist Party leaders in 1927. Runaway communist leaders gathered on the Long March which was organized under the leadership of Mao Zedong, a new anxious revolutionary leader, who would become the heroic ancestor of many Chinese soon. The clash between the Nationalists and the Communists went on for more than 10 years until the end of the World War II. When Japan invaded some portion of the country, they seemed to made alliances against Japanese, yet they were very much separated in philosophy and hence nature. The war between them physically ended when the Communist Party dominated most of the country with its authority by 1949.⁹

1.1.3 The Mao Era and the Communist Revolution

In order to understand present China, it is essential to be aware of the near past. Mao Era is extremely important since it has affected the nation deeply with a unique feature and still keeps its influence for China and for the world.

1.1.3.1 Civil War and the Korean War

After the World War II, the clash of the Nationalists and the Communists broke out as a civil war. Both sides refused the reconciling efforts of the United States and in April 1949, the Communist led by Mao took over Nanjing and founded the People's Republic of China instead of Chiang Kai-shek and his government.¹⁰

At the end of World War II, the 38th parallel divided Korea into North and South Korea. North Korea was led by a Communist dictatorship backed by Soviet Union whereas South Korea was under effect of the United States. United Nations (UN) and United states (US) became involved in the war after a short while and those in turn triggered China's involvement in the situation. On November 26, 1950, millions of Chinese Communists marched to the South Korea and drove the UN forces beyond the South Korea capital Seoul. With this war, People's Republic of

⁹ COHEN, Warren (1997). *Op.cit.*, pp. 150-152.

¹⁰ WRIGHT, David C. (2001). *Op.cit.*, pp. 143, 144.

China stood still against the super powerful nations at the very beginning of its history. Although international politics then became aware of the China's power, many reform programs and militaristic arrangements had been interrupted by the Korean War as land reform and attack plans to Taiwan.¹¹

1.1.3.2 Rearrangement Efforts and the Hundred Flowers Campaign, 1949-1956

Mao wanted to utilize from post-war era stability and began to establish his peacetime reconstruction program which is a highly theoretical transition to socialism. Among the positive that Mao completed, we may list; confiscation of all farmland and its redistribution to landless peasants, reform of marriage law that prohibited concubines and polygamy and ensured women more rights in marriage. On the other hand, nearly 500.000 people who were against the new Communist regime were executed. "Reform through labor" techniques resulted in psychological torture attempting to change the minds of people against the new regime. Five-year development plans were used in transition to socialism period. During the early years of the Maoist rule, People's Republic of China focused on education, industry and health-care. Industrial and agricultural production made peak at that period.¹²

In early 1957, Mao published a significant essay titled "On the Correct Handling of Contradictions Among the People", which was on the very basis an acceptance of constructive criticisms and suggestions about his policies. His message was; "Let a hundred flowers bloom and a hundred schools contend". This message encouraged many intellectuals to criticize socialism and the Communist party intensively. Finally, Mao played his dime; prohibited speaking against socialism and the regime. Many scholars still argue about the aim of that Hundred Flower campaign. Some defines it as a movement clarifying opposition of the regime, some says it was intended to be a positive movement but critics manipulated it harshly.¹³

¹¹ *Ibid.*, pp. 145-147.

¹² *Ibid.*, pp. 147-149.

¹³ *Ibid.*, p. 149.

1.1.3.3 The Great Leap Forward and the Uncertainty Period

The Chinese Communist Party (CCP) launched the Great Leap Forward movement in September 1957. It had two purposes: collectivization of agriculture and massive industrialization. After certain efforts in order to implement the movement throughout the country, by the summer of 1959, everyone in China realized that something had gone disastrously wrong with the Great Leap Forward, but very few people dared say so openly for fear of offending Mao and his supporters. The Great Leap Forward was consequently a leap backwards instead. Estimated 30 million people died of starvation because of agricultural inefficiencies caused by the movement.¹⁴

In the early 1960s, Mao lost all his credits after his impractical adventurism, especially after the Great Leap Forward policies. Mao knew that he had to take action in order to regain the support of people and that action was the Cultural Revolution by which Mao aimed at the cultural roots of the Chinese society and by manipulating them he believed that the revolutionary process towards pure communism would accelerate.¹⁵

1.1.3.4 The Cultural Revolution: 1966–1976 and Mao’s Death

Mao with a revolutionary vision asked Chinese youth to rebel against any authority figure like family, school, government and workplaces. That statement was well appreciated by angry generation and by the summer of 1966; China started to be shaken by disorder that would continue until Mao’s death in 1976. In June 1966, began the thorough anarchy in China. University students left their studies and supported the new movement via rebelling against any authority they found, actually elderly. Mao accepted that his idea of Cultural Revolution went too far so that he tried to suppress the upheavals. He distributed young rebellions to the countryside in order to help peasantry, mostly compel them. The end of the Cultural Revolution was

¹⁴ MORTON, Scott W. (2004). *Op.cit.*, pp. 212, 213.

¹⁵ *Ibid.*, p. 215.

officially declared in 1969. When we look at the consequences of the Cultural Revolution, more than one million Chinese, mostly urban population, died. Mao himself intended to accept the movement's failure by taking backward steps and ending the revolution. He had initiated the movement over young generated in order to utilize from their energy and openness to revolutionary ideas, however, he could not successfully lead their actions and prevent them from harming the whole society and economy.¹⁶

Mao and China tried to open to the outside world by 1970s. Including the United States, many countries recognized the People's Republic of China by the end of 70s. In internal politics, the government tried to reduce the power of radicals. Mao died on September 9, 1976.¹⁷

1.1.4 Deng Xiaoping: 1976-1989 and the Modern China

After Mao Zedong's death in 1976, Gang of Four of which consisted Mao's wife, Jang Qing and three of her associates, Hua Guofeng and Deng Xiaoping struggled to take over the control. By 1980, Deng was the leader of the People's Republic of China and he announced Economic Reforms and Openness policy at the Communist Party congress. These reforms included the de-collectivization of the countryside, industrial reforms providing decentralization of government control over the industry.¹⁸ Deng also imposed loosening of strict government regulations over the foreign investments via establishing Special Economic Zones (SEZ's). Within those zones, government control was so weak that nearly a perfectly competitive free market economy formed.¹⁹ He gave special importance to light industry, which would later trigger development of heavy industry as an evolving consequence. Deng's economic reforms resulted in the development of consumer and export sectors by creating a middle class with higher living standards. Gross Domestic

¹⁶ JIAGI, Yan and Gao Gao (1996). *Turbulent Decade: A History of the Cultural Revolution*, translated and edited by D. W. KWOK, Honolulu, HI, USA: University of Hawaii Press, pp. 40-55; 531-532.

¹⁷ WRIGHT, David C. (2001). *Op.cit.*, pp. 216, 217.

¹⁸ MORTON, Scott W. (2004). *Op.cit.*, 227-230.

¹⁹ WRIGHT, David C. (2001). *Op.cit.*, p. 168.

Product (GDP) per capita dramatically increased just as consumer spending, life expectancy, and total grain output and literacy rate. Human right notion was introduced and improved by the time. People started to demand basic rights and freedom. Despite these apparent developments, conservatives criticized Deng harshly and blamed him for opening up China to hungry capitalist attacks and consequently social breakdowns. Even Liberals did not approve Deng's stance on the political arena since he was still representing the Communist Party figure symbolically. In the Tiananmen Square in 1989, those voices spoke aloud and Chinese government was seen as the only guilty agent. More objective critics of the economic reforms emphasize following consequences of the reforms; wealth disparity among Chinese population, environmental pollution, unemployment due to unplanned layoffs at inefficient state-owned industries, corruption and cultural effects. The last one being the most crucial one, threatened the whole society, the critics stated. In spite of all those critics and reviving respect for Mao socialism did not hurt the rapid growth of free market economy and modernization period following it.²⁰

After the huge protest in the Tiananmen Square, Deng Xiaoping began to lose control while controlling the flow of control. In other words, keeping the ultimate control, Deng transferred his authority to a younger generation led by Jiang Zemin. Jiang established macroeconomic reforms that turned Chinese economy into "Socialism with Chinese Characteristics". Despite foreign trade quotas and embargoes, Chinese economy boomed. Unemployment, social corruption and lack of an efficient social welfare system went on growing hand in hand with the economy, science and technology. In addition, environmental pollution reached to such a serious level that sandstorms started to hit Beijing frequently.²¹ In 1997, Hong Kong and in 1999 Macao involved in Chinese sovereignty from Britain and Portugal respectively. Jiang and Clinton visited each other. Good international relations, however, did not last long. The United States air force bombed the Chinese embassy in Belgrade in 1999 and the US military reports blamed China for spying against the

²⁰ VAN KEMENADE, Willem (1997). *China, Hong Kong, Taiwan, Incorporated*, Westminster, MD, USA: Alfred A. Knopf Incorporated, pp. 160-168; 237; 240.

²¹ *Ibid.* pp. 160-168; 240-253.

US army. In 2001, a US plane crashed with a Chinese jet and political distance between the US and China remained huge.²²

Economic growth, on the other hand, continued to endure with a mean ratio of 8% annually. Only the great Yangtze floods interrupted this growth rate, but even the Asian Financial Crisis in July 1997 did not hurt China's growth much. The World Trade Organization accepted China as a member on December 11, 2001. The wealth distribution was filled with enormous inequalities such as urban-rural and eastern-western gaps. Projects like construction of Qinghai-Tibet Railroad were significant in closing these gaps.²³

When we come to the year 2002, China saw the most crucial crisis of the 21st century so far; Severe Acute Respiratory Syndrome (SARS). Hu Jintao as the leader was blamed in that public health scandal. The support of China on war on terror campaign of the United States brought both countries closer. The Chinese economy grows in double digits and special care is assigned to development of rural areas by the contemporary governments. Brutal censorship applied to the media and critics, Taiwan and political status remain problematic in China. Hong Kong and Shanghai boomed economically and expanded very much.²⁴ In 2008, the Summer Olympics, an international multi-sport event taking place every four years, will hold in Beijing, China. The People's Republic of China with more than 1,3 billion people eyes becoming the super power of the world in the future.

²² MORTON, Scott W. (2004). *Op.cit.*, pp. 251; 259-260.

²³ *Ibid.*, pp..261-263; 254, 255.

²⁴ *Ibid.*, pp. 246, 247.

1.2 China: Contemporary Features

Being the third largest country after Russia and Canada in size, the People's Republic of China, covers an area of 9,596,960 km².²⁵ It spans nearly 4400 km from north to south and hence different regions experience completely different climate conditions. To exemplify, Canton lying in the south region is within tropical belt whereas northern Manchuria feels temperatures of -40° C and lies less than 15 degrees from the Arctic Circle. Those climate and geography variations within China resulted into inclination to separate nations throughout its history. Europe during the collapse of Roman Empire had experienced such conditions and broken up into separate nations after the decline. What prevented this breakup within China seems to be its strong bureaucracy, which in return defended the Chinese script and common culture for ages.²⁶

China's neighborhood consists of all the major countries of Asia except for West Asian ones (The Middle East and Near East). Although its location seems to help China establish close relationships with its neighbors, both geographical and man-made barriers increase isolation. On the east lies the Pacific Ocean and on the north undesirable Mongolia region exists. In addition, inhospitable Tibet plateau on the west and south isolate China from foreign civilizations. This isolation resulted in a unique culture and way of life within China, which do not resemble any of major civilizations. Naturally, contacts with neighbors and other nations occurred through its history. For instance, Buddhism spread along trade routes; contacts with India from the west and with the Arab world from the south took place. Besides, sea trade routes passing through the west, south and southeast coasts provided Chinese people close interactions with "others".²⁷

²⁵ 10th European Country of Origin Information Seminar, *China*, 2005, (online) <http://www.unhcr.org/cgi-bin/texis/vtx/home/opendoc.pdf?tbl=RSDCOI&id=4451d8c64#search=%22china%2C%20square%20km%2C%209%20596%20960%22>, September 13th, 2006.

²⁶ MORTON, Scott W. (2004). *Op.cit.*, pp. 5-8.

²⁷ *Ibid.*, pp. 5-8.

Map 2. China within the Region



Source: Index-china-com, *China Map Index*, (online) http://www.index-china.com/index-english/china_map_index.htm, September 13th, 2006.

1.2.1 Geographical Characteristics

When we look out a physical map of China, China is covered with mountains and hills from west to east and plains are located in Manchuria, Sichuan basin and along Yangzi River mainly. Except for Huai River, all rivers flow into the Pacific Ocean. Major rivers can be listed as; the Sungari in North Manchuria, the Liao in South Manchuria, the Yellow River in North China, the Yangzi in Central China and the West River at Canton region.

The most important mountain range is the Qinling range, extending east from the great Kun Lun system of Tibet. That mountain range divides China into two; Northern and Southern China. Northern China is cold, dry and has desert winds in winter. On the contrary to this, Southern China is affected by monsoon climate, rainy and warmer.²⁸ Not only is the climate separated by Qinling but also the cultures and life styles. For instance, northern side farmers produce tall grain and wheat whereas southern farmers commonly grow rice and tea. In the north, a farmer can mostly harvest twice annually, at the same time southern farmers can harvest at least three times a year. Southern Chinese men do not sit at home, as northern Chinese men do but travel, fish and trade.²⁹ Hence, Chinese immigrants in major capital cities of the world like London, Paris, New York, Berlin, and Istanbul are most likely to be from Southern China.

1.2.2 Demography

General characteristics of Chinese population can be classified as rural rather than urban. Nearly three out of four Chinese live in the countryside, in villages or small towns. Industrialization, therefore, exists in a more decentralized fashion in order to include rural area workforce.³⁰

Erosion is amazingly one of the most dangerous natural disasters for China. Resulting from deforestation process going on for centuries, erosion threatens fertile plains and triggers floods as a sequential disaster. There are researches in order to prevent this fact and government takes some steps in the five-year plans with the assistance of Agricultural Modernization Research Institute.³¹

Another problem for China is its high population. In spite of a strict governmental control and bureaucracy, estimating China's population has always

²⁸ WRIGHT, David C. (2001). *Op.cit.*, pp. 4, 5.

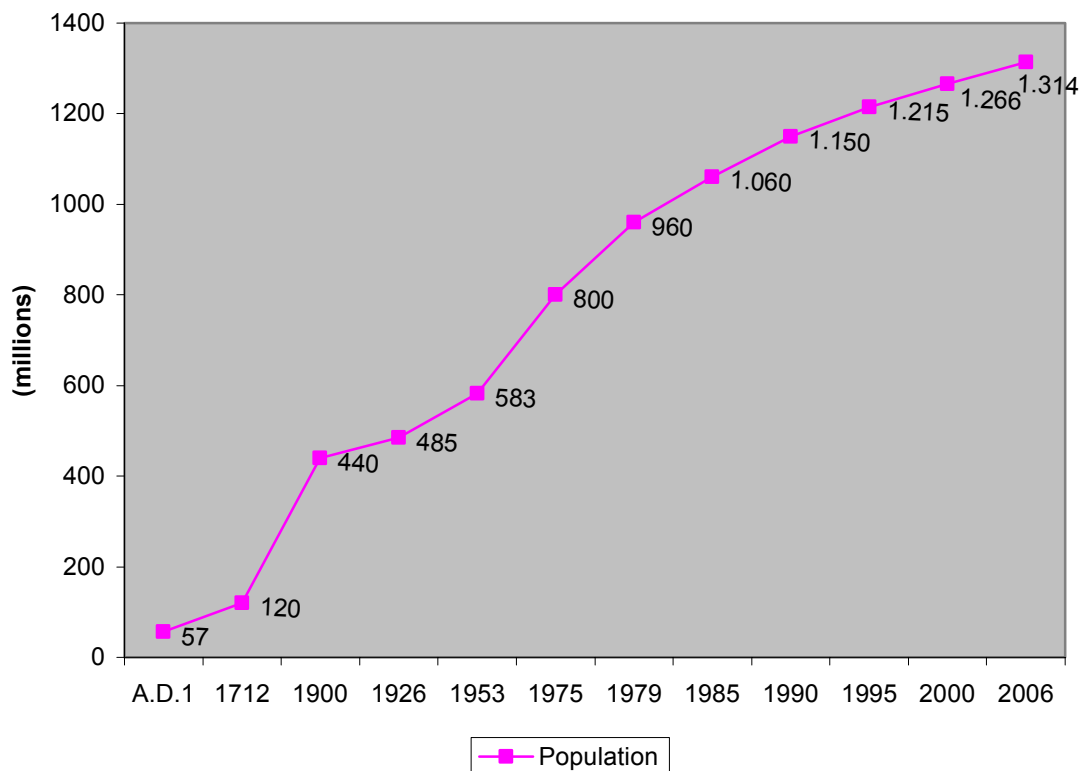
²⁹ *Ibid.*, pp. 3, 4.

³⁰ BBC News, *China's Rural Millions Left Behind*, 2006, (online) <http://news.bbc.co.uk/2/hi/asia-pacific/4782194.stm>, September 15th, 2006.

³¹ Xinhua News Agency, *New Technology to Help Curb Black Earth Erosion*, 2001, (online) <http://www.china.org.cn/english/2001/Sep/19787.htm>, September 13th, 2006.

been problematic. In taxation procedure, population is accepted as the basis for estimation, hence, open to any alteration in order to reduce taxation. For instance, boys under one and girls under five years old are not accounted for population at many counts. Even populations of several regions such as Tibet and Outer Mongolia are not included in the overall population in some counts.³² Figure 1 shows the trend of population starting from 1 AD and more recent data about Chinese population can be seen in Figure 2.

Figure 1. Population of China from AD1 to Today



Note: For the year 2006, the estimated value from CIA is used.

Sources: MORTON, Scott W. (2004). p. 8; LAHMAYER, Jan (2003). *China Historical Demographical Data of the Whole Country*, (online)

<http://www.library.uu.nl/wesp/populstat/Asia/chinac.htm>, September 13th, 2006; Central Intelligence Agency, *The World Fact Book*, September 19th, 2006, (online)

<https://www.cia.gov/cia/publications/factbook/geos/ch.html>, September 21st, 2006.

³² MORTON, Scott W. (2004). *Op.cit.*, pp. 8-10.

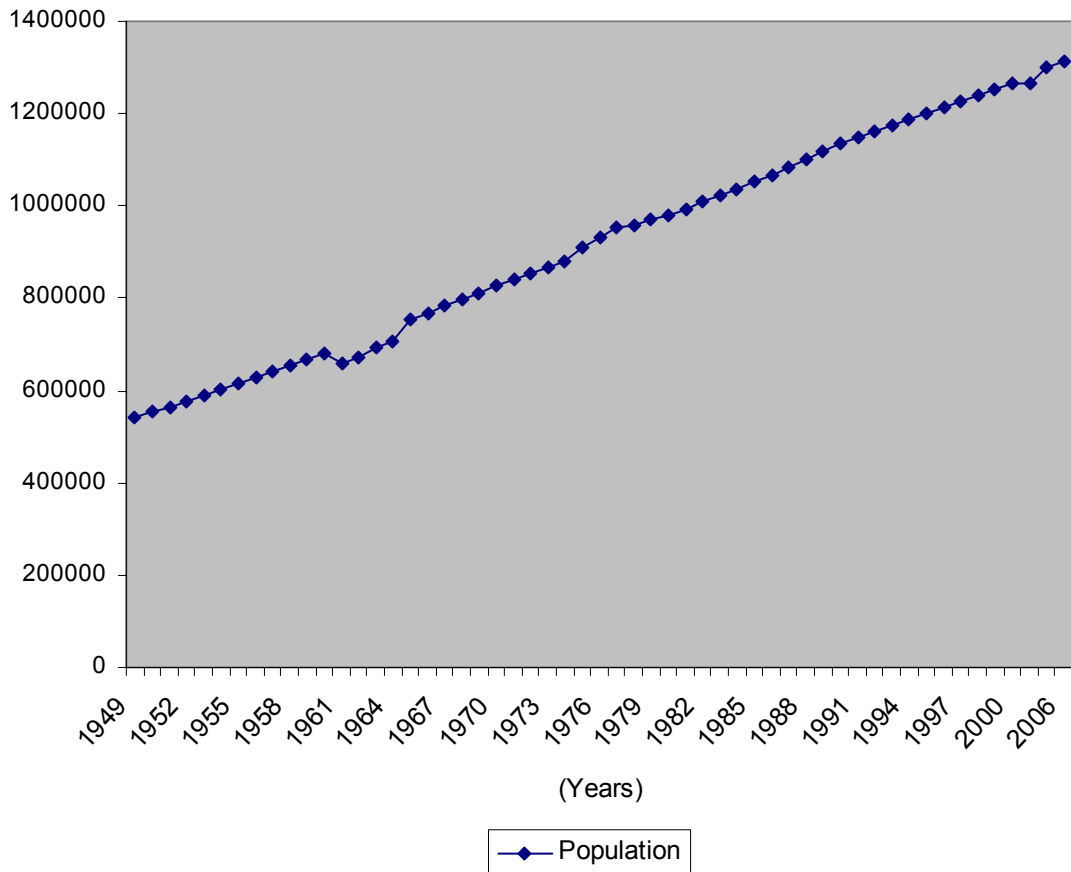
Moreover, there is a serious demographic imbalance, because the traditional nation favors sons over daughters within the country. In 1990, 51,6 percent of the total population were male citizens and 48,4 percent were female.³³

Figure 2 indicates the population trend of China between 1949 and 2006. There are some important points that I would like to mention. First one is the rapid growth from 550.000 to 1.300.000 between 1949 and 1981. Also, there was more than 50 percent reduction in the fertility rate and the mortality rate increased 20 years in those decades. Secondly, the figure shows a flattening in 1981. The population acceleration after 1949 lead government took some steps in order to control the rate. They reduced pressure for the late marriage and applied some policies to discourage the second and more children.³⁴ The most impressive figure is the sharp decline in the period of 1961 and 1967. As stated in the latter chapters more detail, because of some adverse effects of the Mao Era policies, approximately 30 million people are died for some distressful reasons as starvation. The upheavals also caused a lot of people as students or intellectuals, mostly from the urban areas to die. However, as a developing country, China have turned to the a little flatter high rates of population acceleration as seen in the Figure 2.

³³ WRIGHT, David C. (2001). *Op.cit.*, pp. 9-11.

³⁴ COALE, Ansley J. (1984). *Rapid Population Change in China, 1952-1982*, Washington, DC, USA: National Academies Press, pp. 71, 72.

Figure 2. Population of China between 1949 and 2006



Note: For the year 2006, the estimated value from CIA is used.

Sources: LAHMAYER, Jan (2003). *China Historical Demographical Data of the Whole Country*, (online) <http://www.library.uu.nl/wesp/populstat/Asia/chinac.htm>, September 13th, 2006; Central Intelligence Agency, *The World Fact Book*, September 19th, 2006, (online) <https://www.cia.gov/cia/publications/factbook/geos/ch.html>, September 21st, 2006.

1.2.3 Economic Characteristics

When we investigate geographical, demographical and production facts about China; we see that China feeds one person among each five on the world with less than 10% of agricultural lands.³⁵ In addition to that fact, it has a developing export market for

³⁵ China Council for International Cooperation on Environment and Development (CCICED) (2004). *Sustainable Agricultural and Rural Development; In the New Era of Development: Preparing for the Future*, (online), http://www.harbour.sfu.ca/dlam/_ftn1, September 13th, 2006.

agricultural products. However, in the presence of intensive industrialization policies led by recent governments resulted in reduction of the status of agriculture in the national economy, a rising star though is the heavily supported industry. That growing industry requires an abundance of energy resources to run; therefore, China contemporarily has a huge concern of energy supply and sustenance. Industrialization brings urbanization aside and income gap between rural and urban areas widens day by day. Due to several meaningful reasons, investments are concentrated in eastern regions than in western regions in China, leading to another unequal welfare distribution inside the same country. A last but not the least issue faced by Chinese people now and will be faced more severely in the future; environmental problems. Increasing use of agricultural chemicals for efficiency and industrial pollution of water, soil and air cause additional pressures on ecology and biodiversity. Also, boom in number of natural disasters in China warns Chinese loudly about the concepts like the global warming.

1.2.3.1 Agricultural Reform in China

As a part of the economic reforms called “Socialism with Chinese Characteristics”, rural economy of China was de-collectivized under a contract system, the Household Responsibility System (HRS). The generation of the HRS system which provided allocation rights to individual farmers caused a rapid development in the markets of many agricultural products and then the market liberalization.³⁶

Reforms did not totally end collective property ownership, but their responsibility and hence profit was distributed among peasantry. A contract stating the responsibilities and obligations to be fulfilled was signed with individual households (farmers). Therefore, those farmers were given certain rights and responsibilities; in addition, though, they had to meet contract criteria such as production quota and pay local public officers taxes in order to continue ownership of the land. Those contracts were initially very short-term agreements lasting for no

³⁶ SZELENYI, Ivan (1998). *Privatizing the Land: Rural Political Economy in Post-Communist Societies*. London, UK: Rutledge, p. 95.

more than three years. In 1984, HRS contracts were permitted to be valid up to fifteen years in order to sustain soil conservation and encourage land investment. In 1994, that validation period has been extended up to thirty years. Thirty years ownership of peasantry means the end of collective property ownership authority over those lands.³⁷

In line with land redistribution, the Chinese government made several changes in price and market of agricultural products. The government raised producer prices and loosened controls over the market. Those reforms ensured peasantry make the final decision about the amounts, types of grains and crops to produce and amount to sell or store. Despite those advantages, farmers faced with fierce competition and market risks with which they were completely unfamiliar. Land cultivation also arose as a shortcoming of the system.³⁸ Therefore, in 1986, market reforms were established and very welcomed by the farmers. Active free markets founded at small towns spun a web of marketing channels for agricultural products and with certain adjustments and regulation; they helped the HRS reform in de-collectivization of agricultural lands.³⁹

On the other side of the coin, urban population demands most of the agricultural products provided their salaries are enough to meet market criteria. State owned enterprises (SOEs) set the prices on their own and that causes very high and unaffordable prices on demand side. Therefore, the Chinese governments have been trying to subsidize food in urban markets instead of freeing food market thoroughly. That policy contradicts with relaxation of producer prices, because one side of the agriculture market scales is free (supply) and the other side (demand) is pushed heavily by the government, which creates an imbalance and burden over the government. Liberalization and regulations oscillated back and forth during 1990s in

³⁷ KRUSEKOPH, C. Charles (2002). "Diversity in Land-Tenure Arrangements under the Household Responsibility System in China", *China Economic Review*, Vol. 13, Issue 2-3, p. 298.

³⁸ CHEN, Kai and Colin BROWN (2001). "Addressing shortcomings in the Household Responsibility System Empirical Analysis of the Two-Farmland System in Shandong Province" *China Economic Review*, Vol. 12, No: 4, p. 281.

³⁹ ZHANG, Xiaobo, Tim D. MOUNT and Richard N. BOISVERT (2006). "Industrialization, Urbanization, and Land Use in China", *EPTD Discussion Paper*, No. 58, p. 10.

Chinese agriculture market, even the grain and cotton quota increased after 1993. Those oscillations prevented native and foreign investments to accumulate in that supply-demand chain for agricultural products. Without large investors and companies, there is no way to reduce transaction costs of production and thereby liberalization is harshly tackled. That dual pricing and marketing system for agriculture seem to continue furthermore thanks to flow of money through SOEs versus market; in both cases the government does not lose anything but sustain food market healthily. Institutionalized corruption among SOEs is a major problem in that chain but reforms in SOEs attempt to solve those problems. Today, in aggregate, about 20-30 percent of total agricultural production is for quotas, 50-60 percent is consumed by producers and 10-20 percent is freely marketed.⁴⁰

Commercialization and the emergence of private trading sector appeared as the two dominant factors in the market reform of China's transition. Rising integration and the decreases in the transition costs provided the traditional governmental methods to disappear. All those improvements have brought China to market economy, and now, much of the transactions are determined by the rules of the market economy.⁴¹

1.2.3.2 Industrial Restructuring

Chinese industry was quite immature in the late 40s, hence many finished goods were imported and output of major industrial products such as yarn and raw coal were very little. At that time, yarn production amounted to 327.000 tons whereas raw coal production was 32 million tons.⁴²

⁴⁰ ZHOU, Qiren (2000). "Property Rights and New Commercial Organizations: A Comparison of Agricultural Reform in China and Russia" in *The Chinese Economy under Transition*, ed. by Sarah COOK, Shujie YAO and Juxong ZHUANG, New York: St. Martin's Press; London: Macmillan Press, pp. 152, 153.

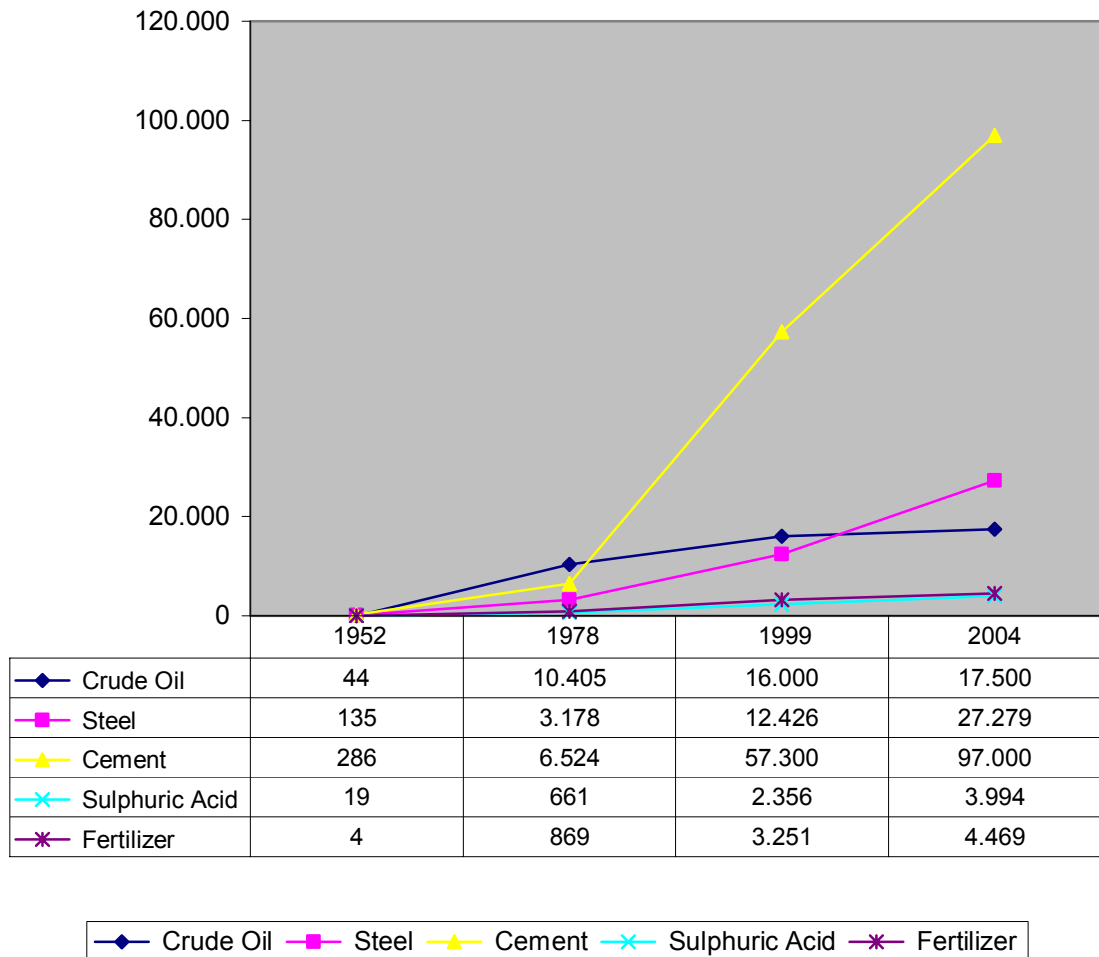
⁴¹ HUANG, Jikun and Scott ROZELLE (2006). "The Emergence of Agricultural Commodity Markets in China", *China Economic Review*, Vol. 17, No. 3, p. 279.

⁴² China National Tourism Administration. *Industry*, (online) <http://old.cnta.gov.cn/lyen/brief/industry/introduction.htm>, September 13th, 2006.

In 1949, with foundation of the People's Republic of China, vast industrialization policies started on a large scale in a planned manner. By those policies, industries like metallurgy, automobile, airplane, energy and mining skyrocketed in size and new industries including telecommunication equipment, computers, petrochemicals and aeronautics was established from scratch in a very limited time. Another breakthrough for the Chinese industry came up in 1978, with openness to outer world policies. The annual growth rate of the Chinese industry between years 1978 and 1999 averaged to 11.1% and China literally became the workshop of the world. That tremendous increase is well observed through increases in output of major industrial products of China from 1952 to 2004. Figure 3 indicates output trends of crude oil, steel, cement, sulphuric acid and chemical fertilizers in China during past 50 years.⁴³

⁴³ China National Tourism Administration. *Industry*, (online) <http://old.cnta.gov.cn/lyen/brief/industry/introduction.htm>, September 13th, 2006.

Figure 3. Industrial Output Trends between 1952 and 2004



Source: China National Tourism Administration. *Industry*, (online)

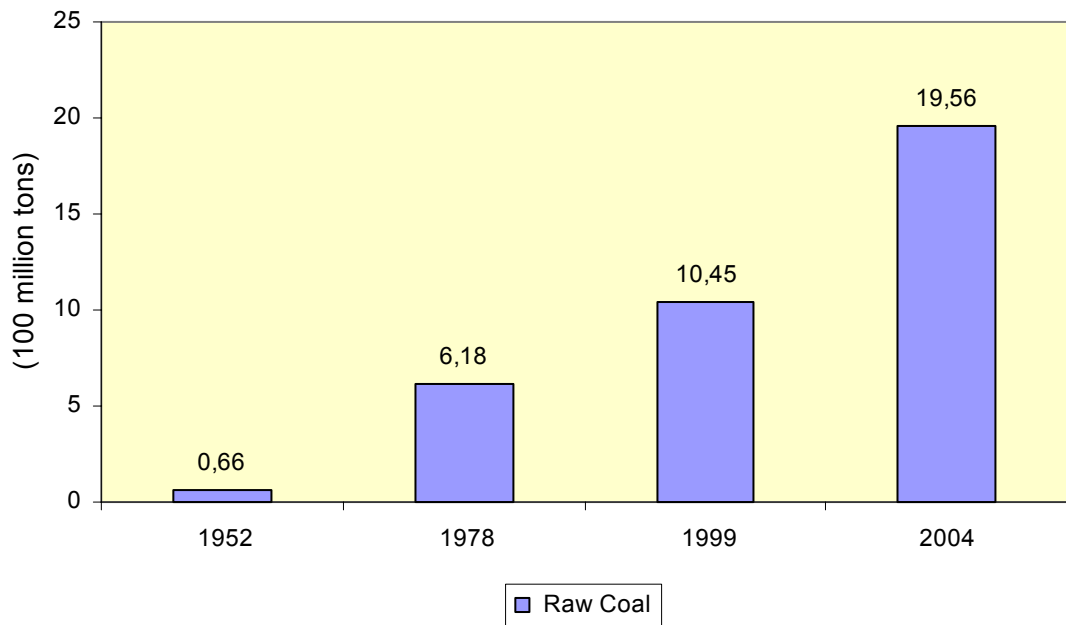
<http://old.cnta.gov.cn/lyen/brief/industry/introduction.htm>, September 13th, 2006.

In Figure 3, we clearly see a sharp increase in output of cement and a more moderate increase in steel through those 50 years. Crude oil, sulphuric acid and fertilizer production did not boom during those years; instead a slight saturation in increasing patterns of those industrial product outputs are observed.

Figure 4 shows the production of raw coal through 1952 to 2004. We saw nearly no production in 1952 as in other industrial products. A real boom is observed

in 1978 and from that time to 2004, raw coal production has tripled reaching to 2 billion tons in 2004.

Figure 4. Raw Coal Output



Source: China National Tourism Administration. *Industry*, (online)

<http://old.cnta.gov.cn/lyen/brief/industry/introduction.htm>, September 13th, 2006.

Increase in industrial products seen in above figures is definitely one of the outcomes of China's industrial reform. The reforms started by giving more rights to enterprises and allowing them to extend their operations independently. The new contract systems regulated by government led a wide independence which soon flourished creativity and improvement within operations of each enterprise.⁴⁴ Furthermore, openness to the world provided foreign capital to flow in the Chinese economy and that capital helped the industrialization process. Foreign capital mostly used joint ventures or opened up subsidiaries in China in order to enter into the growing Chinese market. By that way, not only did capital help the industrialization

⁴⁴ YIN, Xiangkang and CHOE Chongwoo (2000). "Contract Management Responsibility System and Profit Incentives in China's State-Owned Enterprises", *China Economic Review*, Vol. 11, Issue. 1, pp. 99-110.

but also technology, expertise, modern management skills and workforce training (human resources and its management) were transferred into China's industry.⁴⁵

That industrialization process started in 1978 led to dramatic changes in consumption of industrial and technological products in China. For instance, consumption of color TV sets, refrigerators, washing machines, air-conditioners and digital media tools skyrocketed in last 20 years. As a more recent significance of massive industrialization, the production rate of cars is continuously increasing in parallel with the number of cars each household owns.

As a consequence of the industrialization, the standardization process transforms the state owned enterprises into scientifically managed global companies. Mergers occurring between local medium/large-sized enterprises led to large group of companies competing both locally and internationally. To exemplify, mergers between China Petroleum and Natural Gas Group; Shanghai Bashan Iron and Steel Group; Changhong, Haier, Konka, Kelon and TCL household appliances groups were recently formed. Restructuring and reforms in China's industry follows integration with the world path and its adaptation with the unique economy system named as socialist market economy seems inevitable in 21st century.⁴⁶

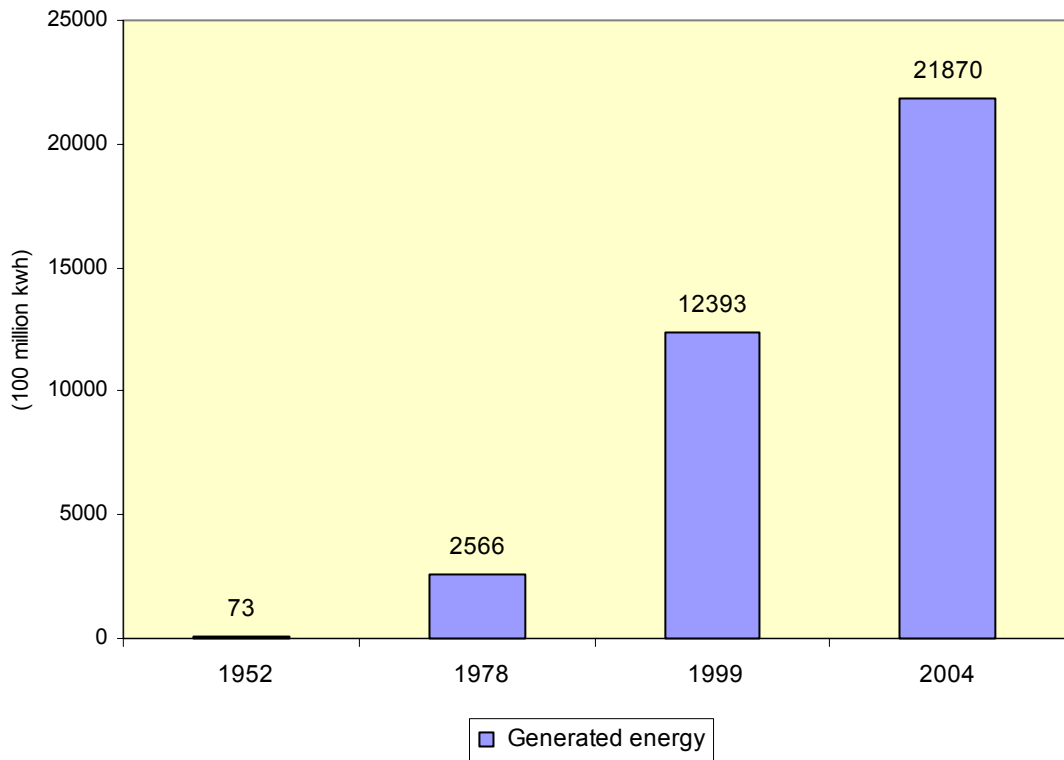
1.2.3.3 Growing Energy Need

China's hunger for energy increases gradually due to above-mentioned industrialization and urbanization processes. Energy consumption has folded nearly 5 times in average since 1980. Figure 5 below, gives some insight about increasing consumption via providing data about the supply side.

⁴⁵ MOORE, Thomas G. (2001). *China in the World Market: Chinese Industry and International Sources of Reform in the Post-Mao Era*, Port Chester, NY, US: Cambridge UP., pp. 10, 11.

⁴⁶ YIN, Xiangkang and Chongwoo CHOE (2000). *Op.cit.*, p. 111.

Figure 5. Generated Energy



Source: China Internet Information Center, *Total Production of Energy and Its Composition*, (online) <http://www.china.org.cn/english/en-shuzi2004/jj/biao/7-1.htm>, September 13th, 2006.

Figure 5 shows the output of energy in China. We see nearly no generation in 1952. Starting with 1978, energy generation boomed and in 2004, 21.870 billion kwh energy was generated in China.

Energy is not just consumption good but also a growing industry within the last three decades. Three reasons assign great importance to energy sector:⁴⁷

⁴⁷ ANDREWS, Philip (2000). "Reform of China's Energy Sector: Slow Progress to an Uncertain Goal" in *The Chinese Economy under Transition*, ed. by Sarah COOK, Shujie YAO and Juxong ZHUANG, New York: St. Martin's Press; London: Macmillan Press, p. 111.

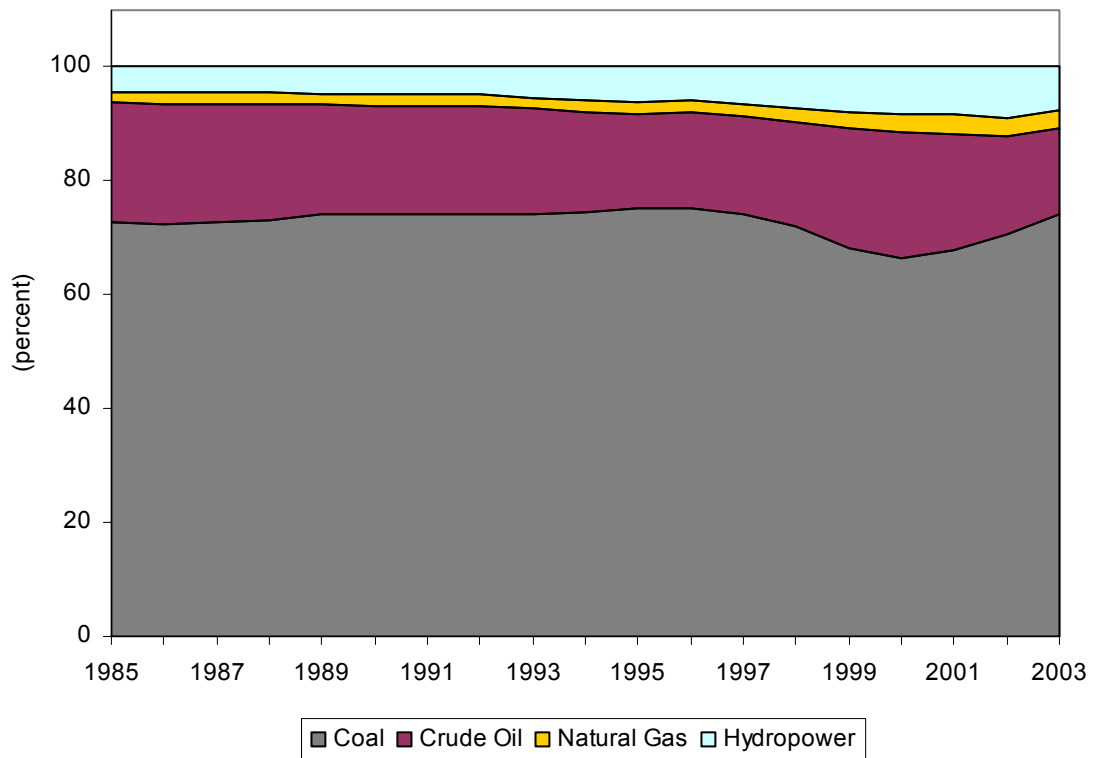
- The portion of energy sector in Chinese industry is very large. (in 1995, the energy industries accounted for 13 percent of the gross output value of China and that percentage is still increasing.)
- With urbanization and industrialization processes, demand for energy is continuously growing and in order to sustain those processes, more and cheaper energy is needed.
- As an extension of first two reasons, Chinese government meaningfully treats energy as the most important and strategic sector, which in turn adds up strength, priority and respect to energy industries.

When we look at the composition of energy sources used from 1985 to 2003, we see a stable ratio of 70 percent coal utilization. Second, comes the crude oil and China's demand for crude oil increased at the end of the 90s. Figure 6 illustrates those ratios throughout past 19 years.

Recent increases in oil prices drew sights on to China's demand for oil. Moreover, China is also looking for cheaper and cleaner ways of energy production and an old friend, coal seems to be the most appropriate alternative. Energy production via coal is dirty, hazardous and polluting, however, China wants to utilize from its vast coal resources as the biggest producer and consumer of coal. Chinese government established a project for turning dirty coal in to clean gas. If achieved, those plants would provide sulphur-free gases like methane that is liquid and ready to be used by millions of cars and in power stations.⁴⁸

⁴⁸ WINGFIELD-HAYES, Rupert. *Satisfying China's Demand for Energy*, 2006, (online) <http://news.bbc.co.uk/1/hi/world/asia-pacific/4716528.stm>, September 13th, 2006.

Figure 6. Composition of Energy Production in China (1985-2003)



Source: China Internet Information Center, *Total Production of Energy and Its Composition*, (online) <http://www.china.org.cn/english/en-shuzi2004/jj/biao/7-1.htm>, September 13th, 2006.

Unfortunately, coal is not enough for China as seen in Figure 6. That is actually why Chinese government attempts to push for renewable energy resources. Currently, just 8 percent of China's total energy output is supplied from renewable energy resources and the target for that ratio in 2020 is 15 percent. In order to achieve that target, new dams are planned on the five great rivers rising in China; the Yellow river, the Yangtze (the Three Gorges Dam), the Mekong, the Salween and The Great Brahmaputra.⁴⁹

That increasing demand for energy shapes the foreign policies of Chinese government. In the early 80s, China was East Asia's largest oil exporter whereas

⁴⁹ WINGFIELD-HAYES, Rupert. *Satisfying China's Demand for Energy*, 2006, (online) <http://news.bbc.co.uk/1/hi/world/asia-pacific/4716528.stm>, September 13th, 2006.

now, it is world's second-largest importer. Government continuously encourages SOEs to establish friendly relationships and supply agreements with countries having energy resources like gas and oil. In addition, social aid, forgiving national debt, building roads, harbors, bridges and signing trade agreements with those countries are other methods China using for reaching to energy resources. China has reached to coal in Philippines, oil in Ecuador and gas in Australia in the presence of these strategic moves.⁵⁰

1.2.3.4 Widening Gap between the Hinterland and the Coastal China

We have been talking about the reforms restructuring China's agriculture, industry and energy. In the presence of those reforms with openness to the world strategy, income levels of both urban and rural population grew drastically, yet in different rates. That difference in growing rates led to huge income gaps between rural and urban populations in China.

Statistically speaking, the Gini coefficient (a standard measure of inequality of income distribution named after an Italian statistician, Corrado Gini) of China in the last decade has been increasing. In 1996, the Gini coefficient of China's individual income was 0.424 growing up to 0.458 in 2000 and 0.465 in 2004. Universally, 0.4 levels are accepted to be the border to absolute income disparity; therefore, we may deduce that China has been living with that disparity for decades.⁵¹

⁵⁰ ZWEIG, David and Bi JIANHAI (2005). "China's Global Hunt for Energy", *Foreign Affairs*, Vol. 84, No. 5, pp. 36-40.

⁵¹ HENG, Li. *How Wide Is the Gap of China's Individual Income?*, 2001, (online) http://english.people.com.cn/200108/31/eng20010831_78962.html, September 15th, 2006.

Map 3. China; Display of the Provinces



Source: China Kontor, *Chinese Provinces Links*, (online) <http://www.chinakontor.de/l-provinces.htm>, September 1st, 2006.

Income gap can be seen more easily from GDP figures. In 1996, net income per capita for urban population was 4,377 yuan whereas for rural population it was 1,900. In 2000, those values increased up to 6316 and 2253 yuan respectively. Lastly, in 2004, GDP per capita reached to 9,422 and 2,936 yuan. The ratio of urban and rural GDP per capita gives a comparable measure of income disparity. According to general principles accepted worldwide, when the average GDP per capita is around \$1000, the ratio defined above should be around 1.7. In other words, urban GDP per capita should be 1.7 times the rural one. However, in China we see

ratios of 2.30, 2.80 and 3.21 for years 1996, 2000 and 2004 respectively, which are way above the accepted figure, 1.7 and still growing.⁵²

The huge rural-urban income disparity based on three main reasons;⁵³

- The governmental policies, for approximately 50 years, restricted the migration from the rural to the urban areas and so, the prices, wages and many economic variables were affected. The rural wages always determined lower than the urban values.
- The educational disparity also arises as a significant factor and this affected the human capital between the rural and the urban areas then the average income levels.
- Since the life in rural area is so familiar for the people living there for ages, the idea of migrating to urban areas and living there is obscure and frightening.

In addition to urbanization factor, different growth rates among various industries led to further income disparity in China. In spite of the fact that each and every industry has been growing rapidly for the last decade, industries as telecommunications and finance make higher profits than fishery, mining, social service and catering firms, architecture and agriculture related industries. That difference in profitability is directly reflected on salaries of employees. To prove that difference with statistics, looking at the growth rates in the sectors is enough. From 1990 to 2000, growth rates in real estate, finance and technology industries are 470, 542 and 466.8 respectively whereas for farming and mining, they are 236.4 and 206.8.⁵⁴

⁵² SHEA, Marilyn, *Ting - The Chinese Experience About Money*, University of Maine at Farmington, 2001, (online) <http://web.archive.org/web/20020213161435/http://hua.umf.maine.edu/Chinese/Faq/money.html>, September 15th, 2006.

⁵³JOHNSON, D. Gale (1998). "China's Rural and Agricultural Reforms in Perspective", Office of Agricultural Economics Research, The University of Chicago, No. 98:01, pp. 4-5.

⁵⁴ HENG, Li. *How Wide Is the Gap of China's Individual Income?*, 2001, (online) http://english.people.com.cn/200108/31/eng20010831_78962.html, September 15th, 2006.

The last but not the least, different regions of China also experience different rates of growth, which in return triggers inequality in income distribution. Erasing the effects of above mentioned factors leading to income disparity and taking a sample of rural population occupied in the same industry in China, we see another huge income gap between Southeast and Northwest regions, the former being the highest. As another striking example, a farmer in Shanghai has nearly 5,600 yuan annual income in average while a farmer in Guizhou has 1,374 yuan. In other words, an industry in Shanghai earns more than four times the one of the same sector in Guizhou.⁵⁵ Map 3 above is given for a better understanding the shape of the gap.

Other than income gap, education, medical care and infrastructure from which Chinese people benefit change in both amount and quality due to urbanization level. For instance, in urban primary schools, nearly 45 percent of the teachers are lecturer-level. In rural primary schools, though, that ratio is about 9 percent lower. Almost 80 percent of medical care centers are located in cities. More strikingly, nearly 50 percent of villages have no access to tap water and no wash out toilets. 2 percent of villages have no electricity supply, 6 percent have no highway connection to neighboring towns, and 6 percent have no telephones. The reason of that gap between rural and urban areas is essentially attributed to historical reasons. The contemporary governments seem to be aware of that issue and certain measures are taken in order to stop widening of the gap and if possible, to reduce it to smaller degrees.⁵⁶

To conclude, Chinese governments have a huge problem of income disparity widening each year. With the most recent data presented above, more than 30 fold GDP per capita differences may occur for the worst case due to urban-rural, industry

⁵⁵ HENG, Li. *How Wide Is the Gap of China's Individual Income?*, 2001, (online) http://english.people.com.cn/200108/31/eng20010831_78962.html, September 15th, 2006.

⁵⁶ SHEA, Marilyn, *Ting - The Chinese Experience About Money*, University of Maine at Farmington, 2001, (online) <http://web.archive.org/web/20020213161435/http://hua.umf.maine.edu/Chinese/Faq/money.html>, September 15th, 2006.

sector and regional variety, which has a potential to cause social instability and insecurity in the meantime as well as health scandals causing epidemics like SARS.⁵⁷

1.2.3.5 Environmental Factors

China's rapid transformation from agriculture to industry has been harming the environment more than anything. Inefficient use of energy-- China consumes 4.7 times much energy as the U.S. to produce each dollar of GDP-- and 11.5 times as much as Japan with unplanned industrialization leads to serious problems for China.⁵⁸ Air, water and soil pollution with massive exploitation of natural resources threaten the future of China very seriously. According to World Bank, six out of ten most polluted cities in the world are located in China. According to Chinese government data, more than 220 cities among 338 suffer from air pollution.⁵⁹ In addition, almost all rivers and water resources are polluted up to certain degree. Statisticians think that 300 million Chinese drink contaminated water each and everyday. Water scarcity as well as pollution is another major problem. Northern China suffers from water scarcity and its consequences such as slower economic growth compared to other regions. Knowing that fact, the Chinese government tries to complete a project, which will direct flow of Yangtze River to northern regions. By this, not only will water scarcity problem be solved, but also damages caused by flood will be reduced. Another rough estimate by economists asserts that pollution costs each Chinese 7-10 % of his/her GDP per capita.⁶⁰

The Chinese governments seem to be aware of that threat. In 1998, the State Environmental Protection Administration (SEPA) was recognized as a ministry-level agency and legislation emphasized and imposed environmental protection all the time. In 2005, China joined the Asia Pacific Partnership on Clean Development. That

⁵⁷ HENG, Li. *How Wide Is the Gap of China's Individual Income?*, 2001, (online)
http://english.people.com.cn/200108/31/eng20010831_78962.html.

⁵⁸ Business Week Online, *China's Dirty Face*, 2006, (online)
http://images.businessweek.com/ss/05/08/environment/index_01.htm, September 13th, 2006.

⁵⁹ US Department of State, *Background Note: China*, 2006, (online)
<http://www.state.gov/r/pa/ei/bgn/18902.htm>, September 13th, 2006.

⁶⁰ US Department of State, *Background Note: China*, 2006, (online)
<http://www.state.gov/r/pa/ei/bgn/18902.htm>, September 13th, 2006.

foundation gathers polluters and legislation at stake and tries to find a mid-way, which protects the nature the most. Tenth five-year plan clearly puts a target of reducing emissions by 10%.⁶¹

China plays an active role in international conventions about protecting environment. The Basel Convention (public transportation and disposal of wastes), the Montreal Protocol (protection of Ozone layer) and Convention on International Trade in Endangered Species are among those conventions China actively participated. Unfortunately, China is still polluting the environment and severely suffering from that fact.⁶²

⁶¹ US Department of State, *Background Note: China*, 2006, (online) <http://www.state.gov/r/pa/ei/bgn/18902.htm>, September 13th, 2006.

⁶² US Department of State, *Background Note: China*, 2006, (online) <http://www.state.gov/r/pa/ei/bgn/18902.htm>, September 13th, 2006.

2 FDI IN THE WORLD: HISTORY, CLASSIFICATION AND MEASUREMENT

2.1 Definition

In daily life, foreign direct investment corresponds to a method of investing in non-native firm or carrying a portion of its own operation to a foreign country. According to a general rule of thumb, buying above 10 percent of a foreign company's shares is enough to be considered as a foreign direct investor. FDI reached to \$315 billion in 1995 and \$896.7 billion in 2005 and became a strong integrating force for world economy with international trade.¹

When nature of FDI is investigated through the recent past, it is growing rapidly with uncertainties and dependence on several regions of the world. To exemplify, total outflows of USA, United Kingdom (UK), Japan, Germany and France went into just 10 countries and that amount was nearly % 70 of the aggregate FDI in 1995 (more than \$ 220 billion). Taking the power balance of contemporary world politics, those 10 countries hold a strong word and so does FDI due to its importance for those large economies.²

According to United Nations Conference on Trade and Development reports (UNCTAD), foreign direct investment is defined as “an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in donor economy (foreign direct investor or parent enterprise) in an enterprise resident in another economy called host. (FDI enterprise or affiliate enterprise or foreign affiliate).”³ FDI implies that the investor exerts a significant degree of influence on

¹ United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

² United Nations Conference on Trade and Development (2006). “Sharp Rise in FDI Driven By M&As in 2005”, *UNCTAD Investment Brief*, No. 1, (online) http://www.unctad.org/en/docs/webiteiia20061_en.pdf, September 17th, 2006.

³ United Nations Conference on Trade and Development (1999). *World Investment Report: Transnational Corporations and Export Competitiveness*, United Nations, New York and Geneva, p. 465.

the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates both incorporated and unincorporated. FDI may be undertaken by individuals as well as business entities.⁴

Flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor.

2.2 Components and Driving Factors of FDI

FDI has three components: equity capital, reinvested earnings and intra-company loans.⁵

Equity capital, the largest part among the components of FDI, is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.⁶ The total share of this component was between 58% and 71% during the period 1994 – 2004. Equity capital is also the most fluctuating component especially in the developing countries.⁷

Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.⁸ The share of this component which reached 15% within developed countries in 2003 and more than doubled in the previous ten years in FDI flows also

⁴ MOOSA, Imad A. (2002). *Foreign Direct Investment: Theory, Evidence and Practice*. New York, USA: Palgrave Macmillan, pp. 1, 2.

⁵ CHEN, John-Ren (2000). "Foreign Direct Investment, International Financial Flows and Geography", in *Foreign Direct Investment*, ed. by John-Ren CHEN (2000) New York, USA: Palgrave Publishers, pp. 6, 7.

⁶ *Ibid.*, pp. 6, 7.

⁷ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 10

⁸ CHEN, John-Ren (2000). *op.cit.*, pp. 6, 7.

increased in all economies in the year 2004. The share of the reinvested earnings is quite high as 33% of total flows.⁹

Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.¹⁰ The sharp decrease of this component's share was recovered in the year 2004 and both the developed and developing countries experienced it. The share of those loans also differs among the host countries. While the ratio in France and Germany was 40%-50% in the period of 1995-2004, Argentina, Australia and Switzerland had less than 10% of shares.¹¹

Three driving factors for FDI growth are also present;¹²

- Trade and investment liberalization policies spread among many countries in order to ensure import and export competitiveness.
- Pure competitive global markets force all companies to cut their operating and overhead costs so that each company looks for low-wage, low raw material and energy cost economies to invest in.
- Emerging markets with accelerating domestic products form model for under-developed countries and trigger the factor as a cycle.

⁹ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 11

¹⁰ CHEN, John-Ren (2000). *op.cit.*, pp. 6, 7.

¹¹ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 11.

¹² United Nations Conference on Trade and Development (2002). *World Investment Report: Transnational Corporations and Export Competitiveness*, United Nations, New York and Geneva, pp. 118, 119.

2.3 Historical Development of FDI

2.3.1 Beginnings

Not only were British men investing in other countries in early 1800s but also capital movements among colonies and many European countries were occurring even before Industrial Revolution. British investors utilized foreign securities especially in France, Austria, Prussia and Russia. Several booms followed those successful investments, such as failures to pay in Latin American and Southern European countries in 1820s and collapses in the American loan market afterwards. Each crisis was originated from speculative booms. The foreign investments witnessed an increase from £280 million in 1800 to £380 million in 1830 and to £800 million in 1850 despite all the problems and crisis. British originated investments made up of two thirds of that amount.¹³

Tracing back the history to ancient times, Sumerian and Finician merchants invested in building up storage houses, so-called “warehouses” contemporarily, abroad to accommodate their inventories (for commodities to be traded). English and Dutch companies opened up facilities (affiliates) abroad during 1500s and that practice became very common by the end of that century. With the Industrial Revolution, foreign investments changed nature. For instance, American investors opened up factories and banks in Canada and Mexico. Those investment decisions were driven by two crucial determinants, which are still valid; the primitiveness of Canadian and Mexican industry relative to American, closeness of those emerging markets to native land.¹⁴ In the meantime, reverse foreign investment flows took place from European countries to growing US market.¹⁵

¹³ ASHWORTH, W. (1967). *The International Economy since 1850*, London, UK: Longmans, pp. 10-15.

¹⁴ WILKINS, Mira. (1970). *The Emergence of Multinational Enterprise*, Cambridge, MA, UK: Harvard University Press, pp. 3-16.

¹⁵ PERSHIN, Vitaly (2003). *Essays in the Economics of Foreign Direct Investment*, Unpublished doctoral dissertation, The University of Western Australia, (online) http://www.ecom.uwa.edu.au/research/research_centres/economics_research_centre, p. 5.

The major assisting force for foreign investments during 19th century was railways built by the state mainly. After building up primary lines, the states allowed many private firms to build secondary lines. With a widespread network of railway lines, international trade and in more common term, capital movements between many European and US firms skyrocketed.¹⁶ Moreover, by the end of 19th century, investments in India, Canada and Argentina grew rapidly while in Africa and South-East Asia investment flows were growing slower. Naturally, investing firms were either European or American thanks to accumulated capital reserves of these regions. Those firms mostly invested in foreign government securities, portfolio investments in transportation, mining and manufacturing. Despite drawing a lot of attention, until 20th century, FDI was not a deterministic portion of international economy yet.¹⁷

2.3.2 Growing Economies and the Stock of FDI

Starting with the end of 19th century, many industrial firms appeared with considerable amount of capital and expertise, which then resulted in oligapolistic economies in Europe, US and Japan.¹⁸ Those firms mostly belonged to petrochemical, electrical and transportation sectors and first invested abroad in marketing and afterwards in manufacturing.¹⁹

With the 20th century, world economy grew drastically and so did FDI stocks. According to 1914 stock of FDI data, British foreign capital has risen up to £4 billion whereas French capital reached £1.8 billion. Figure 7 indicates the rapid growth of FDI stocks of United Kingdom and France from 1850 to 1914. It is noteworthy that UK FDI stocks reached 20 times its 1850 value in 65 years time. In the meantime, France increased its FDI stocks from £50 million to £1.8 billion. UK and France appeared as the first countries in making FDI transactions.

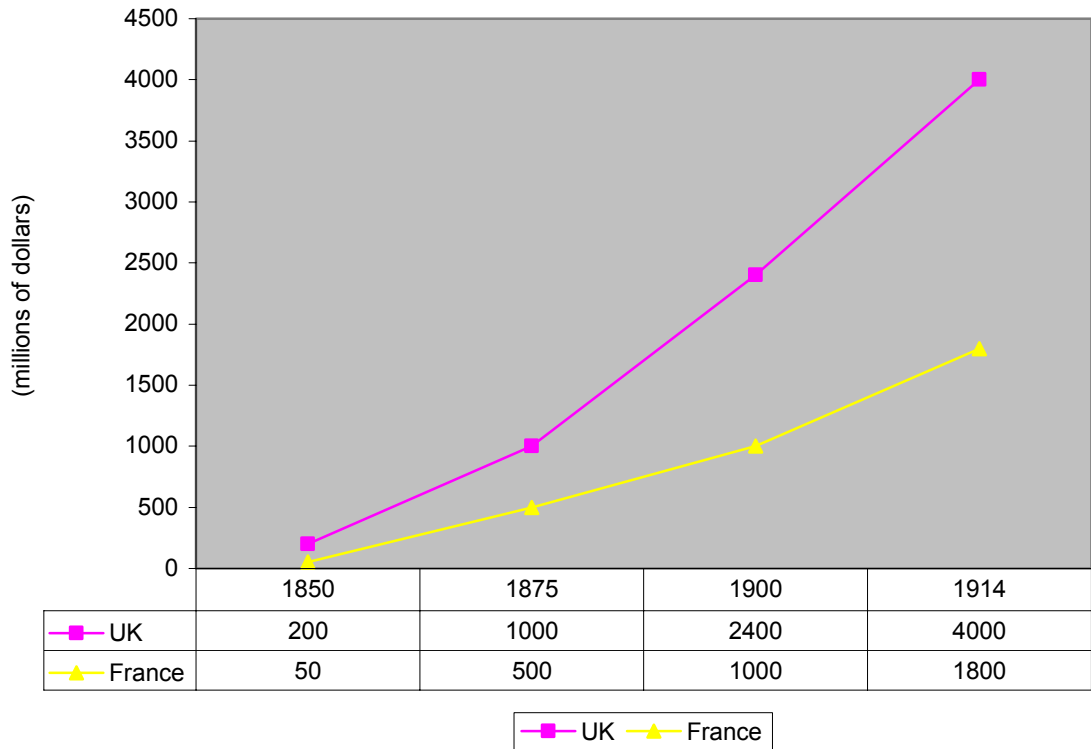
¹⁶ CHANDLER, Alfred D (1989). “Technological and Organizational Underpinnings of Modern Industrial Multinational Enterprise: The Dynamics of Competitive Advantage”, in *Multinational Enterprise in Historical Perspective*, ed. by Alice TEICHOVA, Maurice LEVY-LEBOYER, and Helga NUSSBAUM, Cambridge University Press: Cambridge, UK., p. 30.

¹⁷ *Ibid.*, p. 31.

¹⁸ *Ibid.*, pp. 30, 31.

¹⁹ PERSHIN, Vitaly (2003). *op.cit.*, p. 37.

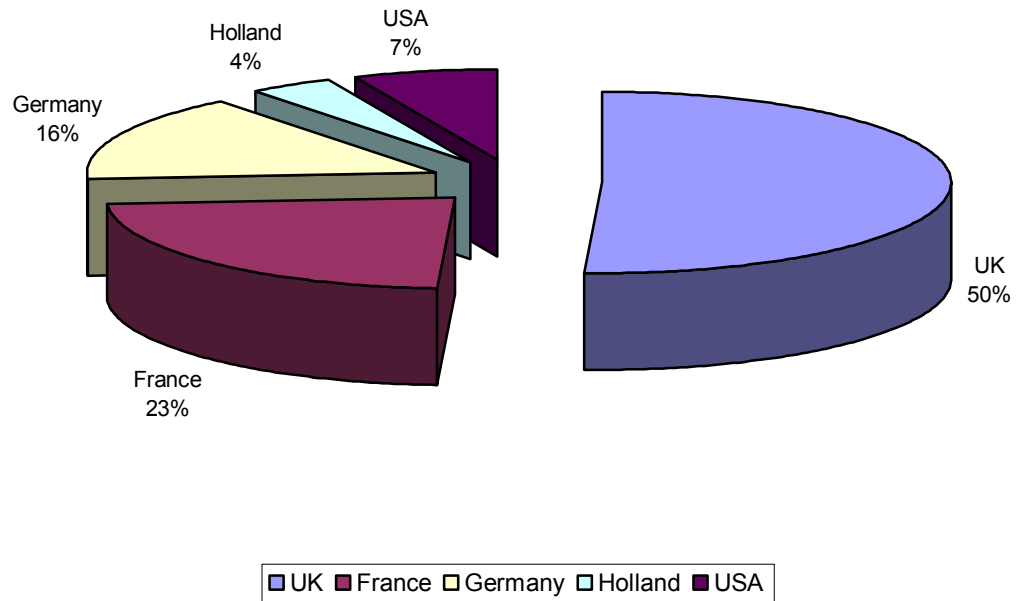
Figure 7. FDI Stock in UK and France from 1850 to 1914



Source: PERSHIN, Vitaly (2003). *Essays in the Economics of Foreign Direct Investment*, Unpublished doctoral dissertation, The University of Western Australia, (online) http://www.ecom.uwa.edu.au/research/research_centres/economics_research_centre, p. 7.

From Figure 8, it is clear that apart from UK and France; Germany, Holland and USA became three important players in FDI stock distribution in the year 1914. Despite UK has 50 percent of the total transactions about the FDI, the prewar industrialization process of Germany whose portion increased from 0 percent to 16 percent is significant.

Figure 8 FDI Distribution in 1914



Source: PERSHIN, Vitaly (2003). *Essays in the Economics of Foreign Direct Investment*, Unpublished doctoral dissertation, The University of Western Australia, (online) http://www.ecom.uwa.edu.au/research/research_centres/economics_research_centre, p. 7.

To gain more insight about the important level FDI stocks reached in UK, the fact that dividends and interests earned from foreign investments made up of a considerable portion of national income, which helped UK recover from trade deficit for many years.²⁰

²⁰ PERSHIN, Vitaly (2003). *op.cit.*, p. 6.

2.3.3 The After War Period

When the 19th century economy is scanned, contribution from financial institutions seemed almost ignorable. However, those institutions increased their influence and became highly involved in any sectors of world economies.²¹ With World War 1, European countries, which were directly linked with the war, demanded capital for financing their war activities. Therefore, when the war ended, the leading player of FDI stocks had changed name; USA which became a net creditor with £1.200 million, emerging as the strongest economy with largest FDI stock while UK and France FDI stocks decreased dramatically. Due to loss of war, Germany had lost all its FDI stock after 1918.²² Until 1970s, foreign investments were never as important as they had been prior to World War 1. After 1920, foreign capital flows oscillated around low amounts and did not increase much. The Great Depression in 1929 led FDI flows to totally vanish thanks to shrinkage in global markets. International Money Fund (IMF) controlled international capital flows from 1950s to 1970s. Although the financial institutions appeared strong as major assisting players for capital flows after World Wars, they were still hesitant about lending capital to the developing countries thanks to bad memories of the Great Depression and its aftermath. FDI stocks started to grow rapidly in the 1970s and 80s. There were three major reasons flourishing capital flows:²³

First, financial institutions started to lend money in order to recycle “petrodollars” after 1970.²⁴ Petrodollars, also known as petrocurrency, refer to the money that oil exporters earn by selling oil to Western countries and then deposit them into Western banks. To exemplify, say Saudi Arabia sells oil to Holland and deposits the money earned to ABN Amro, then that money is called petrodollars. Secondly, the Bretton-Woods system collapsed in 1971. The chief features of the

²¹ Obstfeld, M. and A. Taylor (2002). “Globalization and Capital Markets”, *National Bureau of Economic Research Working Paper N8846*, Cambridge, MA, UK, p. 2.

<http://www.nber.org/papers/w8846.pdf>

²² ASHWORTH, W. (1967). *The International Economy since 1850*, London, UK: Longmans, pp. 218-225.

²³ PERSHIN, Vitaly (2003). *Op.cit*, pp. 6, 7.

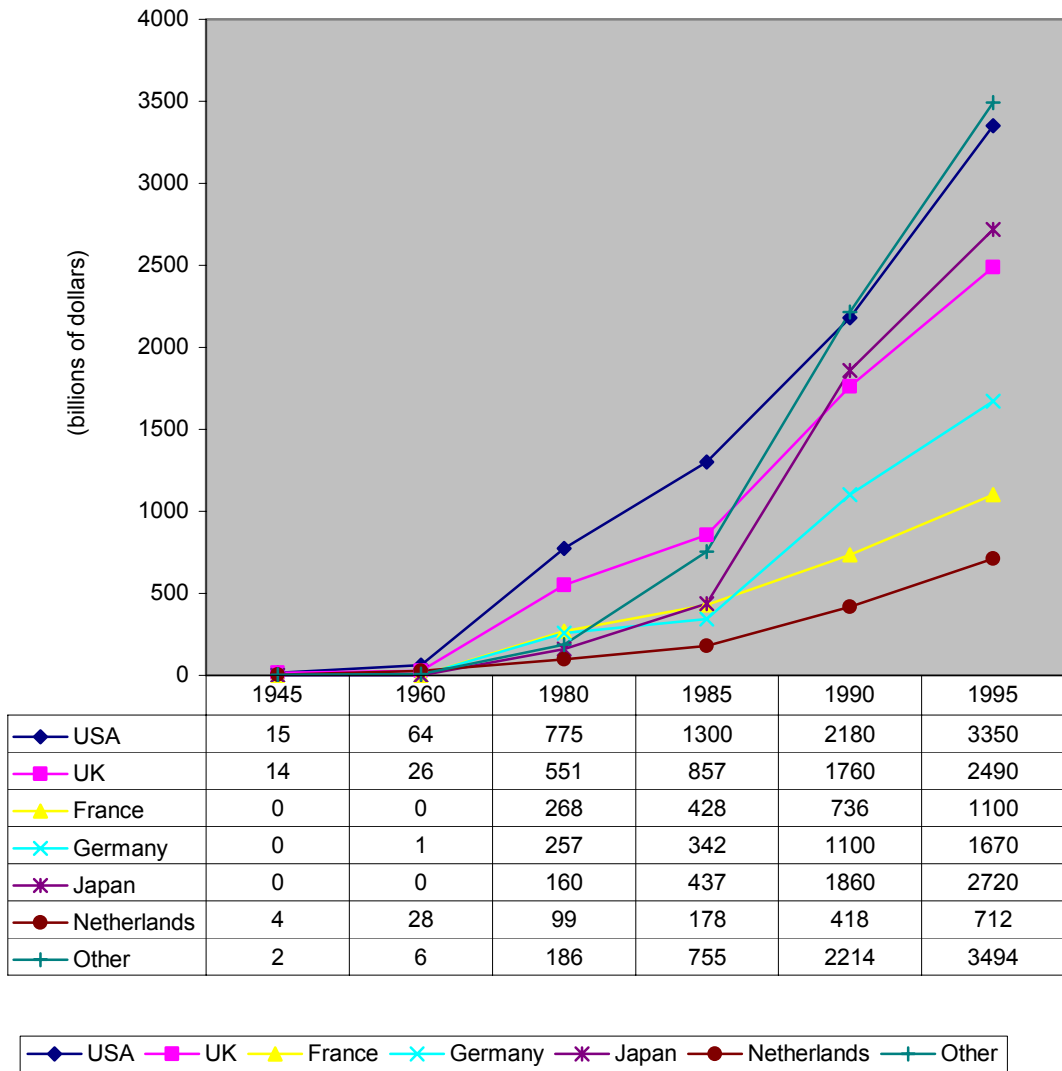
²⁴ PERSHIN, Vitaly (2003). *Op.cit*, p. 6.

Bretton-Woods system were an obligation for each country to adopt a monetary policy that maintained the exchange rate of its currency within a fixed value—plus or minus one percent—in terms of gold; and the ability of the IMF to bridge temporary imbalances of payments.²⁵ Thirdly, adoption of floating exchange rates in industrialized countries such as UK, France, USA was also an important reason lying behind the capital accumulation.

There was accelerating capital flows, however, they had not reached at the importance level of 1914 yet. With the end of the Cold War in 1989, global markets saw dramatic changes and new trends as globalization resulting in interdependent world economy. Figure 9 shows the patterns in FDI stocks of chief economies after World War II.

²⁵ COHEN, Benjamin. “Bretton Woods System”, *University of California, Santa Barbara, Department of Political Science*, (online)
<http://www.polsci.ucsb.edu/faculty/cohen/inpress/bretton.html>, September 13th, 2006.

Figure 9. FDI Stock of Chief Economies After World War II



Source: PERSHIN, Vitaly (2003). *Essays in The Economics of Foreign Direct Investment*, Unpublished doctoral dissertation, The University of Western Australia, (online)
http://www.ecom.uwa.edu.au/research/research_centres/economics_research_centre, p. 7.

2.4 The Present

2.4.1 The Rise of FDI

In 1945, FDI stocks nearly vanished as a consequence to World War II. Increase within 15 years was ignorably small. Starting with 1980, FDI stocks boomed and that increase continued with acceleration up to now. However, some economists still claim that FDI flows have not recovered from World Wars yet, meaning FDI stocks have not reached their pre-war values after inflationary adjustments are made.²⁶ Coming back to Figure 9, USA sits at the top of accumulated FDI stock list and is followed by Japan and UK. Germany is the fourth largest FDI stockholder. It is, henceforth, obvious that Japan and Germany recovered from post-war destructions more rapidly than any country.

As stated previously, many developments and change took place after the World War II. Continuous increase of FDI projects and international trade around the world is one of them. Multinational companies (MNCs), mostly from USA, tripled their subsidiaries in 20 years after the war. Many national companies opened their operations into the world and became global. Therefore, not only the existing MNCs enlarged their activities, but also number of MNCs increased after the Second World War.²⁷ MNCs' operations spread among new markets that provided low-cost, high-profit production sites to those companies. This extensive expansion built up a strong awareness of FDI and its impacts on political, social and economic lives for both donor and host countries. Questionably, that statement may be the reason why many political parties and thoughts governing Turkey in the past decade have been constantly emphasizing the importance of foreign capital and FDI and spoken for its spread via privatization policies.²⁸

²⁶ Obstfeld, M. and A. Taylor (2002). *op.cit.*, pp. 4-6.

²⁷ Porter, Michael (1990). *The Competitive Advantage of Nations*, Harvard Business Review March-April: 73-93, New York, US: The Free Press, pp. 17, 18.

²⁸ PERSHIN, Vitaly (2003). *op.cit.*, pp. 8, 11.

To generalize, less developed (developing countries according to UNCTAD) countries benefit from FDI thanks to capital, technology and know-how inflows while investor countries utilize from their cheap resources (workforce, raw material, energy, etc.). FDI contributes in economic and social development in transition and instable economies. Many governments recovered from budget deficits, economic recessions and turmoil via attracting FDI inflows in their countries.²⁹

2.4.2 The Boom after 1995

FDI increase boomed after 1995 while becoming merely the source of capital and technology for many countries. Especially 1999-2000 financial year saw many cross-border mergers and acquisitions (M&As) resulting in huge increase in FDI flows. In late 90s, cumulative M&As transactions are found to be at least five times larger (in real terms), to involve firms from more OECD nations, and to include many more service sector transactions than their average in 80s.

FDI flows in 1995 shows FDI flows of relatively large-scale investors between the years 1995 and 2004. As obviously seen, FDI flows made a peak for almost every region in the year 2000 and reduced to a reasonable value afterwards. The adverse effects of the global crisis such as Asian and Russian Crisis are also significant.

2.5 Classification and Explanation of FDI

2.5.1 Motives for FDI

FDI follows two different strategies; developed to developed and developed to developing countries. For each strategy, different method of investment is employed; horizontal and vertical direct investment respectively.³⁰

²⁹ PERSHIN, Vitaly (2003). *op.cit*, p. 8.

³⁰ MOOSA, Imad A. (2002). *op.cit*, pp. 4-5.

Horizontal approach includes production of the same product in the host country as similar as the ones produced in its native land. As an example, Daimler Chrysler-Mercedes Benz produces exactly the same car model with the same quality in USA and markets and service conventionally as in Germany. In addition, the production is not fragmented internationally, rather it is all finished in one country, either host or donor. These firms have several characteristics in common, such as strong R & D, intensive technical workforce, a leading or brand-new product and already-established and well-maintained marketing tradition. Horizontal FDI increases as the trade costs increase within the regions. The companies prefer to sell their output within the host country.³¹

Vertical approach is usually employed for developing countries hosting FDI. The production process is fragmented among the most appropriate and cheapest countries. Bosch in Turkey, for instance, produces industrial hydraulic and pneumatic actuators. In other countries, controllers, sensors and electronics are produced and shipped to Turkey for assembly of overall automated-control systems for industry. Those kinds of investments usually conduct in inter-industry partnership. Economies of scale and reducing costs –especially the labour costs- are extremely important for vertical FDI. Manufacturing companies usually prefer this type.³²

³¹ GAO, Ting (2003). “Ethnic Chinese Networks and International Investment Evidence from Inward FDI in China”, *Journal of Asian Economics*, Vol. 14, Issue. 4, p. 615.

³² LEMOINE, Olga W. (2005). “Organizational Business Models In International Operations - The Logistics Service Provider Industry”, *Center for Anvendt Logistik og Transportforskning*, notat. 9, (online) <http://www.calt.dk/notater/CALT-Notat9.pdf>, p. 12.

2.5.2 Types of FDI

In addition to different approaches trying to explain certain characteristics of FDI, several approaches emerged also to classify it. Types by the potential return and the types by the feature of the investments' own can be examined.

2.5.2.1 Types by the Potential Return

Foundation of many types of FDI is the investor's potential return from that investment. There are three types of FDI motivated by investment type are; market seeking, resource seeking, efficiency seeking investments.³³

Market Seeking Investments: The aim of investment of this type is to either penetrate into a new market or enlarge an existing one. The investment would provide high adaptation in production adjustments, reduction of shipment and transportation costs and easy and effective bypass of trade barriers.³⁴ To exemplify, many multinational companies like IBM invested in China for enlarging their markets. Opening up a subsidiary in China provided IBM more flexibility in meeting Chinese market preferences with cost-efficiency in production and transportation. In addition, exporting to China was quite painful due to strict governmental policies. Via entering into the market as a producer not as a seller only erased these difficulties for IBM totally. In Latin America, after World War II, high taxes were imposed on imports. Therefore, FDI was inevitably the best way to invest in those countries as in Eastern Europe after 1990, mostly through acquisitions of local market monopolies that were previously managed by the state.

Resource seeking investments: This FDI type is the most controversial yet commonly employed method for reaching resources of host country. By resources, raw materials, labour, energy, finance and expertise are meant in general. Either the

³³ PERSHIN, Vitaly (2003). *op.cit.*, p. 25.

³⁴ *Ibid.*, p. 25.

availability or cost efficiency or both pave the way for that type of investment consideration. Mostly, host country governments try to attract FDI by reducing costs of certain valuable resources. To exemplify, Hyundai Automotive was looking for an appropriate area in Eastern Europe to open up some car manufacturing plants during 2005 and having talks with candidate host countries continuously.³⁵ Turkey was one of them and offered cheaper construction area for the plant and cheaper energy for a certain period. However, Hyundai decided to invest in Czech Republic because of the fact that Czechs offered some additional advantages about taxation and regulations. Another common example of resource seeking investments is that mass and labour-intensive producers are very interested in China since she has standardized, homogenous and cheap workforce. However, more sophisticated or technology seeking industries prefer more developed countries for availability of required human resources. A striking recent trend in FDI is offering financial resource such as very long-term payment plans, investment credits, tax reductions, etc. The legitimacy of financial resource seeking investment is still very controversial though; because it somehow violates competitiveness and affects social welfare.

Efficiency seeking Investments: This type is usually preferred by investors seeking the highest efficiency in terms of taxation, production rate, quality, and risk reduction by production diversification.³⁶ This type of FDI is not frequent / not seen alone but rather bundled with other two types, resource and/or market seeking investments. However, the main concern and incentive of the donor company is the ultimate and optimum efficiency.

Other than investor's investment motive, means by which investments are made may be utilized to classify FDI.

³⁵ PERSHIN, Vitaly (2003). *op.cit.*, p. 25, 27.

³⁶ *Ibid.*, p. 27.

2.5.2.2 Types Specific to the Investments

A different classification can be made according to the peculiarities of the investment's own.

Greenfield: According to UNCTAD press releases, greenfield FDI is new investment made by setting up a new foreign affiliate.³⁷ This type of FDI is highly employed in Turkey and all over the world. Ford Automotive, Price Waterhouse Coopers, DuPont, Merck Dohme & Sharp are a few examples making Greenfield FDIs intensively. A new building and operating licenses, labor contracts and power purchase agreements stand as the difficulties of this kind of investment.³⁸

Brownfield: That type of investment includes creating a foreign entry that starts with an acquisition but builds up a local operation that uses more resources (especially assets and expertise) from the parent firm than from the acquired firm.³⁹ Brownfield investments are prevalent in the power system and takes place in the privatization of state assets. The potential returns are to be well defined for buyers. For the sellers, the quick cash makes this kind of investment attractive.⁴⁰

Expansion: Expansion involves profit reinvesting, shareholders' equity raising or debt capital from the parent company towards an already-existing foreign affiliate.⁴¹

Mergers and Acquisitions: UNCTAD press releases define cross-border Mergers and Acquisitions as a change in the control of assets and operations of the merged or acquired firm. In a cross-border merger, the assets and operations of the

³⁷ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 9.

³⁸ VICTOR David G., Thomas C. HELLER, Joshua HOUSE, and Pei Yee WOO (2004). "Experience with Independent Power Projects (IPPs) in Developing Countries: The Introduction and Case Study Methods", Program on Energy and Sustainable Development Working Paper, No: 23, p. 11.

³⁹ PERSHIN, Vitaly (2003). *op.cit.*, p. 28.

⁴⁰ VICTOR David G., Thomas C. HELLER, Joshua HOUSE, and Pei Yee WOO (2004). *op.cit.*, p. 11.

⁴¹ PERSHIN, Vitaly (2003). *op.cit.*, p. 28.

two firms are combined to establish a new entity whose control resides in a team from one or both of the two. In a cross-border acquisition, the control of assets and operations is transferred from one company to the other (foreign) company, the former becoming an affiliate of the acquirer. Both firms may be private or state-owned: privatization involving a foreign investor counts as cross-border M&A.⁴²

Joint Venture: Another very common method of FDI is joint venture. A standard joint venture (JV) is a strategic alliance between two or more parties to pursue economic activity together. The parties agree to create a new entity together by investing equity and sharing revenues, expenses and control of the enterprise.⁴³ The venture can be for one specific project only or a continuing business relationship such as well known Sony-Ericsson (Sony + Ericsson), LG.Philips (LG Group + Royal Philips Electronics) and TNK-BP (Tyumen Oil Company + British Petroleum) joint ventures.

2.6 The Decision – Making Process in FDI

When FDI characteristics are examined quantitatively, huge amounts of capital are being invested directly to a business in foreign countries. Naturally, decisions about the route of such huge amounts of capital requires critical questioning preprocess, robust and reliable analysis of the context, dependable and justified forecasts and lastly yet more importantly risk taking during both financing and investing in the business.

A bright investor should consider two questions in order at each step before deciding on FDI; “to invest or not to invest?” and “where, when, how to invest?”

⁴² United Nations Conference on Trade and Development (2003). *FDI Policies for Development: National and International Perspectives*, United Nations, New York and Geneva, p. 248.

⁴³ *Ibid.*, p. 231.

2.6.1 The Decision to Invest or Not to Invest

The very first question to be clearly answered is whether to invest or not. Dixit, A. (1992) suggested three features common to most investment decisions. Accordingly, he says that investment decisions usually entails; sunk costs, uncertain economic environment (both for host and donor countries), relatively larger period than other decision-making processes.⁴⁴

From these features and the huge amount of money to be invested, FDI decision should be taken after stating certain objective determinants and criteria. Bevan and Estrin (2000) try to list those determinants as follows,⁴⁵

Country Risk; Country risk is a multi-variable function of private sector development, industrial development, the government balance, reserves and corruption within the host country. There may be political and economic aspects of this risk.⁴⁶ As an appropriate substitute for measure of country risk, some rating associations contemporarily assign country credit ratings to each country and update those rankings periodically. An investor may rely on those ratings –they are commercially available to anybody-, yet should consider more from the uncertain economic environment. For instance, if a country is on the brink of European Union (EU) accession and a new regulatory set of measures are to be taken for international trade, an intelligent investor should forecast the future by considering those facts besides the country credit rating.⁴⁷

Once coming back to the effect of private and industrial sector development on country risk, we see that both sectors' shares of GDP are the strongest determinants of the country risk. Quality of privatization methods, therefore, offers

⁴⁴ DIXIT, Avinash (1992). "Investment and Hysteresis", *Journal of Economic Perspectives*, Vol.6, No.1, pp. 108, 109.

⁴⁵ BEYAN, Alan A. and Saul ESTRIN (2000). "The Determinants of Foreign Direct Investment in Transition Economies", *William Davidson Institute Working Papers Series*, No: 342, p. 2.

⁴⁶ MOOSA, Imad A. (2002). *op.cit.* pp. 131, 132.

⁴⁷ BEYAN, Alan A. and Saul ESTRIN (2000). *op.cit.*, No: 342, p. 2.

significant clues about the risk. To exemplify from Turkey, shaken by several privatization scandals and cancellations, the country lost a lot of credibility. Although Galataport, Tüpraş and Erdemir auctions resulted in quite a headache, increasing share of private sector in GDP has drawn more attention of foreign investors and Turkey's capital inflow from FDI has dramatically risen during last two years.⁴⁸ Balance of payments together with trade balance are also crucial for the investment risk, meaning larger the deficits higher the country risk. In opposite to deficits, increased reserve stocks cause country credit ratings to skyrocket immediately due to perception of reduced risk. Bribery, corruption within the government and private sector, political instability, currency risk, and high taxation would also increase the country risk for FDI. Interest rates, exchange rates and the level of inflation stand as crucial factors for FDI.⁴⁹

Unit Labour Costs; First of all, firms know that low wage rates does not necessarily mean low labour costs because low wages may result in low productivity and thus, incurred labour cost may even increase. Hence, firms or investors choose the countries at which they pay the lowest wage rate for the same amount and quality of job especially, for the labour-intensive sectors. Turkey and South East Asia is favorable because both labour costs and levels of skills and training are quite satisfying in industrial standards. The labor cost is measured by the average real wage rates and, surely, is negatively related to the FDI inflows.⁵⁰

Host Market Size: Host market size is typically determined by GDP and its forecasted growth. Turkey and China is beyond the expectations in terms of growing market size. This component is very important especially for the market-oriented FDI for which the main target is to take the advantage of the large market.⁵¹ The higher growth rate that means a higher demand potential is the indicator of the

⁴⁸ Forbes.com. "Inflow Alone Won't Stabilize Lira", *International*, June 30th, 2006, (online) http://www.forbes.com/business/2006/06/29/turkey-fdi-investment-cx_0630oxford.html, September 21st, 2006.

⁴⁹ MOOSA, Imad A. (2002). *op.cit.*, pp. 132, 133.

⁵⁰ ZHANG, Kevin H. (2002). "Why Does China Receive so Much Foreign Direct Investment?" *China & World Economy*, Vol. 10, No. 3, p. 53.

⁵¹ *Ibid.*, p. 54.

investment to be convenient for the foreign investor. This is because those investors enter the scales economies when the market size reaches to a noteworthy volume. The effect of the growth rate on the market is greater than the effect on the efficiency-seeking or the resource-seeking investors.⁵²

Gravity Factors: Gravity factors include the costs of transport, communication and local property rights; cultural and linguistic differences, regulations, tax systems and obscurities of an unknown environment. A highly developed transportation and communication infrastructure system is one of the most attractive factors for the FDI to enter a country. The railroad and highway mileage constructions for a region will positively affect the FDI flows since this will provide a crucial convenience for any movement issues about the investment.⁵³ For an investor, to learn the foreign environment in detail will build up confidence to invest bravely. Besides, the property rights and legal terms are the fundamental features about an investment decision.

2.6.2 When, Where and How to Invest

Timing of investment is also crucial in investment decisions. Dixit has shown that optimal timing for investment is analogous to investments and real options in financial markets. Dixit (1992) presents three factors are crucial in the investment decisions;⁵⁴

First, he mentions the sunk costs. Sunk costs are the expenditures may not be refinanced. Secondly, he mentions the uncertainty. The economic environment may have uncertainty and this probably affects the investment negatively. Thirdly, an

⁵² CHANTASASAWAT, Busakorn, K. C. FUNG and Hitomi LIZAKA (2005). "The Giant Sucking Sound: Is China Diverting Foreign Direct Investments from Other Asian Economies?", *Department of Economics, UCSC*, No: 594. pp. 9-10

⁵³ ZHANG, Kevin H. (2002). *op.cit.*, pp. 54.

⁵⁴ DIXIT, Avinash cited in CHEN, John-Ren (2000). "Foreign Direct Investment, International Financial Flows and Geography", in *Foreign Direct Investment*, ed. by John-Ren CHEN, New York, US: Palgrave Publishers, p. 9.

investment decision is mostly related to whether to invest since the investor does not lose the opportunity to invest even he does not take an immediate action.

There are no hundred percent true answers to the questions above but as one may guess, mostly positive answers are expected. Moreover, the questions above form a comprehensive analysis of timing of FDI if answered properly and in detail.

In order to establish a thorough understanding of “where to invest”, UNCTAD data obtained from World Investment Report 2005 is used and following figures are drawn accordingly in order to observe the highly localized nature of FDI flows.

2.7 Methods of Measuring FDI Performance and Potential

2.7.1 The Inward FDI Performance Index

Regional distribution of FDI is well shaped by both the performance and potential of host countries. That is to confirm above mentioned driving factors, each investor seeks advantageous places to invest and usually compares candidates via a common index of FDI inward. UNCTAD defines it as follows: “The Inward FDI Performance Index ranks countries by the FDI they receive relative to their economic size. It is the ratio of a country’s share in global FDI inflows to its share in global GDP”.⁵⁵

If the value is greater than one, it means that the FDI inflows for the country is more than its relative economic size, if the value is lower than one, this indicates that the country receives less. A negative value shows us a disinvestment period.⁵⁶

All the factors beside market size, as the business climate, economic and political stability, the presence of natural resources, infrastructure, skills and

⁵⁵ United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2469&lang=1>, September 13th, 2006.

⁵⁶ *Ibid.*

technologies, opportunities for participating in privatization or the effectiveness of FDI promotion are taken into account by this index.⁵⁷

The formulation is as follows:⁵⁸

$$Ind_i = \frac{FDI_i / FDI_w}{GDP_i / GDP_w} \quad (2.1)$$

Where,

Ind_i = The Inward FDI Performance Index of the i^{th} country

FDI_i = The FDI inflows in the i^{th} country

FDI_w = World FDI inflows

GDP_i = GDP in the i^{th} country

GDP_w = World GDP

2.7.2 The Inward FDI Potential Index

The FDI Potential Index counts some factors which are likely to affect the economy's attractiveness to foreign investors. Those factors are, the GDP per capita, the rate of GDP growth, the share of exports in GDP, telephone mainlines and mobile phone's share among the inhabitants, energy use per capita, R&D expenditures, students at the tertiary level, country risk, export of the natural resources, imports of parts (as accessories of electronics and automobiles), exports in service and inward FDI stock.

With all country indices of inward FDI examined relatively, a two by two matrix is formed as shown in the Table 2.1. Two rows rank countries in accordance

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

to their future potential of FDI whereas columns distinguish them by existing performance. So-called Matrix of inward FDI thereby classifies countries into 4 categories;⁵⁹

- **Front-runners:** countries with high FDI potential and performance.
- **Above potential:** countries with low FDI potential but strong FDI performance.
- **Below potential:** countries with high FDI potential but low FDI performance.
- **Under-performers:** countries with both low FDI potential and performance.

Table 2.1 Inward FDI Performance Matrix

Inward FDI matrix	HIGH FDI PERFORMANCE	LOW FDI PERFORMANCE
HIGH FDI POTENTIAL	Front-runners	Below potential
LOW FDI POTENTIAL	Above potential	Under-performers

Source: United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/Page.asp?intItemID=2468&lang=1>, September 13th, 2006.

According to 2001-2003 UNCTAD figures; countries like Brazil, China, Qatar and Mexico are classified as front-runners for foreign investments whereas Turkey, Algeria, Zimbabwe and Commonwealth of Independent States (CIS) countries except for Russia are placed at the right-bottom of the matrix as under-performers.

⁵⁹ United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/Page.asp?intItemID=2468&lang=1>, September 13th, 2006.

Table 2.2 FDI Performance and FDI Potential

	High FDI Performance	Low FDI Performance
High FDI Potential	<p>Front - Runners</p> <p>Bahamas, Bahrain, Belgium and Luxembourg, Botswana, Brazil, Brunei Darussalam, Bulgaria, Chile, China, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominican Republic, Estonia, Finland, France, Hong Kong (China), Hungary, Ireland, Israel, Kazakhstan, Latvia, Lithuania, Mexico, Netherlands, Panama, Portugal, Qatar, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, Vietnam</p>	<p>Below Potential</p> <p>Argentina, Australia, Austria, Belarus, Canada, Germany, Greece, Iceland, Iran, Islamic Republic, Italy, Japan, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Malaysia, Malta, New Zealand, Norway, Oman, Philippines, Republic of Korea, Poland, Russian Federation, Saudi Arabia, Taiwan Province of China, Thailand, Ukraine, United Arab Emirates, United Kingdom and the United States.</p>
Low FDI Potential	<p>Above Potential</p> <p>Albania, Angola, Armenia, Azerbaijan, Bolivia, Colombia, Congo (Republic), Ecuador, Ethiopia, Gambia, Georgia, Guyana, Honduras, Jamaica, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Nigeria, Peru, Republic of Moldova, Romania, Sudan, Syrian Arab Republic, TFYR Macedonia, Togo, Uganda, United Republic of Tanzania and Zambia.</p>	<p>Under Potential</p> <p>Algeria, Bangladesh, Benin, Burkina Faso, Cameroon, Congo (Democratic Republic), Cote d'Ivoire, Egypt, El Salvador, Gabon, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Kyrgyzstan, Madagascar, Malawi, Myanmar, Nepal, Niger, Pakistan, Papua New Guinea, Paraguay, Rwanda, Senegal, Sierra Leone, South Africa, Suriname, Tajikistan, Turkey, Uruguay, Uzbekistan, Venezuela, Zimbabwe.</p>

Source: United Nations Conference on Trade and Development, (online) http://www.unctad.org/sections/dite_dir/docs/matrix_2001-2003_en.pdf#search=%22matrix%20of%20inward%20fdi%20and%20potential%2C%202001%20-%202003%22, September 13th, 2006.

2.7.3 The Outward FDI Performance Index

Another measure of FDI performance is the Outward FDI Performance Index. According to UNCTAD, The Outward FDI Performance Index is calculated as the share of a country's outward FDI in world FDI as a ratio of its share in world GDP.⁶⁰

According to this index, there are two main factors play role in determining the outward FDI by the transnational corporations (TNCs) headquartered in a given country:⁶¹

- "Ownership advantages of TNCs" (such as innovation, brand names, managerial and organizational skills, access to information, financial or natural resources, and size and network advantages) that they are expecting to grow abroad.
- "Location factors", are as relative market size, production or transport costs, skills, supply chains, infrastructure and technology support. All those factors are fundamental for the production of different goods and services in home and host economies.

Both of the factors above are extremely important for all size firms in our global world which is driven by the competitive pressures. The foreign affiliates in developed and developing countries now stand as an indicator of the competition strength of their main corporate partners.⁶²

The formulation of the Outward FDI performance index is as follows:⁶³

$$Ondi = \frac{FDI_i / FDI_w}{GDP_i / GDP_w} \quad (2.2)$$

⁶⁰ United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3242&lang=1>, September 13th, 2006.

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid.*

Where,

Ond_i = The Outward FDI Performance Index of the i^{th} country

FDI_i = The FDI outflows in the i^{th} country

FDI_w = World FDI outflows

GDP_i = GDP in the i^{th} country

GDP_w = World GDP

Top and worst 10 countries ranked according to their Outward FDI Performance Index is shown in Table 3.3 in Chapter 3. Belgium and Luxembourg sits on the top and there is a huge gap with the second best, Panama. Kuwait and Kyrgyzstan are the worst countries according to their Ond 's. Turkey is placed in the middle of that list ranking 59th with Ond . of 0,114.⁶⁴

2.8 FDI in the World: Projects, Flows, Stocks

2.8.1 Contracted and Actualized FDI

In measuring the country's FDI performance, the terms "contracted" and "actualized" (utilized-used) FDI are used as the key factors.

"Contracted FDI" indicates the schemed and ratified projects for FDI in the year concerned while "actualized FDI" means the projects which have been approved in the previous year and utilized throughout the year concerned.

Figure 10 shows the total number of the FDI projects and their percentages among some regions and some selected countries both announced and utilized throughout the world. This data gives the amounts for both greenfield and expansion

⁶⁴ United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1>, September 13th, 2006.

projects.⁶⁵ China's large share is obvious when compared with other regions. Number of projects in China also is about a little less than the projects in the overall Asia. Only the Western Europe exceeds China in number of FDI projects, thanks to the fact that it includes more than ten developed countries such as United Kingdom, Germany, France, Italy, Spain, etc. Other important players are Latin American and the Caribbean region and undoubtedly United States of America.

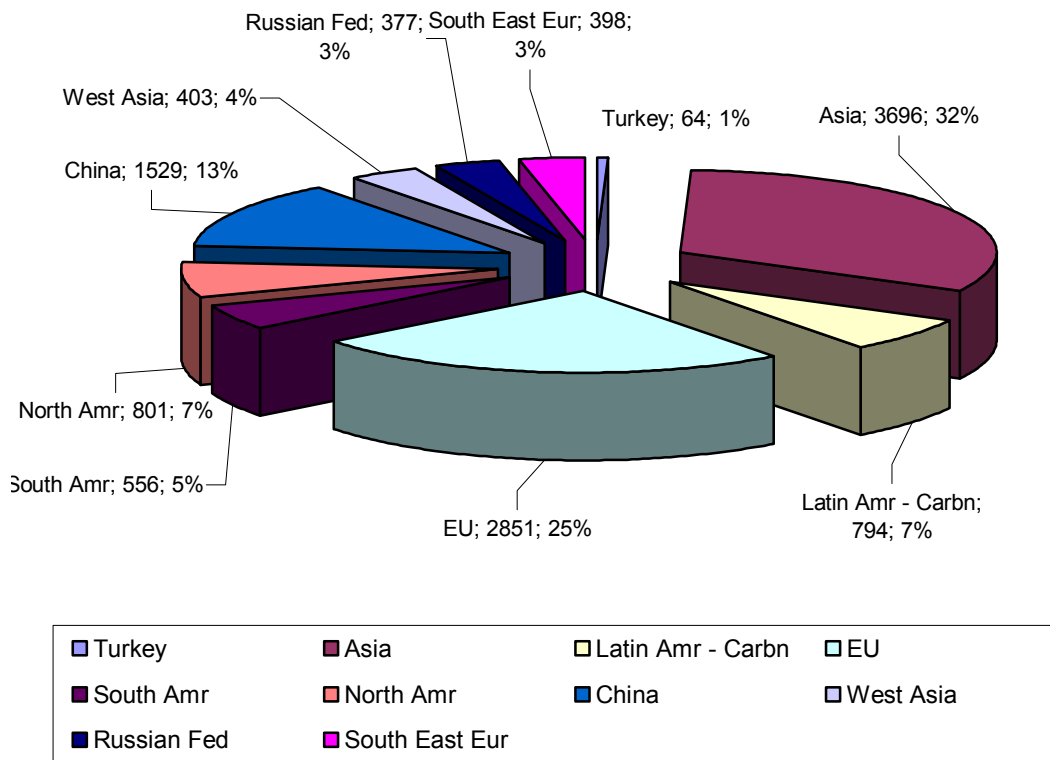
Moreover, almost one out of three FDI projects is hosted by developed countries (% 32) whereas another one is hosted by Asia (mostly South-East Asia included China). Remaining project is expected to be distributed among South-Eastern Europe and the Commonwealth of Independent States (Russian Federation, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan), Africa and Latin America.

The growing investment trend in Research and Development (R&D) was also one of the main sources of the increase in the greenfield investment projects that reached to the level of 429 new R&D activities in 2004.⁶⁶

⁶⁵ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, pp. 257, 258.

⁶⁶ *Ibid.*, p. 8.

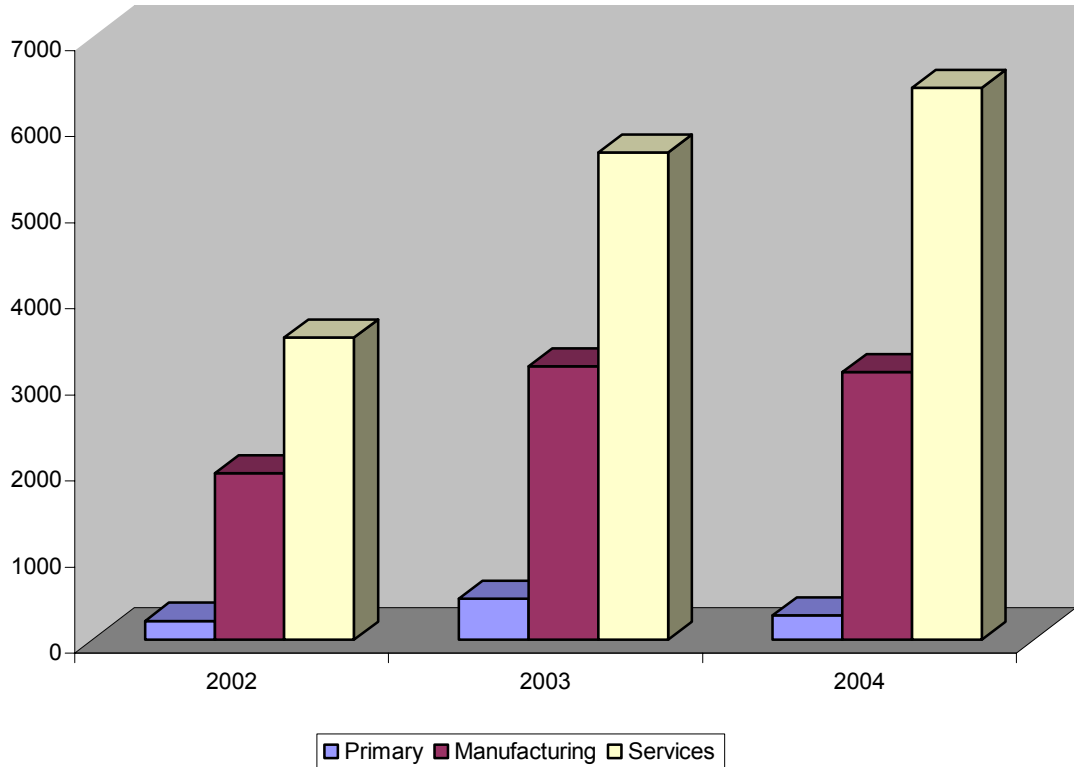
Figure 10. A Distributional Display of Number of FDI Projects by Region in 2004



Source: United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, pp. 257, 258.

For the sake of completeness, the distribution of FDI projects between manufacturing and service industries is given in Figure 11. Note that number of projects at each sector increases gradually from 2002 to 2004, while service industry definitely attracts more projects at each year thanks to low investment risk and capital requirements.

Figure 11. Number of FDI Projects in the World by Sectors



Source: United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 259.

2.8.2 FDI Flows

According to UNCTAD, for associates and subsidiaries, FDI flows consist of the net sales of shares and loans (including non-cash acquisitions made against equipment, manufacturing rights, etc.) to the parent company plus the parent firm's share of the affiliate's reinvested earnings plus total net intra-company loans (short- and long-term) provided by the parent company. For branches, FDI flows consist of the increase in reinvested earnings plus the net increase in funds received from the foreign direct investor. FDI flows with a negative sign (reverse flows) indicate that at

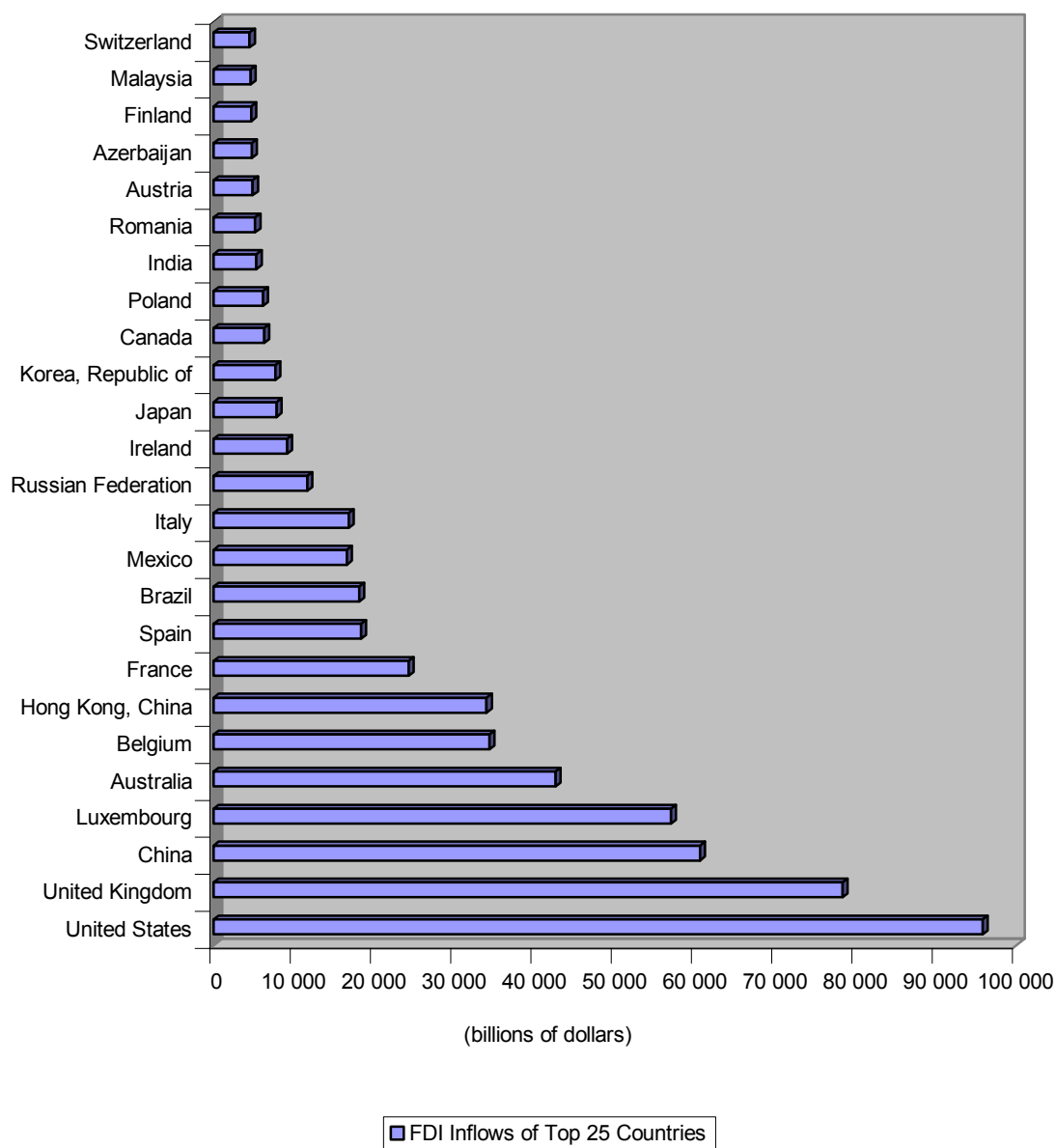
least one of the components in the above definition is negative and not offset by positive amounts of the remaining components.⁶⁷

Figure 12 shows top 25 countries in descending order, which receive the most FDI throughout the world in 2004. United States is the first receipt with 96 billions of dollars. UK, China, Luxembourg, Australia, Belgium and Hong Kong follow her via receiving FDI over 30 billions of dollars. When those twenty five countries are regionally examined, countries in Western Europe, South-East Asia and North America dominate the list.

Among all the capital flows (official flows, portfolio flows, commercial bank loans), FDI has the largest share by 51% and this picture did not change in 2004.

⁶⁷ United Nations Conference on Trade and Development, *FDI Indices*, (2002), (online) <http://www.unctad.org/Templates/Page.asp?intItemID=3165&lang=1>, September 13th, 2006.

Figure 12. FDI Inflows of Top 25 Countries in 2004



Source: United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

Figure 13 indicates FDI flows in million dollars for the world. There is an increase in the FDI flows in the year 2004. FDI flows have been decreasing since the

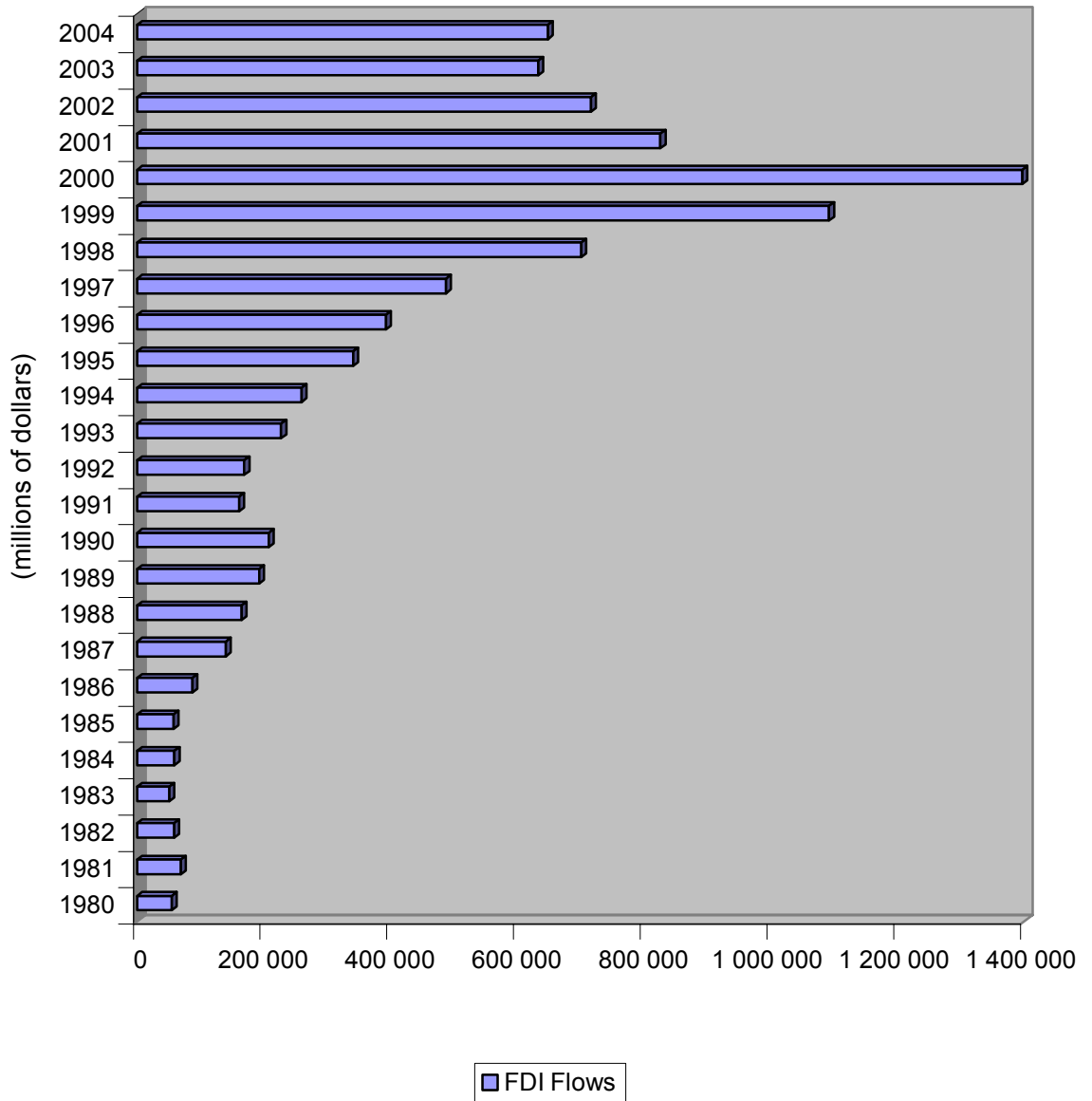
year 2000. Between the years 2000 and 2004, Denmark, Germany, the Netherlands and Sweden witnessed the sharpest FDI inflow decrease by the 86 percent of the total decline. FDI flows also decreased in huge levels in Norway and Switzerland.⁶⁸

There are macroeconomic, microeconomic and institutional factors lying behind this FDI increase after the long decreases. Decrease in dollar lead the prices to be more competitive and hence the volume of efficiency seeking investments increased. The export increase coming from the declining dollar, also caused FDI to improve in order to meet the requirements of exporters. One of the sources of the FDI increase came from the declining country risk all around the world. On the micro side, the corporate profitability related to sustainable economic growth in business affected FDI positively. Privatization as an institutional factor, also, stands as the key factor of the TNCs to invest in different countries by acquisitions of mergers.⁶⁹

⁶⁸ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 6.

⁶⁹ *Ibid.*, pp. 12-13.

Figure 13. FDI Flows between 1980 and 2004



Source: United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

When regional distribution in 2004 is investigated, FDI outflows for developed countries overshadow the inflows to those countries whereas for Asia/Oceania, more specifically South-East Asia, and Latin America inflows are

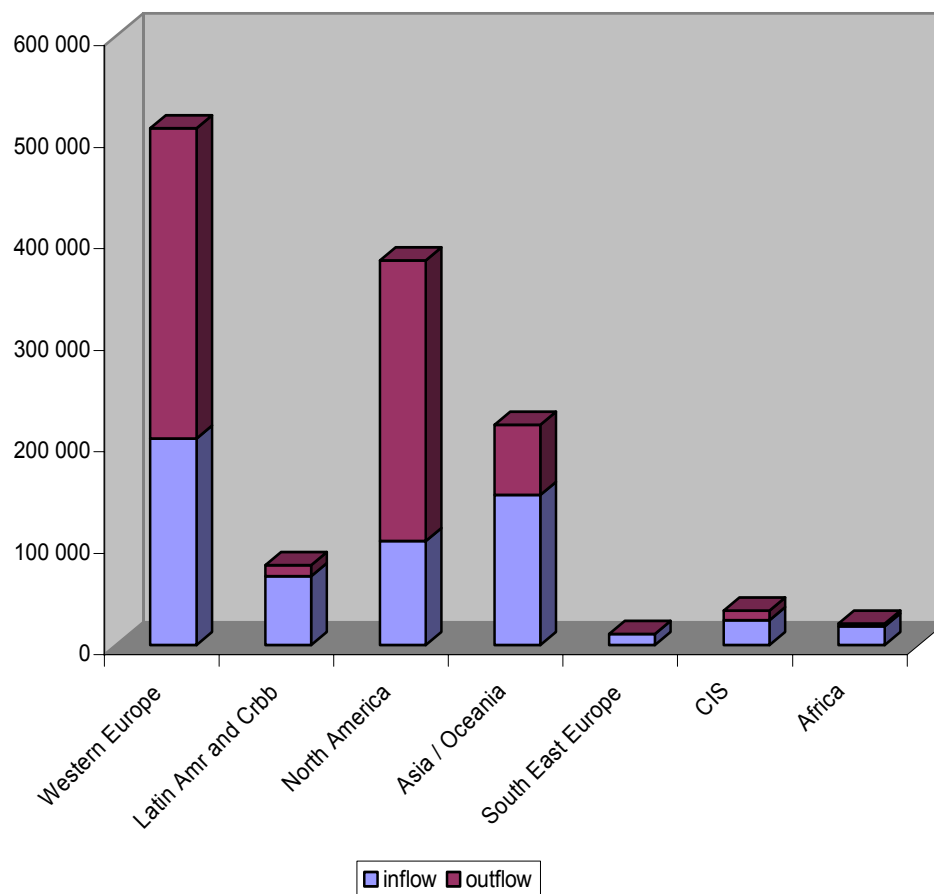
much higher than outflows expectedly. This feature can be seen in Figure 14. By the year 2004, developing countries' FDI inflows also increased by 40% and reached \$223 billion and their share within world reached 30% which is the highest level since 1997. The top five countries in the flow of FDI are China, Hong Kong (China), Brazil, Mexico and Singapore.⁷⁰

There was an increase in the FDI outflows by 18 percent for the year 2004. \$637 billion of the total \$730 billion came from the developed countries consisting Western Europe and North America. The FDI outflows from the developing countries also reached to significant amounts since 1980s.⁷¹

⁷⁰ United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

⁷¹ *Ibid.*

Figure 14. FDI Inflows and Outflows in Main Regions (2004)

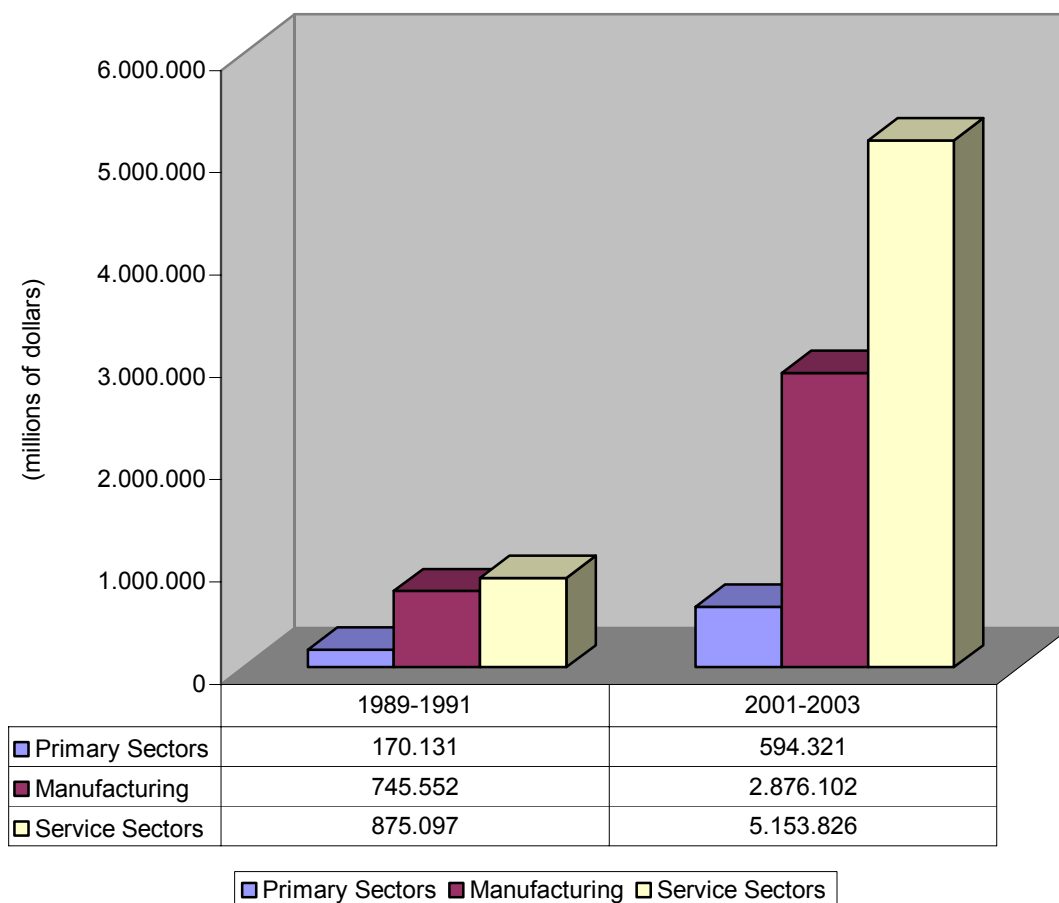


Source: United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 258.

Although there was not a significant change in the sectoral distribution, the volume and the importance of the service sector is still growing fast. As in the figure, the average amount of 461.028 millions of dollars and a 77% of the total share indicate the important nature of the service sector.⁷² Moreover, when we make a comparison between the averages of the 1989-1991 values, there is a considerable increase in the share of this sector.

⁷² United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 258.

Figure 15. Sectoral Distribution of the FDI Flows in the World: A Comparison between the 1989-1991 and 2001-2003 Averages



Source: United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 260.

2.8.3 FDI Stocks

UNCTAD defines the FDI stocks in the World Investment Report 2005: For a large number of economies, FDI stocks were estimated by either adding up FDI flows over a period of time, or adding or subtracting flows to an FDI stock that had been obtained for a particular year from national official sources, or the IMF data series on

assets and liabilities of direct investment, or by using the mirror data of FDI stock of major economies as proxy.⁷³

FDI stock consists of the FDI flows and is an important parameter for many calculations and also is a fundamental indicator for the related analysis.

Figure 16 shows the top 25 countries with FDI inward stock amounts they own by the year 2004. The dominance of the United States is obvious since this country's FDI history dates back to the early years of the 20th century. FDI, however, did not lose its popularity in later years and United States continued to witness significant rises in FDI flows after 1980s.

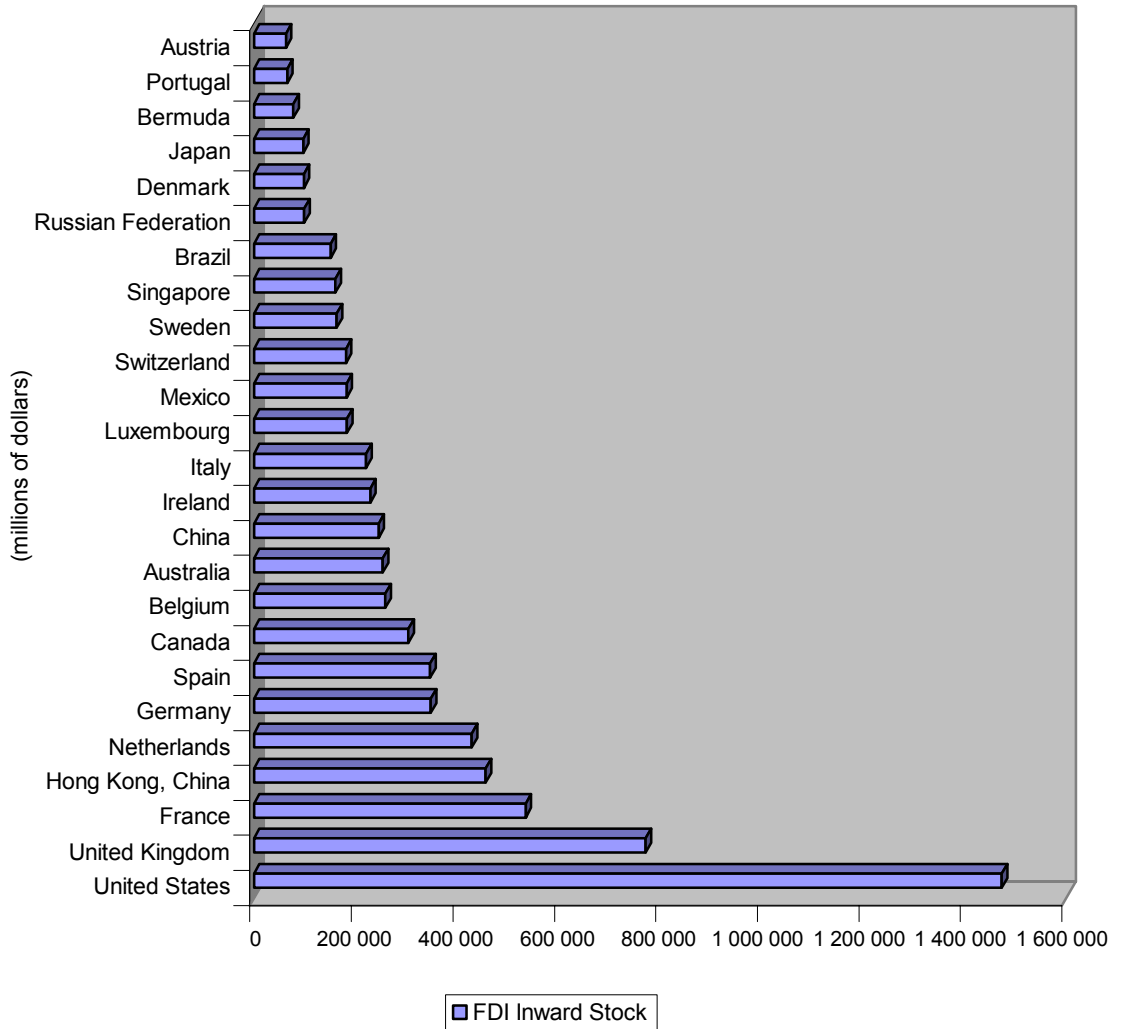
The relatively huge share of United Kingdom and France is also seen since those countries are the first two countries making FDI transactions since 1850 as stated in the previous parts in this chapter. The big share of the inward stock of FDI is then not surprising rather expected. Because of the interaction with the other European countries, namely, Netherlands, Germany, Spain, Belgium and Australia follow UK and France with significant shares.

However, the situation in Hong Kong and China is different. Those countries met with FDI in relatively later years but both witnessed the very famous FDI booms. Hong Kong started the economic reforms by 1950s and has been receiving very high amounts of FDI since then. Although, the economic reform period started just in the early 1980s, with approximately 250.000 millions of dollars of the FDI inward stock, China stands as one of those top countries. China, today, is one of the most popular countries for the FDI inflows.

Figure 17 illustrates the FDI inward and FDI outward stock distribution among some main regions around the world by the year 2004. The dominance of the

⁷³ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 299.

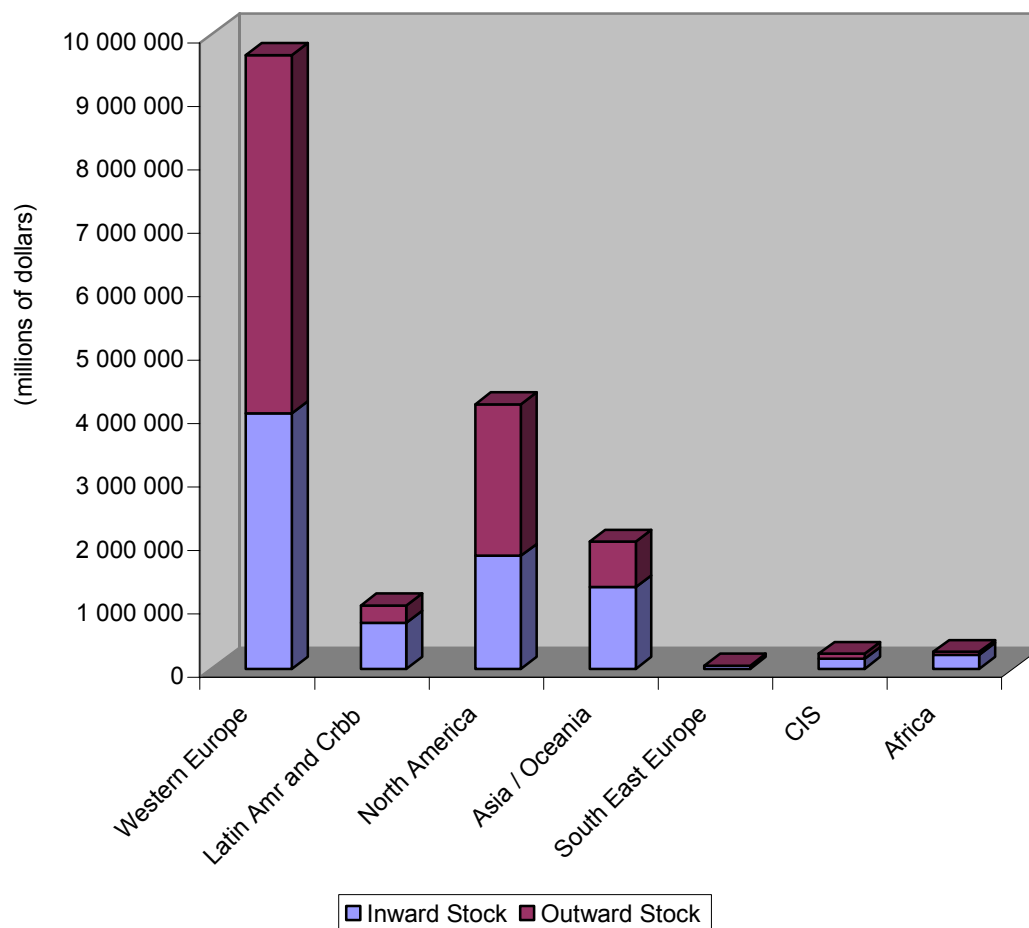
Figure 16. Top 25 Countries of FDI Inward Stock by 2004



Source: United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

Western Europe and the North America are obvious, but especially for the inward stock, the rate for Asia is more than impressive.

Figure 17. FDI Inward and Outward Stocks of Some Regions in 2004



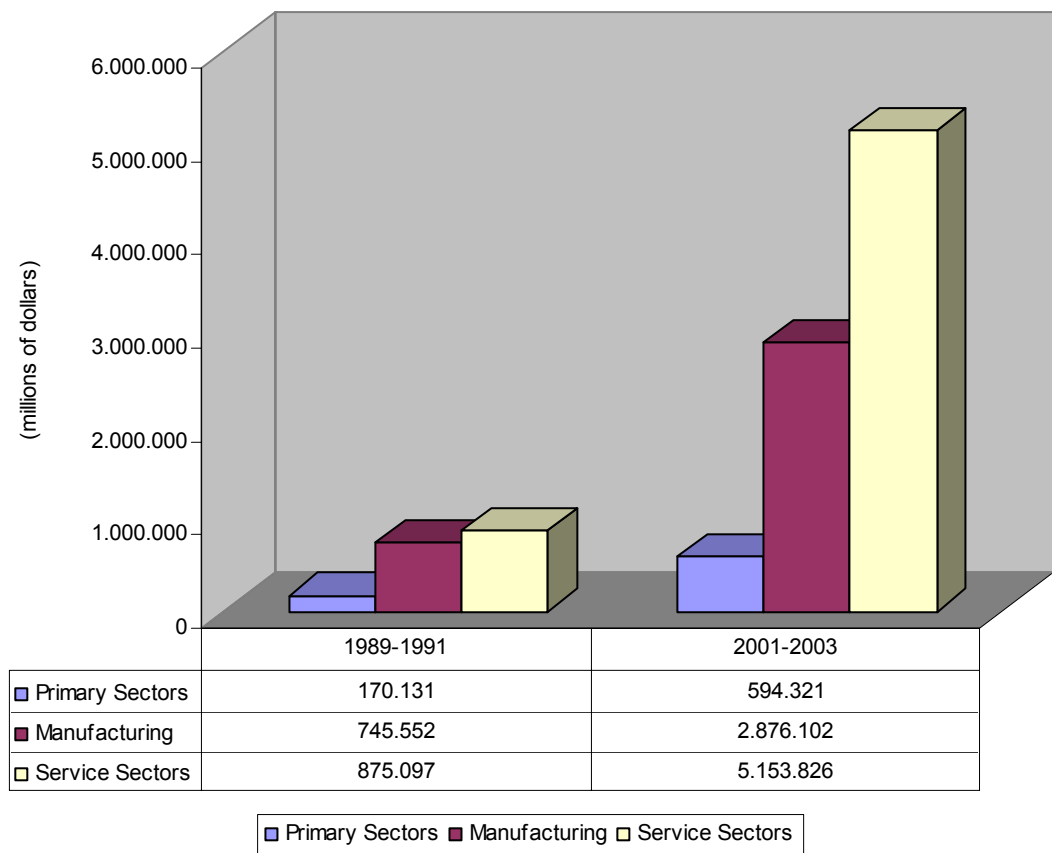
Source: United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

When we analyze the sectoral distribution of the FDI stocks, by 68 percent of the world total, the share of the service sector is more than even the sums of the manufacturing sector and the primary sectors.⁷⁴ As mentioned in the Figure 15, the increase in both the volume and the share of the service sector is present. This fact can be seen in Figure 18. However, the sectoral distribution of the FDI is different in many countries. For example, for China, as a recently opened country, the highest share of FDI has been made in the manufacturing sector in which the labor-intensive investments are conducted. The investments on service sector are primarily made

⁷⁴ Primary sectors are agriculture, forestry, fishing, etc.

into the relatively developed countries which are able to satisfy the needs of infrastructure, the usage of high technology and the demand potential for the services supplied.

Figure 18. Sectoral Distribution of the FDI Stocks in the World: A Comparison between the 1989-1991 and 2001-2003 Averages

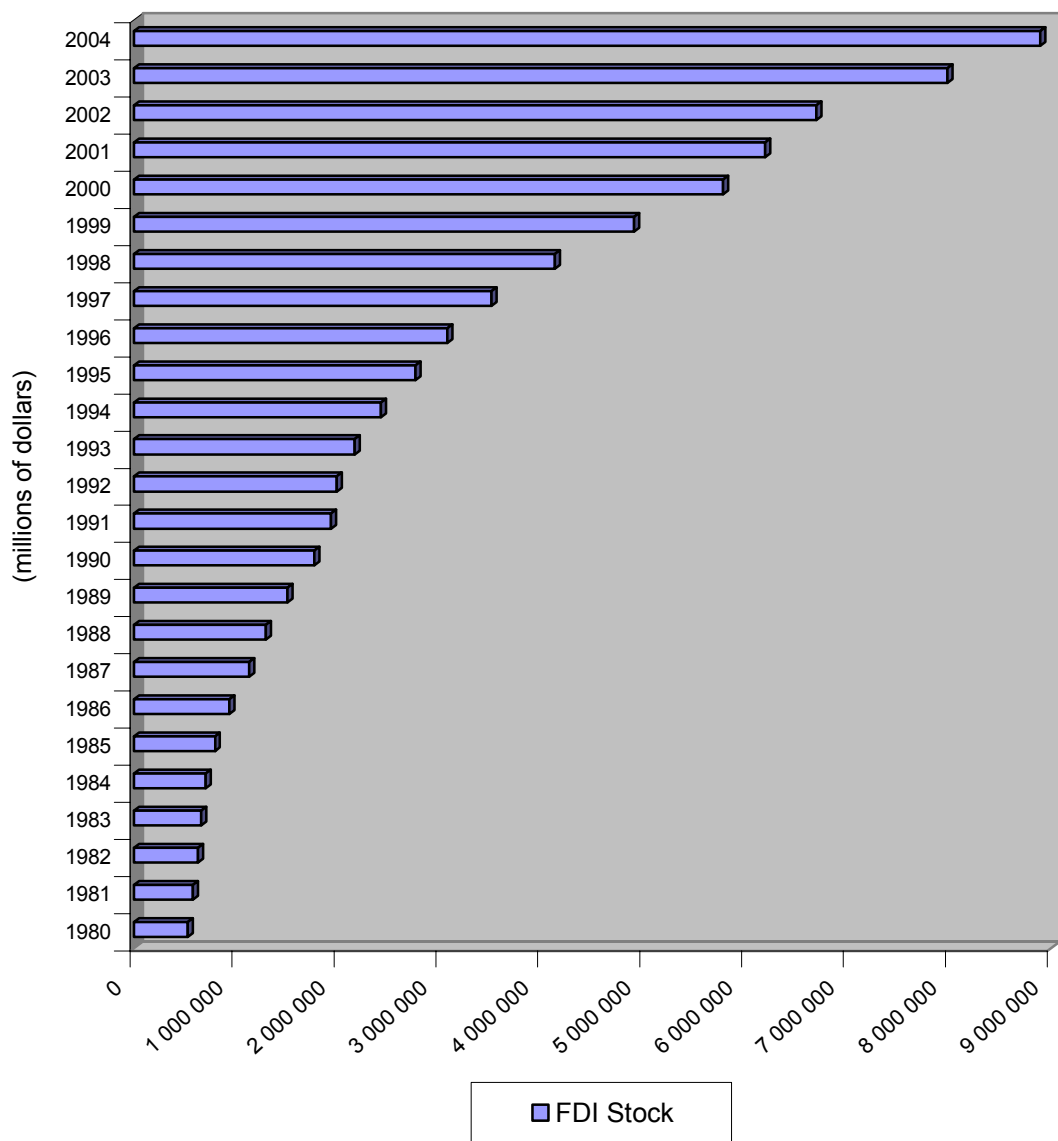


Source: United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva, p. 263.

Figure 19 gives us the twenty four year trend of the FDI stocks by referencing the inward stock data. The boom in 90s can be seen in the period of 1993 – 2000 and the adverse effects of the global crisis are also present in the flattening period of 2000 – 2002. The 2003 – 2004 periods can be said as a recovery.

In spite of the regional, global crisis and adverse effects, this figure is significant evidence indicating a more than 15 times increase in the world's total FDI stock.

Figure 19. FDI Stock (referencing the inward stock) between 1980 and 2004



Source: United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

3 FDI IN CHINA

3.1 Introduction

Increasing FDI in China for the past two decades is the major success of opening up strategy. The FDI stock has reached to hundreds of billions of USD (United States Dollars) by the end of the century from \$19 billion in 1990. China ranked first among developing countries and second among Asia-Pacific Economic Corporation (APEC) countries in terms of inward stock. The United States ranked first although there is some discrepancy within data as a result of “round tripping”.¹ USA used round tripping, i.e. utilized from Chinese domestic savings whose aim is to attract foreign investors, hence the ranking data should be suspiciously examined.²

When distribution of FDI is investigated, between 1992 and 1996, we see Asian nations dominating total FDI flows to China. Starting from 1996, however, Europe, North America and Japan have been investing quite intensely. The character of FDI also changed in the mid 90s as a result. Before, Asian nations directed their investments towards the domestic market where China has no competitive advantage. On contrary to this policy, Europe, Japan and the US invested in export-processing activities in order to exploit China’s comparatively cheap workforce, energy resources and growing hunger for international trade.³

FDI can be seen as an ironic mutual parasitism, advantages and disadvantages of which are exposed to both donor and host country. Many economists praise increasing FDI coming from flow of capital while few opposes that idea since they

¹ According to the ‘round-tripping’ hypothesis, Chinese firms illegally transfer funds to neighbouring countries (mainly, Taiwan, Macao and Hong Kong) and that in turn gets invested in mainland China as FDI inflows in order to benefit from the preferential treatment given to FDI in terms of fiscal and other incentives. See, The Hindu Business Line, *FDI to China and India: The Definitional Differences*, (online) <http://www.thehindubusinessline.com/2004/05/15/stories/2004051500081000.htm>, September, 23rd 2006.

² GRAHAM, Edward M. and Erika WADA (2001). "Foreign Direct Investment in China: Effects on Growth and Economic Performance," *IIE Working Paper Series*, WP01-3, pp. 2, 3.

³ *Ibid.*, pp. 2, 3.

attribute parallel meanings to FDI and brand-new methods of resource exploitation recently found by the capital. Despite these disagreements, it is obvious that FDI contributed very much to China's economic development. If we assume the GDP per capita is an appropriate measure of economic development, we may look for a parallelism between the regional distribution of FDI and income level in order to verify FDI's contribution in economic development. That relationship exists, meaning concentrations of FDI and high income levels probably match.⁴

This chapter will explain FDI in China starting from its historical development and characteristics, continuing with policies and factors affecting FDI decisions and ending with consequences of FDI flows to China.

3.2 Historical Background

3.2.1 1949 - 1978

As we have mentioned in Chapter 1, China was an isolated country trying to self-manage and sustain itself within until 1978. During the rule of Mao (1949 – 1976), China rejected foreign investment offers and paid back foreign loans as much as it could. For instance, despite all harsh conditions and sufferings Chinese experienced during that revolutionary period, China closed nearly all of its liability accounts to the Soviet Union by late 1960s.⁵

3.2.2 1978 – today

Deng Xiaoping, the successor of Mao, opened up Chinese economy to the world at the end of 1978. International trade and foreign investments paid increasing attention to Chinese market just after that date. Special Economic Zones, where perfectly free market conditions were formed, were established to attract FDI furthermore in the

⁴ *Ibid.*, pp. 2, 3.

⁵ WRIGHT, David C. (2001). *op.cit.*, pp. 151, 152.

early 1980s. All of those initial steps ensured a steady but still moderate growth in FDI inflows during the 80s. Most of the foreign investments, then, followed joint-venture with state-owned enterprises method. That steady growth was struck by the Beijing Massacre in 1989.⁶ Japanese and western investors withdrew capital and left the country after that unfortunate event. However, increasing inflow of Taiwanese capital in to China refreshed FDI growth.⁷

In 1992, Deng Xiaoping's visits to Guangdong and Shanghai refueled western foreign investors and a new era started for FDI in China: foreign companies opening up wholly-owned branches in China. That era brought acceleration in GDP growth and inflation. Statistically speaking, FDI made a peak in 1997 with more than \$45 billion inflow.⁸

Another breakthrough for FDI history of China came with the accession of China to the World Trade Organization in 2001 carrying China to the top between the most favorable FDI host countries in a few years time.

3.3 Driving Factors

3.3.1 Governmental Policies

China's opening success can be investigated by three stages.⁹ Firstly, by the year 1979, the establishment of SEZ's in Guangdong, Fujian and, later, Shenzhen provinces and giving them decision making power in approving the foreign investments provide those provinces to make international transactions without tight

⁶ PEARSON, Margaret M. (1992). *Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment under Socialism*. Ewing, NJ, USA: Princeton University Press, pp. 22-33.

⁷ United Nations Conference on Trade and Development, Key Data from WIR Annex Tables, <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 21st, 2006.

⁸ Chinability. *FDI inflows in US\$ billion, 1984-2003*, (online) <http://www.chinability.com/FDI.htm>, September 13th, 2006.

⁹ ZHANG, Wei-wei (1999), *Transforming China*. New York, NY USA: Palgrave Publishers, pp. 20-23.

restrictions of the government. The per capita income in those provinces reached 6.37 times the general average. Since those provinces were not very successful in attracting high technology, by a second step, Economic and Technological Development Zones (ETDZ) were established. Significant tax advantages were provided for those regions and a favorable investment area was created. The “coastal development strategy” helped to attract especially the labor intensive investments and China became an important area for foreign investment all around the world. As a third stage, Chinese government formed another zone in Eastern Shanghai and provided additional advantages for trade. As a part of the open-door strategy, the government’s aim was to make Shanghai a world-city; the low transaction costs were crucial and not labor but technology based investments became the key feature of this stage. The major sectors were selected as, automobiles, steel, petrochemicals, telecommunications, power station equipment and household electric appliances. Besides, Shanghai, as a world-city, became the core of financial sector. I would also like to mention the fascinating results of those policies. Within the period 1991 – 1995, the annual growth rate of Shanghai was about 14 percent and 12000 new joint ventures whose significant portion were high-tech establishments were formed. By the year 1992, another important government policy was established to open the inland provinces to the international trade and provide favorable facilities for them.¹⁰ By the year 2005, the FDI growth rate of the inland regions was greater than the coastal regions’. The improvements in international trade carried China to an integration process with the world. In 1997, the trade volume reached \$325 billion and in 1998, the used FDI was \$233.6 billion.¹¹

China was also affected from the globalization waves which accelerated after 1980s. The multinational corporations operating in the pure competitive global markets spread throughout the world. Since decreasing the operation costs are crucial, looking for low-wage and low raw material energy cost economies to invest

¹⁰ *Ibid.*, p. 23.

¹¹ China Daily, *Central China Sees Rapid FDI Inflow*, 2006, (online) http://www.chinadaily.com.cn/bizchina/2006-06/24/content_625113.htm, September 13th, 2006.

in became very widespread.¹² China has been one of those countries since she opened her economy to international trade. The details about the low labor cost can be seen in the “Investment Decision” part of this chapter.

3.3.2 WTO

By the accession to the World Trade Organization (WTO) on December 11, 2001, China faced many rules and obligations about some social, economic and legislative areas. Those headlines were committed on June, 2001 and can be listed as follows;¹³

- Revising Laws and Regulations
- New Legislation
- Publishing Laws
- Some New Preparations about Shanghai
- Revisions to Foreign Investment Laws
- Pilot Projects in Services
- Intellectual Property Rights
- Commodity Inspection & Technical Standards
- Customs; Custom’s Law
- Removal of Non-Tariff Barriers
- Tariff Reductions
- Education and Training

The framework of these headlines concentrated on five bases: nondiscrimination, market opening, transparency and predictability, undistorted trade, preferential treatment for developing countries.

¹² United Nations Conference on Trade and Development (2002). World Investment Report: Transnational Corporations and Export Competitiveness, United Nations, New York, pp. 3, 4.

¹³ The US-China Business Council. *Toward WTO: Highlights of PRC Implementation Efforts to Date June 2001*, 2001, (online) <http://www.uschina.org/prcwto.compliance.pdf>, September 13th, 2006.

The Chinese policy-makers accepted the capitalistic norms of WTO.¹⁴ On September 2002, a new commitment was prepared and the remaining gaps were expressed as the headlines below;¹⁵

- Retail and Distribution
- Telecommunications
- Agriculture
- Price Controls
- Trading Rights
- Education and Training

According to the 2006 work report of the government, related to the WTO obligations, tariff reduction and service sector's opening up to the foreign competition stand as the two of the key targets for the year 2006. The improvement of the export growth and to reach an optimized balance with the import content of which mainly formed by energy, important raw materials, some crucial technologies and equipment are the following aims of the government.¹⁶

Most of the policy instruments have changed by the accession to the WTO such as tariffs, barriers or coverage of the trade rules which have significant impacts on prices, output, employment, trade and factor returns, household incomes, etc.

China envisioned her targets more clearly in the presence of predefined regulations of WTO. Thus, each and every step that China should take to make WTO criteria is well-established.

¹⁴ ZHANG, Wei-wei (1999), *op.cit.*, p. 25.

¹⁵ The US-China Business Council. *Toward WTO: Highlights of PRC Implementation Efforts to Date September 2001*, 2001, (online) <http://www.uschina.org/wtocompliance2.pdf>, September 13th, 2006.

¹⁶ OECD (2003). *OECD Investment Policy Reviews - China: Progress and Reform Challenges*, OECD Publishes, (online) <http://www.oecd.org/dataoecd/44/17/33830343.pdf>, pp. 15, 18, 22.

3.4 Classification and Explanation of FDI

3.4.1 Vertical and Horizontal Motives

For East Asia and China, the portion of FDI on GDP is impressively greater than that of the US or European countries. Both the horizontal and the vertical FDI have been effective since the economy started to implement the opening up strategies. However, especially, Japanese and US investments are mostly vertical in order to get benefit from labor cost. The *vertical FDI* is preferred when there is a considerable difference in factor prices of the both –donor and host- economies, China as a developing economy has been taking the advantage of this fact for approximately two decades.¹⁷

China is a unique country in transition to free market from a conservative socialist economy. One of the most important reasons of the dominance of the vertical FDI comes from this uniqueness of China. As a new opened economy, Chinese government had noteworthy restrictions and barriers for the foreign investors in the domestic markets. Most of the foreign investing firms imported the inputs and exported them outside China in order to take the advantage of hard currency for the debts arising from the imports. Because of the restrictions on foreign exchange rates, the convertibility of yuan was a big problem for the foreign investor. These limitations and relatively very cheap labor directed the huge part of FDI to vertical investments.¹⁸

On the other hand, the *horizontal investments* mostly take place when the size and source of the donor and the host countries are similar.¹⁹ As market-seeking investments, for horizontal type, the size of the market is very important. The volume of the market is supposed to be large enough in order to satisfy the supply. For

¹⁷ FUKAO Kyoji, Hikari ISHIDO and Keiko ITO (2003). "Vertical Intra-Industry Trade and Foreign Direct Investment in East Asia" *Discussion Paper Series*, a434, Institute of Economic Research, Hitotsubashi University, pp. 4, 5.

¹⁸ GAO, Ting (2003). *op.cit.*, pp. 611, 614, 615.

¹⁹ *Ibid.*, p. 615.

China, the volume of the horizontal FDI is lower than the volume of the vertical FDI since the market is not strong enough to satisfy the foreign produced output supply.²⁰

The FDI inflows coming from the export-oriented economies such as, South Korea, Taiwan and Hong Kong, have been mostly vertical in order to take the advantage of the low production costs. However, the flows from the countries of North America and Western Europe have been horizontal which aims to exploit the domestic market.²¹

3.4.2 Types of FDI

3.4.2.1 Types by Potential Return

As I mentioned in the previous chapter, there are three types of FDI by the potential return; *market-seeking*, *resource-seeking* and *efficiency-seeking*.

When we investigate the distribution of those types in China, the dominance of *resource-seeking* type is noteworthy. This type of investment is slightly relevant with the differentials in the factor prices of the host and donor economies since the cheap labor is the greatest incentive of the labor-intensive investments for the export oriented Multinational Enterprises (MNEs).²² According to the regional distribution, the eastern region especially Guangdong and Shanghai have been the most popular provinces for the FDI since 1980s. Guangdong is one of the best examples for the resource-seeking investment areas with its low labor cost, favorable geography and market conditions. For the opening up the western region, attractive export-oriented policies were applied. One of the most important targets of the opening policy was to

²⁰ *Ibid.*, p. 615.

²¹ WHALLEY, John and Xian XIN (2006). "China's FDI and Non-FDI Economies and the Sustainability of Future High Chinese Growth", *National Bureau of Economic Research Working Paper*, No. 12249, p. 3.

²² TAUBE, Markus and Mehmet ÖĞÜTÇÜ (2002). "Main Issues on Foreign Investment in China's Regional Development: Prospects and Policy Challenges" in *Foreign Direct Investment in China: Challenges and Prospects for Regional Development*. Paris: OECD, (online) www.oecd.org/dataoecd/30/23/1939560.pdf, p. 9.

utilize from the region's comparative advantage among the others. This comparative advantage also caused resource seeking investments to take a huge portion among the total investments.²³

When we look at the *market-seeking* side, the fundamental target is to supply the output to the local production area. The closeness of the factor prices, the potential of the market for the foreign production, demand structures and a favorable market condition are the attracting factors for this kind of investments.²⁴ The long term market-seeking investments to take place in China, especially in R&D areas can be a chance for the West in order to produce the imported products by the East and hire more skilled labor. The purchasing power should be increased for the market-seeking investments to take the advantage of the factor endowments and to find an appropriate region in order to find a market for the output. The infrastructure investments are now the urgent requirements for the area to attract those kinds of horizontal investments in China.²⁵

China is a fitting country for the *efficiency-seeking* investment since she satisfies the criteria of low factor costs, a flexible labour market, a small regulatory burden, and customs.²⁶

3.4.2.2 Types Specific to the Investment

Due to variation in classification of FDI types, I deviated from the definition of UNCTAD towards a more generally-used terminology in application of theory to China. Data about FDI types are presented in 'characteristics of FDI in China' chapter under 'distribution among different types of FDI' title. For subsequent parts of this thesis, the same classification scheme will be used distinguishing FDI in

²³ *Ibid.*, p. 16.

²⁴ *Ibid.*, p. 9.

²⁵ *Ibid.*, p. 21.

²⁶ World Bank (2004). *Public Policy for the Private Sector; FDI Trends*, (online) http://rru.worldbank.org/documents/publicpolicyjournal/273palmade_anayiotas.pdf, September 13th, 2006.

China as *Share-Based Enterprises (Sino-Foreign Ventures)*, *Contractual Joint Ventures*, *Wholly Foreign-Owned Enterprises*, *Cooperative Development*, *Equity Joint Ventures*. Each type and its share in China's FDI inflow will be examined statistically in coming parts.

3.5 The Decision – Making Process in FDI

3.5.1 The Decision to Invest or Not to Invest

There are five fundamental factors affecting the investment decision as stated in the previous chapter. China's position for each factor is detailed below:

Country risk: As detailed in the previous chapter, in analyzing the country risk of China, we have to look out the factors as privatization steps, industrial development, government balance and political stability, the reserves owned, country ratings, and corruption. Privatization was a goal for China. By the SOE reform in early 90s, the privatization policies were applied. The achievements can be listed as, increasing competition, establishment of government procedures, introduce of profit motives, new management incentives, hardening of budget constraints, reducing administrative interference, improves in responsiveness to shareholders and increasing transparency.²⁷ All those goals created a favorable area for foreign investors. This standardization process also provided a trustable and convenient atmosphere for new projects. As mentioned in Chapter 2, industrialization has been one of the most impressive features of the Chinese development especially since 1980. A lot of new industry branches were established while the existing ones got huge benefits from the economic changes. The consumption of raw materials increased to significantly high levels indicating the input demand for industrial products. (See, Figure 3 in Chapter 1.) Those improvements decreased the concerns

²⁷ KERINS William F. *Privatization and Public Offerings – Instilling Good Governance Early*, 2004, (online)
http://www.acga-asia.org/public/files/Presentation_BillKerins_ACGAconference.pdf#search=%22privatization%20success%20in%20china%22, September 13th, 2006.

about the failure risk of an investment and hence the general country risk. The political stability is also a crucial concern for a developing country since the fragility of economic and financial environment is high. Political instability, however, is one of the most problematic issues for China. The events in 1989 and downfalls of the two of some important government officers caused instability in politic arena and affected the economy hence the investments badly. The politic instability is still a problem and one of the China's most head-aching issues.²⁸ On the country ratings side, according to the latest reports of S&P, China's long-term sovereign credit rating raised from "A-" to "A" and the outlook seemed stable. This improvement indicates China's continuous endeavors for regulating the fiscal and monetary sector and decreasing the risk of any kind of investments. Government's policies for financial restructuring provided important improvements for many economic indicators.²⁹ The very high level of the foreign exchange reserves are also a cause for the country rating increase hence the risks decreased. China has the largest level of the foreign exchange reserves which is expected to reach to \$1 trillion by the end of the year 2006. Another important factor for country risk is corruption which exists within the bureaucracy and causes huge amounts of loss in FDI inflow.³⁰

Unit labour cost: For China, the low level of labour cost has been the most popular incentive for the investment decisions. China has the largest manufacturing workforce which is also known as the lowest paid famously around the world. The per hour compensation is averagely \$0,95 for the city manufacturing companies while it decreases to \$0,41 levels, less than a half, for the non city residents whose population is greater than the city residents in the year 2002. According to the 2002 data, number of city manufacturing workers is 30 million and this number reaches to 71 million for the employees who work outside the cities. The graded average for the compensation can be computed by \$0.57 and this amount is approximately three percent of estimated average manufacturing compensation in the US and many

²⁸ MINXIN Pei, China's Precarious Balance: Political and Social Cohesiveness and Stability in a Fast-Changing Society, (online) <http://www.comw.org/cmp/fulltext/0003minxin.htm>, September 13th, 2006.

²⁹ *Ibid.*

³⁰ *Ibid.*

developed countries. Moreover, the average labor cost in the other countries of China is also more than 10 times for the employees in the manufacturing sector.³¹ Undoubtedly, those rates provide a great competitive advantage to China against the world. Especially in the town and village enterprises, the social benefits as medical insurance or unemployment insurance, and pensions are extremely rare and weak. Also, for the weekly working hours, the total hours in rural areas are relatively more than those in the urban. While the average is about 46 hours a week in the urban area, this amount is more than 50 hours in the rural areas, but those hours may be more than the statistically announced.³² The above mentioned rates of compensation, the social system, and the long working hours put China ahead in global competition by attracting numerous foreign investors then put the number of FDIs to the significant levels.

Host market size: This component of the decision making process is mostly about the GDP and its growth rate and a very important determinant for the market-seeking investment. China has been witnessing sustainable high rates of growth for more than two decades and as her market size grows, the sales volume of the country also rises. The need for resources, minerals and raw materials also rises. This means that the foreign investors also produce for the Chinese people as a market-seeking investment. On the other hand, some other MNCs invest to the other regions of Asia in order to export those resources and minerals to China. This fact is called as “investment-creation effect”.³³

The GDP growth rates for China are given in the Figure 20.³⁴

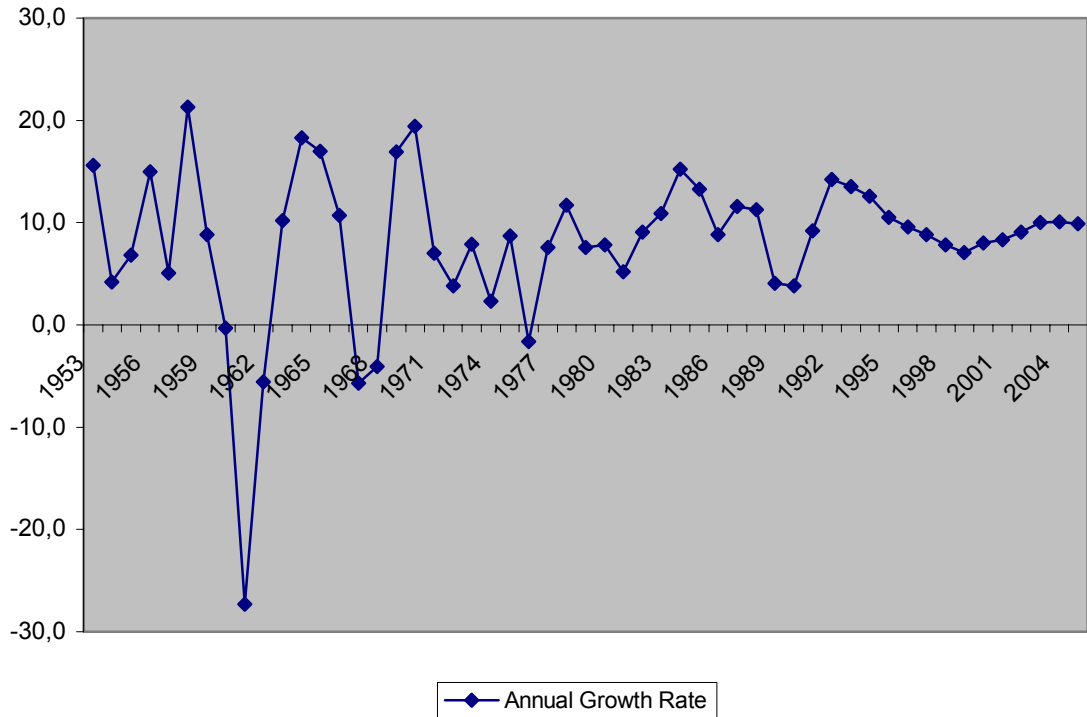
³¹ BANISTER, Judith (2005). “Manufacturing Earnings and Compensation in China”, *Monthly Labour Review Online*, Vol.128, No. 8, p. 1.

³² *Ibid.*, p. 9.

³³ CHANTASASAWAT, Busakorn, FUNG, K. C. and LIZAKA, Hitomi, "The Giant Sucking Sound: Is China Diverting Foreign Direct Investments from Other Asian Economies?", *Department of Economics, UCSC*, No: 594, p. 9.

³⁴ Chinability, *GDP growth 1952-2006*, (online) <http://www.chinability.com/GDP.htm>, September 13th, 2006.

Figure 20. GDP Growth Rate for China



Source: Chinability, GDP growth 1952-2006, (online) <http://www.chinability.com/GDP.htm>, September 13th, 2006.

China witnessed high growth rates before the economic reforms of the 80s, but this ratio was not stable and sharp decreases followed the high rates of the growth. Especially after 90s, the picture is quite stable and no dramatic fluctuations were occurred.

For China, the growth rates of the various provinces are also important especially for the manufacturing investments. The high rates of the manufacturing output share among the provincial GDP is a strong indicator for the foreign investments since the market size hence the demand volume for the output is enormously important.³⁵

³⁵ ZHANG, Kevin H. (2002), "Why Does China Receive so Much Foreign Direct Investment?" *China & World Economy*, Vol. 10, No. 3, p. 54.

Gravity factors: The cultural similarity undoubtedly is an incentive for the investors who are contemplating about investing in foreign countries. For example, the pairs of Hong Kong – Guangdong and Taiwan – Fujian are geographically close to each other and also speak the same dialect. This, of course leads to a favorable environment to conduct any investment activities. The large FDI shares can be explained by this fact.³⁶ However, cultural disparities may arise as a dangerous risk for an investment to establish and conduct its activities. Beside the linguistic, cultural and historical background and the disparities coming from those facts should also be taken into account intensively. More than 80 percent of the foreign enterprises were badly affected from this situation.³⁷ Entering the Chinese market with a local supporter may be very helpful for the adaptation process. For a hundred percent foreign investment, the training courses of those elements seem as a good solution for the communication of the two parties.³⁸ For China, a forethoughtful investor should also take the property rights and some legal terms into account in order to avoid extra costs that may come from the disputes between the government and another investor. In China, there is uniqueness about the degrees of the two types of property rights. Although the formal property rights are not defined formally, the capital investments are encouraged by the government whereas the individual rights as farmers' or workers' rights are defined more detailed.³⁹ There are also some deficiencies arising from the laws about the land or the taxes. Those deficiencies are directed by the local governors in order to earn more from the FDI.⁴⁰

³⁶ *Ibid.* p. 54

³⁷ GATTAI, Valeria (2003). "Foreign Direct Investment in China: The Entry Mode Choice Evidence from the Italian Case", Institute of Economic and Social Studies on South East Asia, (online) http://www.unisi.it/santachiara/aree/conf_phd_econ2003/conference_siena/papers/gattai.pdf, pp. 16, 17.

³⁸ *Ibid.*, p. 17.

³⁹ ZHANG, Xiabo (2006), "Asymmetric Property Rights in China's Economic Growth", *DSGD Discussion Paper*, No. 28. Washington, D. C.: International Food Research Institute, Development Strategy and Government Division. p. 10.

⁴⁰ *Ibid.*, pp. 17-18.

3.6 Characteristics of FDI in China

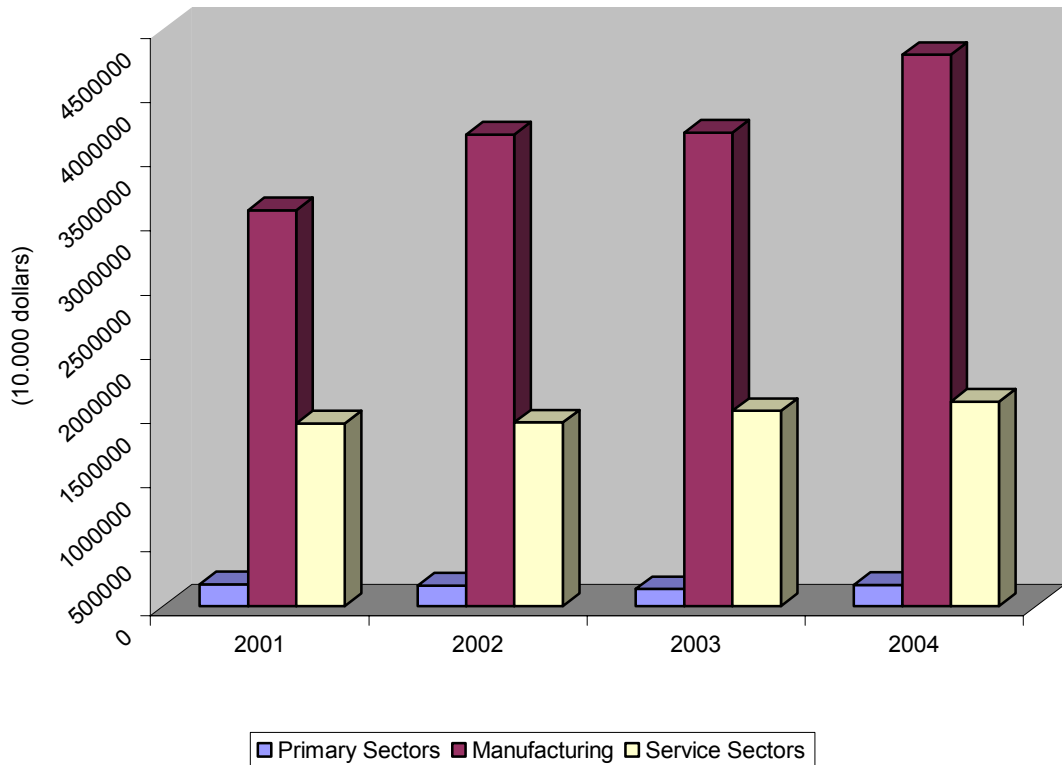
3.6.1 Sectoral Distribution of FDI

Over two decades, China has stand as a labor-intensive country in terms of industry. The sectoral distribution of the foreign direct investment obviously flowed into those sectors especially in the 80s and the early 90s. That means a very high portion of foreign investment directed to the labor intensive industries (light industries) especially textile, garment or real estate. The ultimate intention of the foreign companies is to trade on the relatively very low labour costs and the investment area formed as manufacturing.⁴¹

Figure 21 indicates the sectoral distribution of FDI;

⁴¹ OECD (2000). "Main Determinants and Impacts of Foreign Direct Investment on China's Economy", *Working Papers on International Investment*, Vol. 4, pp. 6, 8.

Figure 21. Sectoral Distribution in China between 2001 and 2004



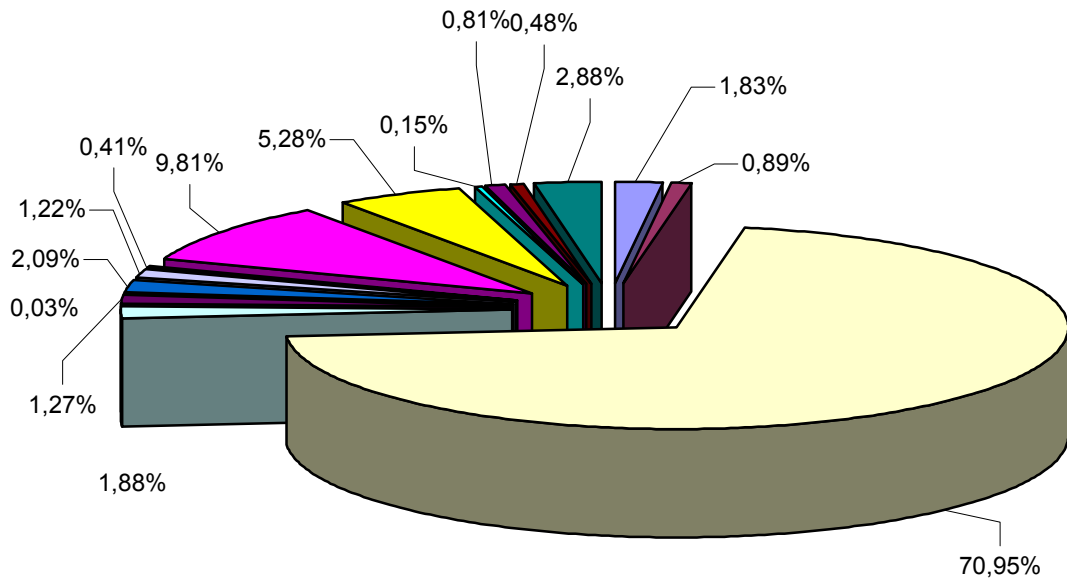
Source: China Internet Information Center, *Amount of Actually Used Foreign Direct Investment by Sector*, (online) <http://www.china.org.cn/english/en-sz2005/jj/biao/18-18.htm>, September, 21st 2006.

Figure 22 also shows the distribution more detailed. The percentage of manufacturing is 70.95 percent by the year 2004. This amounts to 43.017 millions of dollar if computed from the total value of 60.630 millions of dollars.

However, within the manufacturing sector, even though a considerable portion of the labor-intensive foreign investments are still valid, the last decade has witnessed a transition to the more capital-intensive flows within the country. A very striking example of this improvement can be seen in the period of 1997-2000. While the amount of contracted FDI in textiles has increased by a small percentage (73%) and the utilized investment witnessed a decline (27%) on this period, the contracted

investment in telecommunications and electronics realized a 188% increase and the 50% of this amount was utilized.⁴²

Figure 22. Distribution of the Used FDI in China among Different Sectors in 2004



Source: China Internet Information Center (2005). *Amount of Actually Used Foreign Direct Investment by Sector*, (online) <http://www.china.org.cn/english/en-sz2005/jj/biao/18-18.htm>

⁴² PINGYAO, Lai (2002). "Foreign Direct Investment in China: Recent Trends and Patterns", *China & World Economy*, Vol. 10, No. 2, p. 28.

3.6.2 Regional Distribution of FDI

As mentioned in previous chapters, when we analyze the last twenty or twenty five years of China, it is obvious that the significant economic reforms in numerous branches and opening up the country as a meaning of globalization, made crucial changes in the country's profile both in economic and social terms. One of the most visible improvements actualized in the regional distribution of the economic activity. While the coastal regions were improved and adopted to the high economic activity fast, the inland region neither could integrated with the outside of the world except some regions nor catch the inflows of the reform since more than two decades.⁴³

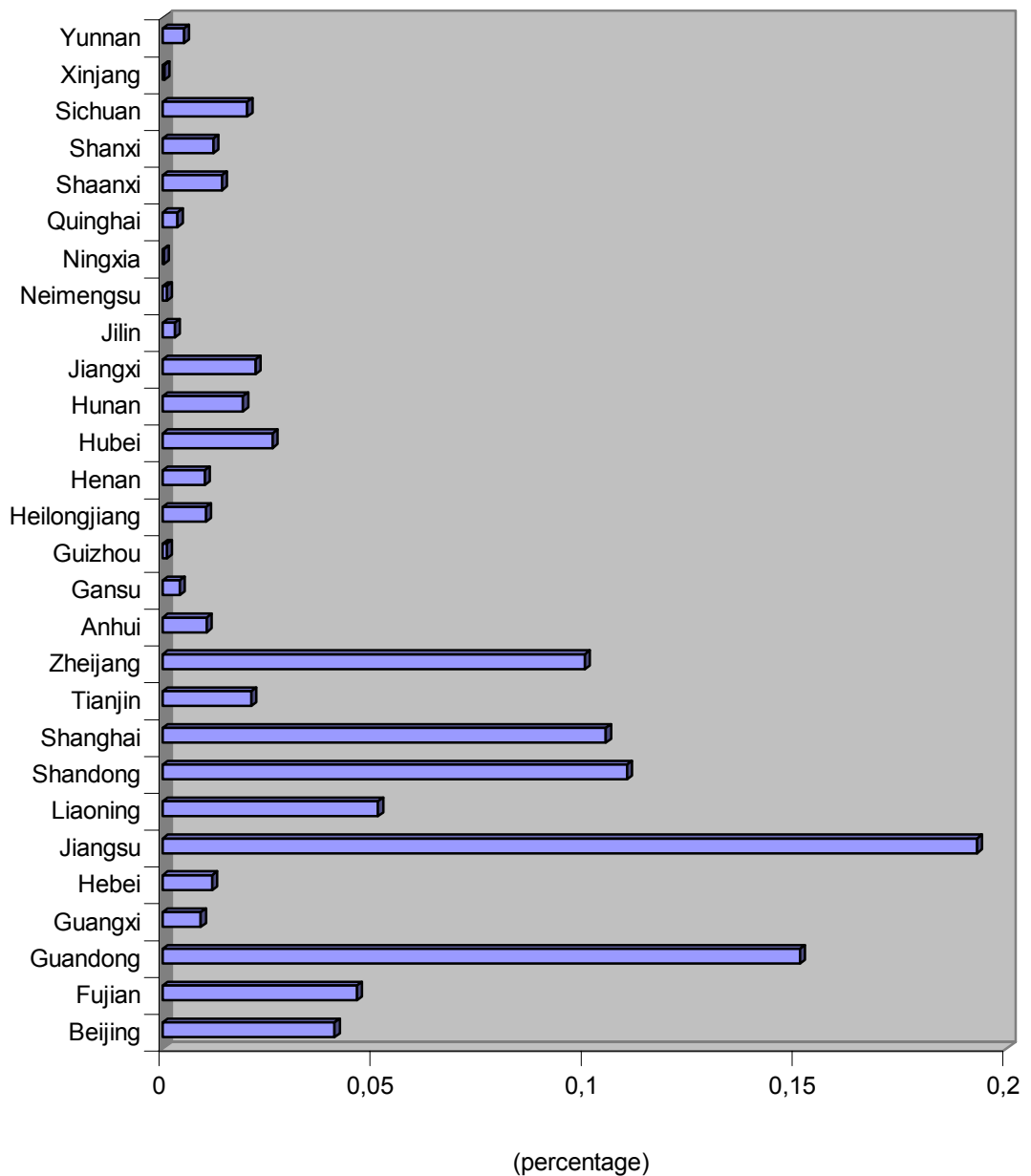
Figure 23 indicates regional distribution of FDI justifies the gap between the hinterland and the coastal China. This gap can easily be observed from the graph. For example, Jiangsu –leader province in FDI-, Guangdong, Shandong, Shanghai, Liaoning and Fujian, the coastal provinces of the generally western China, mean more than 75 percent of the total FDI. The reasons behind this fact can be about the agglomeration of the economy and the regional comparative advantage. Those regions' comparative advantages depend on the transportation and labor cost and the availability of the necessary sources as energy, raw materials, etc. Special economic zones were also established over those provinces and those areas were encouraged by the state rules in order to attract the foreign investment. (See also, Map 3 in Chapter 1)

The Chinese government, now, issues and applies many policies to narrow the gap between the inland and the hinterland. As I have mentioned in the Chapter II, the income distribution among those provinces is unfair and Gini Coefficient is also very high. Since FDI is one of the most important factors of the economic growth,

⁴³ HU, Albert G. and Robert F. OWEN (2005). "Gravitation at Home and Abroad: Regional Distribution of FDI in China", (online) http://www.aeaweb.org/annual_mtg_papers/2006/0107_0800_0503.pdf, September 15th, 2006.

hence the welfare, it arises as a very convenient way to reduce the gap between per capita incomes.

Figure 23. Regional Distribution of FDI in China in 2004



Source: HU, Albert G. and Robert F. OWEN (2005). “Gravitation at Home and Abroad: Regional Distribution of FDI in China”, (online)

http://www.aeaweb.org/annual_mtg_papers/2006/0107_0800_0503.pdf, September 15th, 2006.

3.6.3 FDI Distribution of according to Donor Country

More than 60 percent of the utilized FDI in China have been conducted by the overseas Chinese Diaspora in 1990s, so by the expatriate investment, the light industry manufactures gain an opportunity to flow into China from the outside. Those countries are Taiwan, Macao, Hong Kong and Singapore. Although the non-Chinese investments have had an increasing trend since 1995, the huge portion of the Pacific Rim (Taiwan, Macao, Hong Kong and Singapore) still remains. The underlying factors behind this extremely high dominance of the expatriate investment can be listed as below:⁴⁴

- Since 1950's, those Chinese Diaspora countries were applied the export oriented labor intensive policies which increased the wages and many similar costs in the host country. The transfer of the operations to the inland China was meaningfully very profitable, then.
- Since these economies started to focus on service sector since 1980s, China as a liberalized economy in 1979 became a very convenient and tradable area for the foreign investments on manufacturing sector. The investment advantage on manufacturing was also one of the key factors beneath the Pacific Rim interest on China.
- The Chinese Diaspora business class was powerful in the period of 1990s and generated high volume FDI flows to mainland China.
- According to the rules imposed by the Communist regime in China, the private property was illegal and people hoarded their money or gold until the liberalization reform in 1979. The money was kept by the relatives of those Chinese people in abroad and brought back in the form of FDI flows especially from the short distance countries of Pacific Rim.

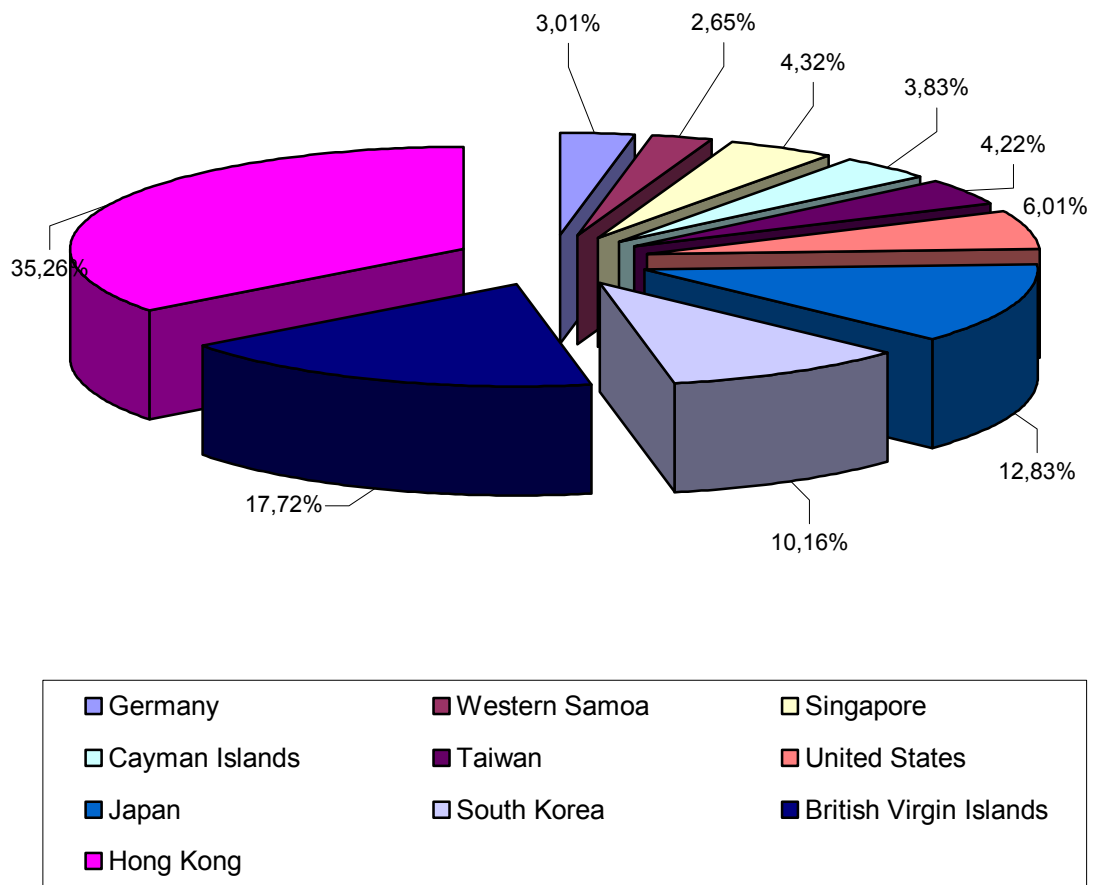
⁴⁴ DASGUPTA Nandita (2004) "Foreign Direct Investment Inflows to India since the 1990s – Issues and Challenges: Comparison with China", *An Honors University in Maryland Fall 2005 Seminar Series*, (online) http://www.umbc.edu/economics/seminar_1.html, pp. 26, 27.

Within those countries, Hong Kong is the leader by the portion of 60 percent of the FDI in China.⁴⁵

As seen in the Figure 24, for the year 2005, United States and some European countries have also considerable shares in Chinese FDI inflows. However, with a 35.26 percent ratio, Hong Kong is still the uncontested leader of the approximately 60.630 millions of dollars of total foreign investment.

⁴⁵ BALDI, Ambassador M. (2000). "Global Investment Trends and Policies: An OECD Perspective", *OECD-China Conference on Foreign Direct Investment*, p. 5.

Figure 24. Top Foreign Investors in China by 2005



Source: The US – China Business Council, *Foreign Investment in China*, (2006) (online) <http://www.uschina.org/info/chops/2006/fdi.html>, September 13th, 2006.

3.6.4 Distribution among Different Types of FDI

Joint ventures are the most important part of the FDI in China. Different types of the joint ventures are briefly examined below.⁴⁶

Share-Based Enterprises (Sino-Foreign Ventures): Share-based enterprises are invested with a foreign capital and a Chinese company in mainland China. All terms of the investment as operations or the burden of risk are conducted together proportionally to the shares of the capital. The capital ratio of the foreign investor should be at least 25 percent. This kind of investments does not have a significant portion among the other types with a 1.27 percent in the year 2004.

Contractual Joint Ventures: They are formed in China with joint capitals or terms of cooperation by foreign companies, enterprises, other economic organizations and individuals with Chinese companies, enterprises, other economic organizations and individuals. Both parties determine the rights and obligations by the contract. While the Chinese party usually supplies land or factory building with an amount of capital, investing the important portion of the capital is opt to the foreign party. With a 5.13 percent ratio, this investment type is seen rarely.

Wholly Foreign-Owned Enterprises: 66.38 percent of the total foreign investment means 40.220 millions of dollars among the overall volume according to the figures of the year 2004. The foreign party generates the whole investment in mainland China by foreign companies, individuals, enterprises or other economic organizations. However, there are some governmental restrictions like the law of foreign-funded enterprises which forces foreign investors to contribute in development of China via constructing high-tech plants and using export-oriented inputs.

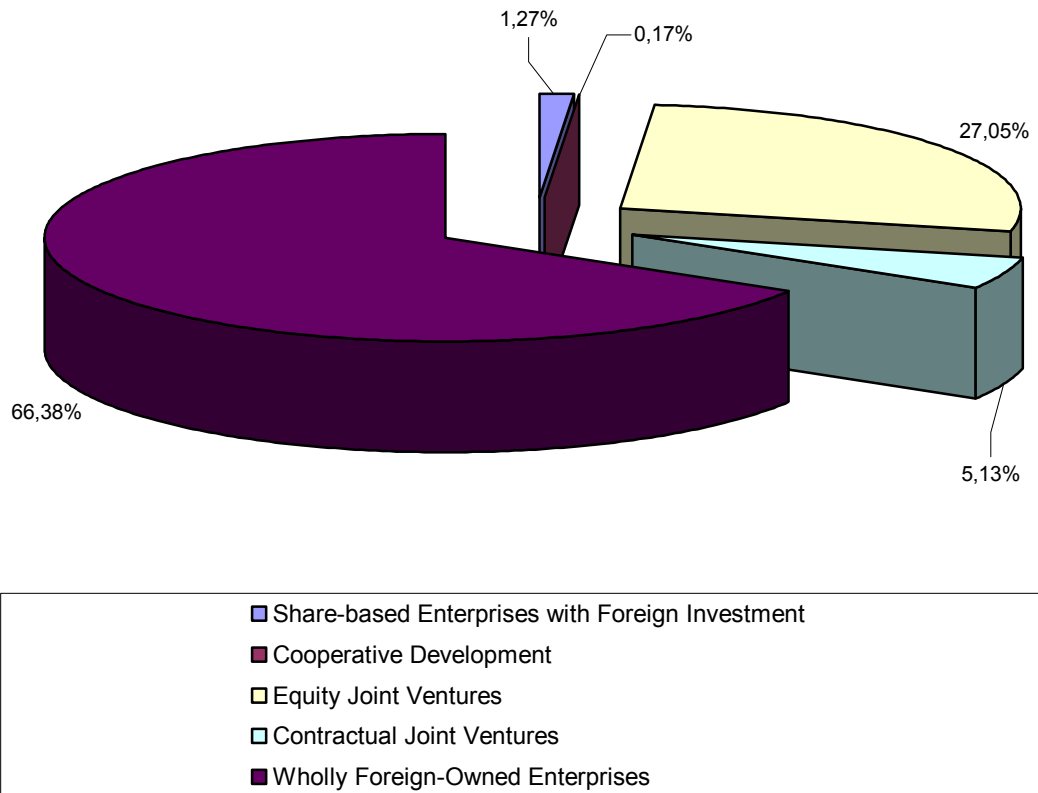
⁴⁶ Invest in China, *China's Absorption of Foreign Investment*, (online)
<http://www.fdi.org.cn/lteconomy/index.jsp?currentPage=1&category=10&app=0000000000000000000005&language=en>

Cooperative Development: Exploitation, development and production are the levels of this high risk and high profit investment. Among other types, this cooperative development has a very small ratio as 0.17 percent.

Equity Joint Ventures: This kind of enterprises can be formed between foreign companies, enterprises, other economic organizations, individuals and Chinese companies, enterprises and other economic organizations in China. The capital of the enterprise is divided into two and the obligations and responsibilities of the parties are determined by the amount of the share they hold. The company burdens all the responsibilities coming from the debts while the shareholders both the foreign holder and the Chinese holder, hold the shares. With a very considerable amount, 27.05 percent, the equity joint ventures conducted 22.400 millions of dollars foreign investment flow in 2004.

Figure 25 indicates the distribution of the above detailed types of FDI in China. The percentage details are given in the explanation of the types above.

Figure 25. Composition of FDI types (Distribution among Different Types of FDI) by 2004



Note: Total amount is 60.59 billions of dollars.

Source: China Business Review, *China Data: A Macro Snapshot on China*, (2005), (online) <http://www.chinabusinessreview.com/public/0505/chinastats.pdf>, September 15th, 2006.

3.7 Methods of Measuring the FDI Performance in and the Potential for China

3.7.1 The Inward FDI Performance Index

Table 3.1 shows the inward FDI performance of China compared with the countries around the world through the period 2002 - 2004. As detailed in the previous chapter,

the inward performance index measures the country's FDI inflow rate relative to its economic size. GDP is used in calculation of this ratio. China was 46th among the world in the period 1988 – 1990 and 45th in the period 2002 – 2004 with a ratio of 2,134.⁴⁷

Table 3.1 The Inward FDI Performance Index Results between 2002 and 2004

Rank	Economy	Score
1	Azerbaijan	23.839
2	Belgium and Luxembourg	19.653
3	Brunei Darussalam	12.038
4	Angola	10.191
5	Ireland	7.865
6	Gambia	6.539
7	Hong Kong, China	6.531
8	Singapore	6.079
9	Mongolia	5.473
10	Congo	5.394

100	Philippines	0.592
101	Senegal	0.579
102	Pakistan	0.564
103	Norway	0.554
104	United Arab Emirates	0.547
105	Uzbekistan	0.535
106	Thailand	0.506
107	Paraguay	0.484
108	Egypt	0.481
109	Korea, Republic of	0.474

41	Botswana	2.258
42	Albania	2.220
43	Bolivia	2.188
44	Nigeria	2.142
45	China	2.134
46	Hungary	2.087
47	Latvia	2.053
48	Jordan	2.031
49	Spain	2.025
50	Viet Nam	2.004

131	Sierra Leone	0.175
132	Yemen	0.151
133	Haiti	0.122
134	Japan	0.100
135	Nepal	0.059
136	Indonesia	0.049
137	Cameroon	0.001
138	Kuwait	-0.036
139	Denmark	-0.132
140	Suriname	-3.9

Source: United Nations Conference on Trade and Development, *Inward FDI Performance Index - Results*, (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2471&lang=1>, September 17th, 2006.

⁴⁷ United Nations Conference on Trade and Development (2004). *World Investment Report: The Shifts towards Services*, United Nations, New York and Geneva, p. 281.

3.7.2 The Inward FDI Potential Index

The scores included in the FDI potential index of China by the period of 2000 – 2002 according to the calculations of UNCTAD are expressed below⁴⁸;

Real GDP Growth; 9%, score: 1

GDP per Capita; \$901.7, score: 0.021

Total Exports; 27.1% of GDP, score: 0.147

Telephone Mainlines; 137.7 of 1000 inhabitants, score: 0.185

Mobile Phones; 112.3 of 1000 inhabitants, score: 0.119

Energy Use per Capita; 897.5, score: 0.029

R&D Expenditures; 1% of GDP, score: 0.164

Students at the Tertiary Level: 0.95 of the total population, score: 0.144

Country Risk: 75 (composite risk rating), score: 0.697

Export of Natural Resources: 1.83 % of world total, score: 0.206

Imports of Parts: 5.21% of the world total, score: 0.294

Exports in services: 2.232% of the world total, score: 0.119

Inward FDI Stock: 5.987% of the world total, score: 0.308

Although the score of GDP growth has been very high, other factors have been affecting the Chinese overall potential index downwards. Table 3.2 indicates China's place among the 140 countries in the period of 2002 - 2004.

For the Inward Potential Index, while China was 41st country in the period 1988 – 1990, this level reached to the 38th among the world total in the period 2002 – 2004.⁴⁹ The results between 2002 and 2004 can be seen in the Table 3.2.

⁴⁸ United Nations Conference on Trade and Development (2004). *World Investment Report: The Shifts towards Services*, United Nations, New York and Geneva, p. 285.

⁴⁹ *Ibid.*

Table 3.2 The Inward FDI Potential Index Results between 2002 and 2004

Rank	Economy	Score (0-1)
1	United States	0.659
2	Norway	0.463
3	United Kingdom	0.460
4	Canada	0.457
5	Singapore	0.448
6	Sweden	0.438
7	Qatar	0.438
8	Germany	0.433
9	Belgium and Luxembourg	0.430
10	Ireland	0.427

71	Algeria	0.178
72	Turkey	0.176
73	South Africa	0.176
74	Venezuela	0.175
75	Egypt	0.173
76	Angola	0.170
77	Yemen	0.168
78	Armenia	0.164
79	Myanmar	0.162
80	Albania	0.161

31	Saudi Arabia	0.294
32	Estonia	0.282
33	Greece	0.281
34	Libyan Arab Jamahiriya	0.280
35	Malaysia	0.277
36	Portugal	0.275
37	Malta	0.273
38	China	0.269
39	Czech Republic	0.268
40	Hungary	0.267

131	Rwanda	0.085
132	Madagascar	0.084
133	Malawi	0.084
134	Benin	0.080
135	Nepal	0.080
136	Zambia	0.077
137	Haiti	0.066
138	Zimbabwe	0.049
139	Sierra Leone	0.034
140	Congo, Dem. Rep.	0.031

Source: United Nations Conference on Trade and Development, *Inward FDI Potential Index - Results*, (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2472&lang=1>, September 17th, 2006.

3.7.3 The Outward FDI Performance Index

The ratio of total FDI outflows of the country with respect to the country size among the world gives us the outward performance index value of that country. China was the 36th country by the period of 1988 – 1990 and became 72nd in the period 2002 - 2004.⁵⁰ Table 3.3 indicates China's location within the world.

Table 3.3 The Outward FDI Performance Index Results between 2002 and 2004

Rank	Economy	Index value
1	Belgium and Luxembourg	20.070
2	Panama	9.791
3	Hong Kong, China	7.002
4	Azerbaijan	6.535
5	Iceland	5.604
6	Bahrain	3.774
7	Singapore	3.526
8	Sweden	2.870
9	Switzerland	2.786
10	Spain	2.649

71	Uruguay	0.061
72	China	0.052
73	Jordan	0.050
74	Egypt	0.046
75	Sri Lanka	0.045
76	Paraguay	0.040
77	Romania	0.039
78	Congo	0.037
79	Guinea	0.036
80	Moldova, Republic of	0.033

51	Mexico	0.139
52	Greece	0.139
53	Armenia	0.135
54	India	0.131
55	Tajikistan	0.130
56	Costa Rica	0.126
57	Thailand	0.119
58	Senegal	0.115
59	Turkey	0.114
60	Angola	0.114

123	Togo	-0.070
124	Slovakia	-0.071
125	Bulgaria	-0.158
126	Namibia	-0.159
127	Belarus	-0.204
128	Gabon	-0.262
129	Denmark	-0.307
130	Kazakhstan	-0.568
131	Kyrgyzstan	-1.654
132	Kuwait	-3.127

Source: United Nations Conference on Trade and Development, *Outward FDI Performance Index - Results*, (online) <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1>, September 17th, 2006.

⁵⁰ United Nations Conference on Trade and Development (2004). *World Investment Report: The Shifts towards Services*, United Nations, New York and Geneva, p. 291.

3.8 FDI in China: Projects, Flows, Stocks

3.8.1 Contracted and Actualized FDI

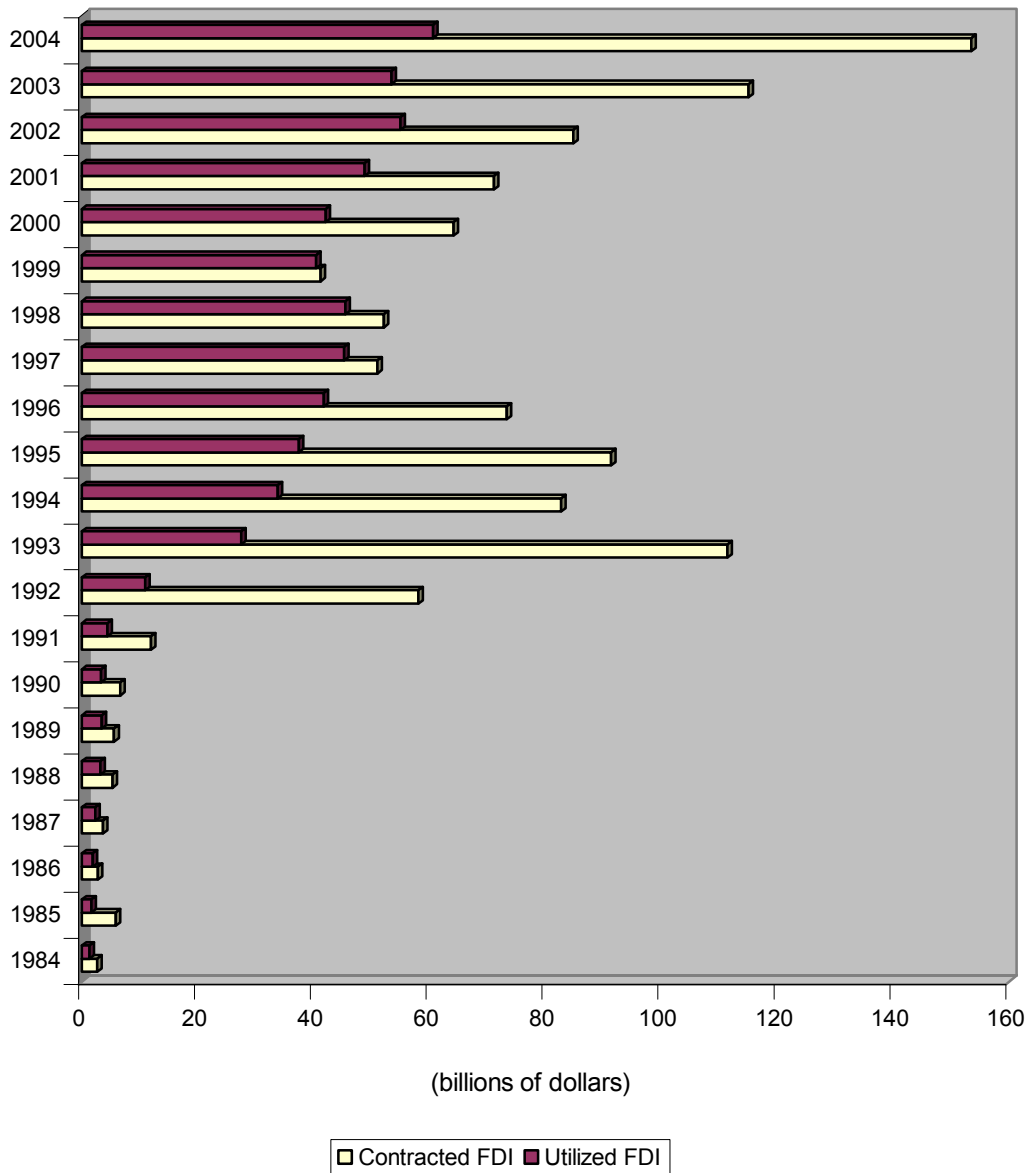
Since the available data for the contracted FDI may be different in various sources, it will be better to use the used FDI values rather than the contracted values. The correlation between them may also be misleading for the predictions about the future inflows.⁵¹

Contracted and used FDI data differs from each other by a gap that indicates how both parties (donor and host) are realistic in registering inflows. That gap for China was quite high in the early 1990s and narrowed after 1995. However, after 2000, the gap started to widen again reaching irrational amounts (i.e. the contracted FDI amounted to more than twice the actually utilized amount. In other words, more than 1 out of 2 dollars of FDI contracted is not used.)

Figure 26 indicates the contracted and used FDI values in a time-series path. The recent data for the contracted and utilized FDI value and their distribution among FDI types can also be seen in the Table 3.4.

⁵¹ US Department of State, 2005 *Investment Climate Statement – China*, (2005), (online) <http://www.usconsulate.org.hk/uscn/trade/sprpt/2005/ics.htm>

Figure 26. Contracted and Utilized FDI Inflows in China from 1984 to 2004



Sources: Chinability, *FDI inflows in US\$ billion, 1984-2003*, (online)

<http://www.chinability.com/FDI.htm>, September 13th, 2006; The Consulate General of Switzerland in Shanghai, *Economic Situation of China and the Yangtze River Delta for the First Half of 2005*, (2005), (online) <http://www.sinoptic.ch/shanghai/flash/2005/200505.htm>, September 13th, 2006.

Table 3.4 Distribution of the Contracted and Used FDI Data among FDI Types

	Number of Projects			Used FDI Value (\$ billion)		
	2005	2004	% Change	2005	2004	% Change
Total FDI	44,001	43,664	0.77	\$60.33	\$60.63	-0.5
EJVs	10,48	11,57	-9.42	\$14.61	\$16.39	-10.81
CJVs	1,166	1,343	-13.18	\$1.83	\$3.11	-41.15
WFOEs	32,308	30,708	5,21	\$42.96	\$40.22	6,81
FISVs	47	43	9,3	\$0.92	\$0.78	18.21

Source: The US-China Business Council, *FDI in China*, 2006, (online) http://www.uschina.org/statistics/fdi_cumulative.html, September 17th, 2006.

Where,

EJVs = equity joint ventures

CJVs = cooperative joint ventures

WFOEs = wholly foreign-owned enterprises

FISVs = foreign-invested shareholding ventures

As seen in the Table 3.4 in the year 2005, utilized FDI dropped 0.5 percent according to the previous year 2004 while the first quarter of the year 2006 has witnessed a 6.4 percent increase. In 2005, Ministry of Commerce reported that investments from 18 foreign banks, securities firms and insurance companies were ratified.⁵²

The Ministry of Commerce statistics indicate that in the first five months of the year of 2006, used FDI in central China has increased 10.5 percent when

⁵² China Daily, *Central China Sees Rapid FDI Inflow*, 2006, (online) http://www.chinadaily.com.cn/bizchina/2006-06/24/content_625113.htm, September 13th, 2006.

compared with the same period last year and reached to 1.5 billion dollars. This figure is 2.78 percent higher than the national average of used FDI increase and 1.74 percent higher than the western area.⁵³

The central region and the six provinces namely Shanxi, Anhui, Jiangxi, Henan, Hubei and Hunan stand at the core of the improvement policies for the Chinese policymakers since this region is less developed than the coastal provinces. According to the reports of the Ministry of Commerce, this region realized a rapid growth in actual FDI that many authorities called as a big success in the first quarter of 2006.⁵⁴

3.8.2 FDI Flows

According to the data taken UNCTAD, the FDI trends in China are detailed on the time series graphs below.⁵⁵

For the FDI inflows and the inward stocks, both trends indicate the FDI boom in 1990s, especially, after 1992. China reflects this boom completely. While the FDI inflow was 10.000 millions of dollars at the second half of 1992, this figure reached to the level of 60.000 millions of dollars for the second half of 2004 as seen in the Figure 27. However, the reverse effects of the Asian crisis also take place in the graph. From late 1998 to 2001, there was a decline, then the convergence process last in 2002. In the year 1992, the gap between the inflow and outflow started to increase and made a peak in the pre-crisis⁵⁶ period. The year 2002 stands as the China's outflow year that reached to the levels of approximately 9.000 millions of dollars.

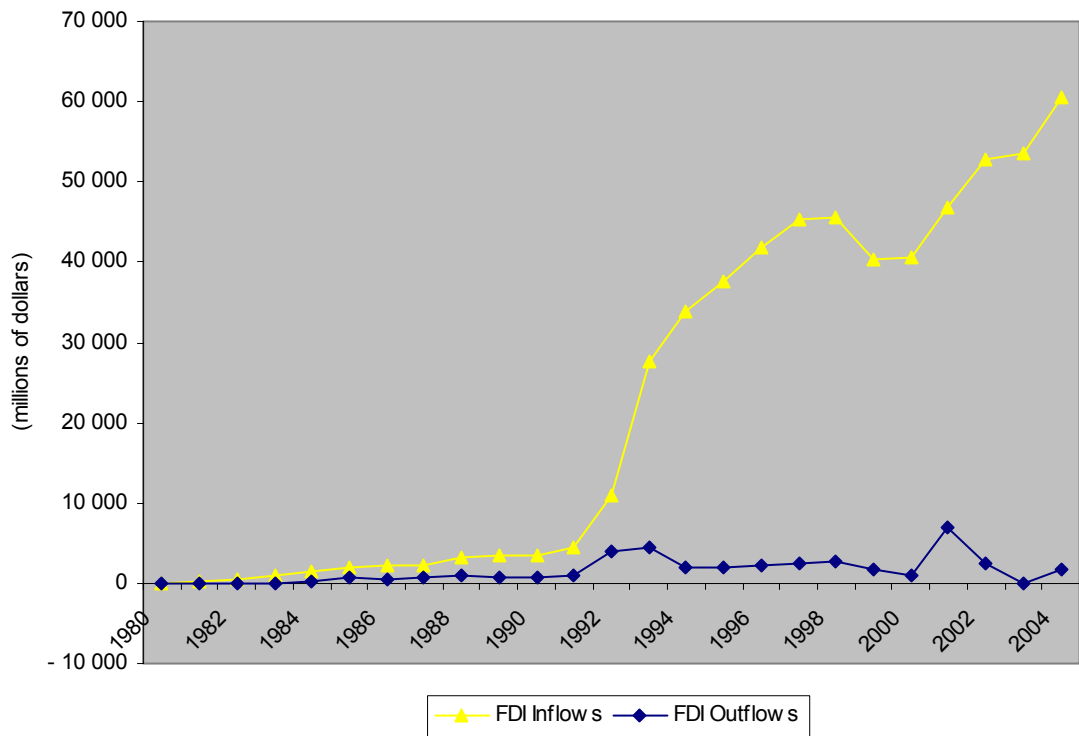
⁵³ China Daily, *Central China Sees Rapid FDI Inflow*, 2006, (online) http://www.chinadaily.com.cn/bizchina/2006-06/24/content_625113.htm, September 13th, 2006.

⁵⁴ *Ibid.*

⁵⁵ United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva.

⁵⁶ The reverse effects of the Asian Crisis can be seen from the graph. Since the huge amount of investments are coming from the Pacific Rim countries who had the crisis in their economies severely, the inflows declined sharply.

Figure 27. FDI Inflows and Outflows in China

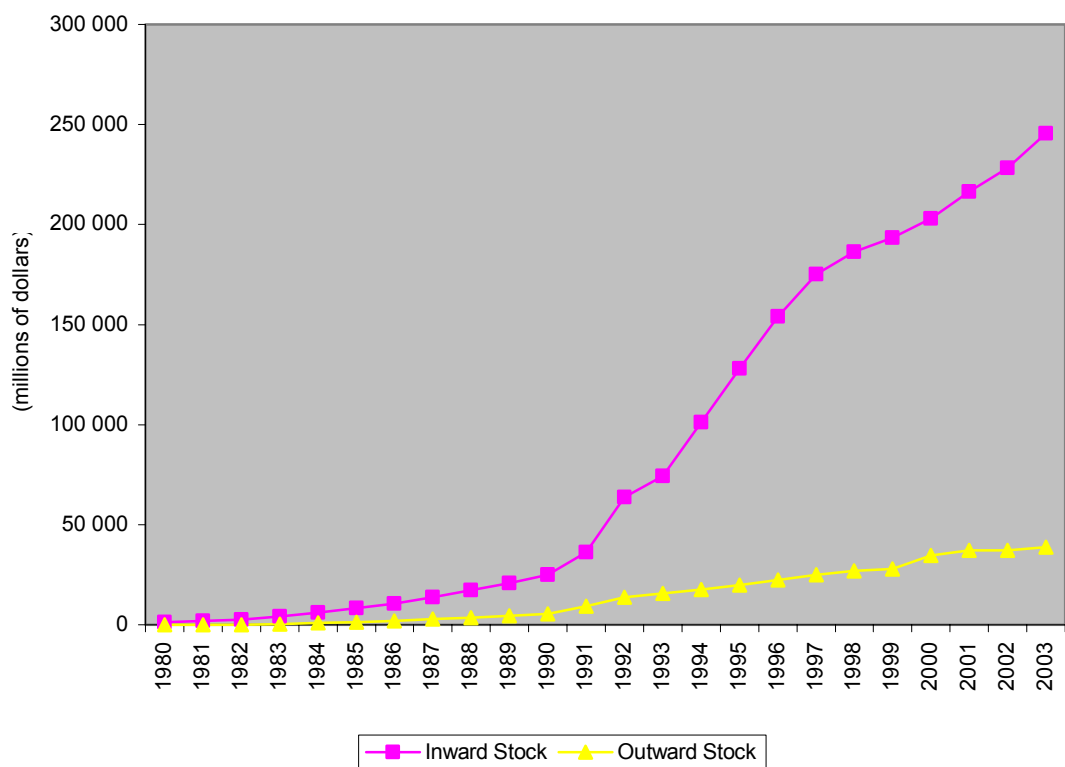


Source: United Nations Conference on Trade and Development, *FDI Inflows, by Host Region and Economy, 1970 - 2004*, 29/09/05 and *FDI Outflows, by Home Region and Economy, 1970 - 2004*, 29/09/05, (online) <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 17th, 2006.

3.8.3 FDI Stocks in China

Figure 28 indicates the FDI stock levels between the years 1980 and 2004. While the steepened piece of the graph shows the reflection of the FDI boom in China, flattened curve between 1998 and 2000 stylizes the reverse effects of the Asian crisis.

Figure 28. FDI Inward and Outward Stock in China



Source: United Nations Conference on Trade and Development, *Inward FDI Stock, by Host Region and Economy, 1980 - 2004*, 29/09/05, *FDI Outward Stock, by Home Region and Economy, 1970 - 2004*, (online) <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>, September 17th, 2006.

3.9 Impacts of FDI in the Chinese Economy

Foreign direct investments flowing in a country lead to many direct changes in related economy and indirect ones for international trade and global economy. China itself has been exposed to those changes thanks to skyrocketing FDI during the past two decades. We may distinguish the impacts of FDI on China's economy in to two sections; namely impacts of FDI on China's international trade and domestic effects of FDI.

3.9.1 The Impacts of FDI on China's International Trade

Since the opening up policy was formally established, foreign trade including China signaled to dominate international-worldwide trade. By the end of the last century, nearly one out of twenty five exported goods was registered to China (That was one out of hundred two decades prior to that date.). In other words, increase in the FDI inflow led to development of China's international trade and integration with the rest of the world (i.e. a major contribution in globalization of China.).

Researches conducted by OECD count up to 12 major impacts of FDI on China's international trade⁵⁷:

New Comparative Advantages: In manufacturing industries, labor costs constitute the hugest portion of operational expenses. That fact may help us predict which sectors China should have comparative advantages over other countries. These sectors producing leather, shoes, apparel, manufactured toys are labor-intensive and thus very developed in China.⁵⁸ However, industries requiring capital and technology such as machinery, engine, textile production and plastics were relatively weak before a very-well established FDI inflow as I have mentioned before. China

⁵⁷ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). "Main Determinants and Impacts of Foreign Direct Investment on China's Economy", *Working Papers on International Investment*, No. 4, p. 16.

⁵⁸ *Ibid.*, p. 17.

continued to have comparative advantages in labor-intensive products while developing new advantages in high-tech products.⁵⁹ We observe that fact in daily life in Turkey also. There is a rapid increase in export of Chinese electronics and hardware products to Turkey. China's expansion in specialization has been much affected by the foreign investors and companies who carried high-tech and know-how about these sectors to China. This process is still continuing and China will benefit from a wide range of expertise about many industries with its advantageously cheap workforce.

Increased Participation in the International Segmentation of Production: According to the Centre d'Études Prospectives et d'Informations Internationales (CEPII), primary products, basic manufactured, intermediate goods, equipment goods, mixed products, consumer goods, capital goods and others constitute the eight stages of production.⁶⁰ China has been experiencing weaknesses in intermediate products and capital goods while specializing in production of consumer goods. That specialization pattern resulted in adaptation to international segmentation of the production process: China imports intermediate products and assembly and transform them to export. Mostly, foreign companies lead that transformation with subsidiaries or joint-ventures founded in China. That process naturally enables China further develop assembly and transformation industries. Textile and consumer electronics assembly industries work very efficiently with billions of dollar annual export revenues in China.⁶¹

The Impact on China's Trade Growth: China's exports during the last decade doubled while imports increased by more than 75 per cent.⁶² Foreign Invested Enterprises (FIEs) lead the way in China's great quest of being the most crucial player of international trade throughout the world. Both imports and exports have been driven by mostly FIEs whereas domestic firms losing power and share each

⁵⁹ FUKAO, Kyoji, Hikari ISHIDO, Keiko ITO (2003). *op.cit.*, p. 3.

⁶⁰ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, pp. 19, 20.

⁶¹ LI Yong (2003). "The Impact of FDI on Trade: Evidence from China's Bilateral Trade", *Journal of the Academy of Business and Economics*, (online).

http://findarticles.com/p/articles/mi_m00GT/is_1_1/ai_113563595/pg_6, September 22nd, 2006, p. 6.

⁶² OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, pp. 19, 20.

day. China's trade policy has also affected export and import regimes; promoting exports and restricting imports as any host country would meaningfully prefer to do. Foreign affiliates with export orientation, thus, had many advantages and support so that their growth was quite rapid.⁶³ That growth is still continuing in parallel with China's trade growth.

The Role of FIEs in Processing Trade: Processing trade as we mentioned before is the assembly and/or transformation of intermediate goods and exportation. China is comparatively advantageous for processing trade activities thanks to tariff exemptions granted to intermediate products used in production of exports and cheap workforce. FIEs thoroughly realized that fact 15 years ago and now almost 3 out of 4 processing trade activities are run by those firms. Actually, increase in FDI and processing trade triggers each other; because FDI inflows increase opening up new FIEs in order to utilize from processing trade and as processing trade increases, more FDI flows in China for higher profitability. Mostly Japanese, American and European investors utilize from that trade increasing China's share in international processing trade.⁶⁴

The Comparative Trading Performance of FIEs: The industries which FIEs in China operate differ from the ones domestic firms are common in terms of two orientations; labor intensity and export-orientation. Foreign investors mostly utilize from China's supply of low labor cost and therefore concentrate on labor intensive industries like leather, textile, plastics and toy manufacturing industries.⁶⁵ In addition to labor intensity, export-oriented and technology intensive sectors are invested extremely by foreign investors and comparatively that fact booms China's exports. On the other hand, domestic firms export capital intensive products in moderate

⁶³ FUKAO, Kyoji, Hikari ISHIDO, Keiko ITO (2003). *op.cit.*, p. 3.

⁶⁴ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 20; The China Business Forum, *US-China Trade in Perspective: Asia's Emerging Union and Implications for the United States*, (online) <http://www.chinabusinessforum.org/pdf/gresserreport.pdf>, September, 22nd 2006, p. 1.

⁶⁵ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p.21, 22.

amounts. Other than that their contribution to China's total export may be neglected, which in turn assigns much importance to FIEs performance.⁶⁶

Building Dynamic Specializations: Foreign investors, especially Japan and USA origin firms, have been working hard to integrate China's comparative advantages to new manufacturing sectors besides traditional ones. That effort flourishes a very dynamic environment for Chinese industry in specialization process. As we mentioned in previous items, China has already specialized in assembly and transformation industries which heavily rely on imports of intermediate products. Instead of traditional industries like apparel and footwear producing industries, industries like electrical machinery and instruments require more high technology intermediate products. By introducing assembly and transformation sections of production of those items, high technology intermediate products are also introduced to China by FIEs, which in the long-run enables improvement in Chinese expertise in new industries.⁶⁷

Domestic Penetration of FIEs: FDI not only served in development of export industry, rather some portion of FDI is directly used to enter in to domestic markets in China. Domestic sales of FIEs are mainly parceled to 6 sectors: transport equipment, electronics and telecommunication equipment, food processing, electrical machinery and equipment, textiles and chemical materials. Moreover, in electronics and telecommunication sector, FIEs dominate the domestic market and in other sectors their market shares are expected to rise with new Multinational Enterprises entering in. To conclude from those facts, domestic firms face a fierce competition in not only export but also domestic markets with FIEs. Hence, they have to revise, restructure and improve their operational efficiency comparatively with FIEs in order

⁶⁶ Hkust Business School, *Why Some FDI's Do Better than the Others*, Autumn 2000, (online) <http://www.bm.ust.hk/newsletter/autumn2000/autumn00-09.html>, September, 22nd 2006.

⁶⁷ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 23; SAKAKIBARA Eisuke and Sharon YAMAKAWA (2003). "Regional Integration in East Asia: Challenges and Opportunities, Part Two: Trade, Finance and Integration", *Policy Research Working Paper*, WPS. 3079, p. 40.

to survive. FDI pushes them to struggle hard to develop so that China's economy benefits much from that competition.⁶⁸

Rising Local Content: Processing trade surplus has been increasing since the mid 1990s, indicating considerable value added to intermediate products in China. Actually, domestic firms seem more profitable in processing trade since their tendency is to produce intermediate products locally instead of importing them like FIEs. In both situations, many enterprises try to incorporate all production stages in to China so more products are directly produced and sold to the world from China. Lack of an intra-firm pricing, therefore, leads to rising of local content.⁶⁹

Exchange Rate: Another indirect effect of foreign direct investment is the isolation of China from exchange rate fluctuations. That phenomenon actually stems from increase in processing trade since that kind of trade mainly depends on foreign currency; say US dollars in real terms.⁷⁰ During the Asian financial crisis, Yuan stood stronger against other Asian currencies by the help of inflows from processing trade. (That strength, however, raised the fear that Yuan would have to be devalued; yet, contrarily no devaluation occurred.)⁷¹

Domestic Firms Have Lagged Behind: Domestic firms have lagged behind FIEs in sales since 1992. However, it is not evident that they suffered from the competition of FIEs. It is safe to assert that domestic firms had to specialize in different sectors than sectors at which FIEs were relatively more powerful. Duties exemptions granted to foreign firms create a difference in access to imported machinery and thus the total production.⁷² That benefit provided to FIEs makes domestic firms lag behind in an indirect way.⁷³

⁶⁸ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 25; SAKAKIBARA Eisuke and Sharon YAMAKAWA (2003). *op.cit.*, p. 2, 3, 97.

⁶⁹ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 24.

⁷⁰ SAKAKIBARA Eisuke and Sharon YAMAKAWA (2003). *op.cit.*, p. 2, 3.

⁷¹ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 24.

⁷² *Ibid.*, p. 25.

⁷³ HUANG Yasheng (2000). "Why is Foreign Direct Investment Too Much of a Good Thing for china?", *Modern Asia Series, Harvard University Asia Center*, (online) www.fas.harvard.edu/~asiactr/Archive%20Files/Huang%20MAS%20FEB%202000.pdf, p. 3.

Regional Disparities Have Increased: As mentioned in the parts above this chapter, regional distribution of economic openness and integration to foreign trade appears to be parallel with the distribution of FDI in China. Coastal provinces of South-east China attract more FDI than any other region and thus their integration to international trade is much faster. Therefore, inland economies lag behind with increasing gap between the coastal economies at integration process.⁷⁴

The Impact on China's Balance of Payments: China's foreign trade has been dominated by FIEs during the past two decades. Those enterprises operate mostly at export-oriented sectors. Apparently they earn foreign exchange surplus which contributes positively to China's balance of payments and foreign exchange reserves. That fact ensured China to sustain economic growth during the Asian financial crisis at the end of the century.⁷⁵

Mainly two factors will determine whether China will continue to benefit from that balance of payments surplus: the export performance of FIEs and new-coming FDI inflows. Both factors mean more foreign investments in China and consequently more exports. Increase in exports would definitely heal China's fragility against balance of payments.⁷⁶

3.9.2 Domestic Effects

OECD also counts up 8 major domestic impacts of FDI on China:⁷⁷

FDI - An Increasingly Important Source of Capital: FDI has been the one of the most crucial source of capital during the past two decades.⁷⁸ The ratio of FDI to GDP has been increasing year by year like FDI inflows. The share of FDI in

⁷⁴ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 24, 25.

⁷⁵ *Ibid.*, p. 25.

⁷⁶ *Ibid.*, p. 25.

⁷⁷ *Ibid.*, p. 26.

⁷⁸ HUANG Yasheng (2000). *op.cit.*, p. 3.

domestic gross investment has reached to 15 per cent in 1994 and more than 10 per cent of China's domestic fixed capital formation is realized by FDI inflows. Despite those increases in FDI inflows and shares in China's economy, still FDI inflows are not being used efficiently. Statistics indicate that nearly 60 to 70 per cent of FDI inflows are utilized as fixed capital investment and remaining portion stays as working capital, short-term investments and inventory.⁷⁹

FDI Has Created Jobs: Unemployment is one of the most crucial issues in developing economies: capital is scarce whereas labor is abundant. FDI inflows in China help avoid that scarcity and create new employment opportunities for tens of millions of Chinese.⁸⁰ As expected, FDI's contribution in employment opportunities concentrate on labor intensive sectors like leather, clothing, education and sports products and some technology intensive sectors like electronic equipment and electrical machinery. Looking at FDI's regional distribution, we may assert that more job opportunities are created in the eastern regions than in the central and western regions of China. From that it is inferred that FDI contributes to widening gap between the eastern and western regions of China by creating unevenly distributed jobs.⁸¹

FDI Has Upgraded Skills: Technically an industry employs four types of workforce: workers and apprentices, technicians and professionals, managerial staff and clerical and administrative staff. Workers and apprentices are the ones who are directly involved in manufacturing. When we look at their distribution within FIEs and domestic firms, we see workers and apprentices are higher, and clerical and administrative staff is lower in ratio in FIEs than in domestic firms. That situation justifies that FDI firms electively form the workforce with higher labor utilization by employing more to direct manufacturing. In addition, statistics show that FDI firms hire more university graduates and professionals than domestic firms do in China. Therefore, labor quality is higher in FDI firms and that fact may cause severe

⁷⁹ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 26.

⁸⁰ GRAHAM, Edward M. and Erika WADA (2001). *op.cit.*, p. 11.

⁸¹ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 27.

problems for domestic firms. Since FDI firms pay higher wages, skilled and educated workforce is slipping towards to those firms, thus leaving domestic firms with low skilled labor and technology.⁸²

FDI Has Paid Higher Wages: FDI firms generally provide more benefits to their employees than domestic firms do worldwide. In China, in terms of wages, bonuses and fringe benefits, this situation is also valid except for two sectors: petroleum refining and coking.⁸³ Domestic firms in China traditionally try to minimize labor costs by cutting wages; however, labor costs are not only related with wages/salaries but also highly linked with productivity. Hence, paying relatively low does not guarantee minimization of labor costs due to low productivity. Domestic firms suffer from that fact much as they have to compete with FIEs in order to attract skilled and productive workforce. Therefore, they have to pay higher wages and offer more benefits; which in long-term heals worker conditions in China.⁸⁴

FDI Has Risen Factor Productivity and Increased Technology Transfer: Both managerial skills and technology are transferred to China by FDI firms. This claim implies that FDI firms more developed than domestic firms in terms of managerial skills and technology. First of all, FDI firms benefit from economy of scale more efficiently and generally have higher capital to labor ratio compared with domestic competitors. That ratio showing the physical capital intensity is the highest in technology intensive industries, then, second highest in capital intensive industries and lowest in labor intensive industries.⁸⁵ In the presence of that classification, FDI firms in China can be categorized to engage in technologically advanced production methods. In addition to intensive utilization from advanced technology, FDI firms follow up a different human resources policy than domestic firms. FDI firms usually have higher human capital intensity since they provide higher benefits to attract skillful workforce and that workforce guarantees higher productivity. Those facts

⁸² YUSSOF Ishak and Rahmah Ismail (2002). "Human Resource Competitiveness and Inflow of Foreign Direct Investment to the Asean Region", *Asia-Pacific Development Journal*, Vol. 9, No. 1, p. 90; OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, pp. 27, 28.

⁸³ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 29.

⁸⁴ YUSSOF Ishak and Rahmah Ismail (2002). *op.cit.*, pp. 97, 98.

⁸⁵ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 28.

reflect on factor productivities of FDI firms. On average, labor productivity of FDI firms is two and a half times and capital productivity is one and a half times that of domestic firms. When we look at marginal productivities, we see that domestic firms dominate numerically; meaning almost perfect competition pushes domestic firms to raise their factor productivities by adopting technology, attracting high-skilled workforce and developing qualitative managerial skills.⁸⁶

FDI Has Modified China's Industrial Structure: FDI finances three out of five industrial activities in China. It is not surprising that foreign investors prominently choose industry for their investments. However, foreign investments in service sectors are relatively low in China when compared with other FDI attracting developing countries.⁸⁷ That fact stems from the fact that China still imposes barriers to entry in strategic service sectors such as transportation, communication, energy and trade of particular goods. Supplying service to nearly 1.3 billion people draws foreign investors' attention very much, and China's accession to the World Trade Organization seems to butter up their bread because China had to open up service sectors after that event.⁸⁸

FDI Has Increased Domestic Competition: FIEs surpassed state-owned enterprises and collective enterprises in production of electronic products, cultural and sports goods and leather products. Collective and private enterprises are responsible for half of the production in many sectors but SOEs dominate 6 sectors: tobacco, timber, petroleum and gas extraction, petroleum processing, coal mining, and ferrous metallurgy, i.e mostly heavy industries. That segmentation is a result of competition among FIEs, SOEs and collective and private enterprises. Their competition led to lower profits in many sectors and later they distinguished their activities into different sectors. SOEs, which were monopolies in each sector prior to opening up, suffered most from that competition. They demonstrated poor financial

⁸⁶ GRAHAM, Edward M. and Erika WADA (2001). *op.cit.*, pp. 11, 12.

⁸⁷ ROSEN, D. (1999) "Behind the Open Door: Foreign Enterprise Establishment in China", Washington, DC: Institute for International Economics, (online) www.iie.com/publications/chapters_preview/23/2ie2636.pdf, p. 78.

⁸⁸ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 30.

performances after 1980 although non-state owned domestic firms were doing well. Those firms either privately or collectively owned still supply more than 80 per cent of domestic demand for industrial good in average.⁸⁹ The strong existence of FIEs increases the competition among those firms in domestic production and imports since FIEs have comparative advantage in importing instruments, machinery and intermediate products. With the accession of China in the WTO, tariffs on industrial products drastically dropped favoring a much fiercer competition from imports.⁹⁰

FDI Has Increased Industrial Performance: It is statistically proven that a direct relationship exists between the share of foreign capital in total capital and the annual growth rate of industrial production. That fact leads the foreign-capital driven industries beyond the others. According to UNCTAD in 2000-2001, the foreign affiliates contribute to 23% of China's industrial production. Due to uneven distribution of foreign capital among different regions of China, output elasticity with respect to foreign capital is higher in the coastal regions than in the inland regions of China. In other words, for a given amount of foreign capital variation, production varies more in the coastal regions than it does in the inland regions. That positive correlation clearly states that FDI increases industrial performance of the host country.⁹¹

⁸⁹ OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, p. 34.

⁹⁰ BRAUNSTEIN Elissa and Gerald EPSTEIN (2002). "Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?", *Center for Economic Policy Analysis Working Paper*, No. 13, pp. 2, 32.

⁹¹ tdcTrade.com, *Foreign Direct Investment in China*, 2003, (online) <http://www.tdctrade.com/econforum/boc/boc030101.htm>; OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). *op.cit.*, pp. 35, 36.

CONCLUSION

This thesis is about the FDI, its development and the impacts on the Chinese economy. We started with the “The Great Wall of China” by Kafka and explored the degree of integration of China. Is this wall still isolating China from the outsiders or is it just no more than a fascinating construction. FDI is one of the ways that is likely to integrate China with the world.

Chinese history gives us the first clues about the uniqueness of the civilization like plenty of important inventions such as paper, gunpowder, iron plows, trace harness and important medical founding. The 20th century of Chinese history is filled with abrupt transitions from dynasties to republic, Mao era and finally a capitalist regime started by Deng Xiaoping. Many significant reforms have conducted both in the Mao era and in the capitalist regime in agriculture, industry and energy beside many others. We tried to explain the current situation by choosing some of the important factors as agriculture, industrialization, energy, and the income inequality. Examining those factors also helped us in comprehending the dimensions and the reflections of the transformation within the economy. The 20th century reforms account for the most crucial roots of those economic features reflecting the social and political changes. The agricultural transformation brought new systems with the land reforms. Industrial outputs have increased significantly within the near past. Such kind of a transformation caused an increasing energy need and efforts to find new resources. Since then, China has been dealing with the environmental problems as a consequence of rapid industrialization, especially for the last decade.

FDI has been our key variable in analyzing the Chinese economy. The historical background and development of FDI is examined before its application in China. Examining global FDI trends enabled us to compare and contrast Chinese experience with FDI with these trends. The interaction between the open economies led FDI spread among the world. The 20th century witnessed a significant increase in

the FDI flows whose volume reached to the billions of dollars. Especially by the post 1980s period, we can mention an FDI boom all around the world. While the FDI outflows from the developed countries had a rising trend, the FDI inflows to the developed countries jumped to the amazing levels. The sectoral distribution of the FDI also changed on behalf of the service sector within the world. Although, the FDI flows to the manufacturing sector still have the highest portion in the developing countries, for the developed countries the service sector investments prevail especially after the 1980s.

China opened her markets by the 1980s and started to witness the effects of globalization which were reflected by the unusual economic trends in the country when compared with the pre-80s period. Examining FDI in the world enabled us to determine the main features which are examined for China later. In China, FDI is mostly vertical and resource seeking as many other developing countries. The dominance of the investments in the manufacturing sector is significant although the dominance of the service sector is significant in the world. The regional distribution, however, arises as one of the most interesting features. While the coastal regions have the ultimate share of the investments, the hinterland rarely receives foreign investment flows. The government aims at increasing the market seeking and horizontal investments and encourages service sector investments. Also the investments to the Central China are encouraged.

Although globalization started in the early 1900s¹, the emergence of the FDI in China was after 1980s since the economy was closed to the outside world before. By the 1980s, openness and hence FDI made great changes on the Chinese economy on both the macro and the micro scale. The doors opened to the outsiders and the markets became competitive both in domestic and international terms. China is now a fear for those outsiders with her high competitive power. WTO is also a factor which facilitated the integration. For the WTO accession, she obeyed the rules of the organization and is still trying to rearrange many social and economic regulations

¹ Sun Yat Sen, revolutionary leader of China, educated abroad and became a doctor. He was affected from the revolutionary waves in the world and his ideas lead the future of the country.

according to the standards of the WTO. The policies of the government concerning international trade were totally altered. By the encouragements for the foreign investors, FDI flows have been accelerating for more than two decades.

There have been numerous essential changes even about the roots of the country since then. Our main question was about the existence of the Great Wall and its possible impacts on the isolation from the global system. The openness and the FDI seem to destroy it. At this point, another passage of Kafka will help us in order to make a better interpretation about post 1980 era and its possible impacts on the Great Wall.

Kafka mentions a very interesting feature about The Wall's construction in his book; "... *It was for this reason that the system of piecemeal construction was chosen; five hundred yards could be accomplished in about five years*". The piecemeal construction is very important, because this style of the work is interestingly related to the impacts of the economic changes of China's today. The Wall also arises as a symbol in China's uniqueness. The piecemeal construction was chosen in order not to exasperate labourers with a continuous and unending work. Instead of a massive construction, to destroy a piecemeal work is more confusing since a knock on a massive wall indicates a break down. Those knocks in a piecemeal construction is rarely noticeable. As a piecemeal constructed wall, the Chinese economy still reflects features specific to its own past despite increasing contact with the outside world. FDI as a new economic factor has made great changes on the structure of the Chinese economy and altered many of the restrictions. However, there is still huge difficulties for the foreign investors in deciding when, where and how to invest since the cultural and governmental differences may cause investment failures.

China differs from other countries; even from her neighbors located in the Mainland China from the governance to the life style. Her uniqueness arises as an effective factor for the economic developments and changes. As for FDI, it is obvious that investing in China requires different analysis for an investor. In order to

have an enterprise, an astute investor should examine cultural, economic, regulative and even linguistic peculiarities of the region beside the country's own. This may be same as the case in the world, but as I have mentioned in Chapter 3, in China, 80% of the foreign owned enterprises have gone bankrupt because of the adverse effects coming from those differences. Moreover, even the other countries located in the mainland China as Hong Kong, Macao and Taiwan have this risk. In order to get rid of the risk of investment, those countries prefer the regions similar to their countries by the dialect or cultural characteristics for the FDIs. When we look at the governmental restrictions, the regime and the people living within, there are numerous unique features that should be taken into account. Those features are also effective for the impacts of the FDI.

As a consequence, China, today, is an open giant in which many of the economic activities of Western Europe or US can be conducted. Did this destroy The Wall protecting China from the Northern Barbarians as closing her inside the land? We have tried to bring out the parallelism between the uniqueness of the Chinese economy and the uniqueness of The Wall. Piecemeal construction, as mentioned with the Kafka's words above, means there is not a total collapse. The Wall has been being broken down since the early 1900 and at an accelerating rate since the 1980s. FDI has been a significant economic factor in getting rid of many segments of the so called Wall while many other segments still continue to exist. FDI is still falters because of the problems arising from the manners about China's own.

For the future, if the economy and the trends do not witness an evolutionary change, other segments of the wall are strongly possible to be destroyed. In this period, FDI and many other elements of the open economy will probably continue to increase. Even though those integrating factors continuously strengthen, it seems impossible for a country like China to be the same as a Western Europe country or even a neighbor. All the things be the same, China will be a more open country in the future. The flows of FDI will continue to increase, also its share in the country's GDP. However, every single foreign investor will be supposed to learn some basic peculiarities of the region to invest in and the actual government regulations on that

region. The profile of China combined by her civilization, history and culture will modify itself according to the conditions of today but it will also require any of the entries to learn about country and to compromise.

REFERENCES

ANDREWS, Philip (2000). "Reform of China's Energy Sector: Slow Progress to an Uncertain Goal" in *The Chinese Economy under Transition*, ed. by Sarah COOK, Shujie YAO and Juxong ZHUANG, New York: St. Martin's Press; London: Macmillan Pres, pp. 111-130.

ASHWORTH, William. (1967). *The International Economy since 1850*, London, UK: Longmans.

BALDI, Ambassador M. (2000). "Global Investment Trends and Policies: An OECD Perspective", *OECD-China Conference on Foreign Direct Investment*, (online) <http://www.oecd.org/dataoecd/11/23/1902814.pdf>, September 15th, 2006, pp. 1-6.

BANISTER, Judith (2005). "Manufacturing Earnings and Compensation in China", *Monthly Labour Review Online*, Vol.128, No. 8, pp. 22-40.

BEYAN, Alan A. and Saul ESTRIN (2000). "The Determinants of Foreign Direct Investment in Transition Economies", *William Davidson Institute Working Papers Series*, No: 342, (online) www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp342.pdf, September 15th, 2006, pp. 1-57.

BRAUNSTEIN Elissa and Gerald EPSTEIN (2002). "Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?", Center for Economic Policy Analysis Working Paper 2002-13, (online) www.newschool.edu/cepa/publications/workingpapers/archive/cepa200213.pdf, September 15th, 2006, pp. 1-45.

CHANDLER, Alfred D. (1989), "Technological and Organizational Underpinnings of Modern Industrial Multinational Enterprise: The Dynamics of Competitive

Advantage”, in *Multinational Enterprise in Historical Perspective*, ed. by Alice TEICHOVA, Maurice LÉVY-LEBOYER, and Helga NUSSBAUM, Cambridge University Press: Cambridge, UK., pp. 30-54.

CHANTASASAWAT, Busakorn, K. C. FUNG and Hitomi LIZAKA (2005). "The Giant Sucking Sound: Is China Diverting Foreign Direct Investments from Other Asian Economies?", Department of Economics, UCSC, No: 594. (online) <http://repositories.cdlib.org/ucscecon/594>, September 15th, 2006, pp. 1-30.

CHEN, John-Ren (2000). “Foreign Direct Investment, International Financial Flows and Geography”, in *Foreign Direct Investment*, ed. by John-Ren CHEN New York, USA: Palgrave Publishers, pp. 6-33.

CHEN, Kai and Colin BROWN (2001). “Addressing shortcomings in the Household Responsibility System Empirical analysis of the Two-Farmland System in Shandong Province” *China Economic Review*, Vol. 12, issue. 4, pp. 280-292.

COALE, Ansley J. (1984). *Rapid Population Change in China, 1952-1982*, Washington, DC, USA: National Academies Press.

COHEN, Warren (1997) *China: Understanding Its Past*, Honolulu, HI, US: University of Hawaii Press.

DASGUPTA Nandita (2004) “Foreign Direct Investment Inflows to India since the 1990s – Issues and Challenges: Comparison with China”, (online) http://www.umbc.edu/economics/seminar_1.html, September 14th, 2006.

DIXIT, Avinash (1992). “Investment and Hysteresis”, *Journal of Economic Perspectives*, Vol.6, No.1, pp. 107-132.

FUKAO Kyoji, Hikari ISHIDO and Keiko ITO (2003). "Vertical Intra-Industry Trade and Foreign Direct Investment in East Asia" *Discussion Paper Series*, a434,

Institute of Economic Research, Hitotsubashi University, (online) <http://www.ier.hit-u.ac.jp/Common/publication/DP/DP434.pdf>, September 15th, 2006, pp. 1-57.

GAO, Ting (2003). "Ethnic Chinese Networks and International Investment Evidence from Inward FDI in China", *Journal of Asian Economics*, Vol. 14, issue. 4, pp. 611-629.

GATTAI, Valeria (2003). "Foreign Direct Investment in China: The Entry Mode Choice Evidence from the Italian Case", Institute of Economic and Social Studies on South East Asia, (online) http://www.unisi.it/santachiara/aree/conf_phd_econ2003/conference_siena/papers/gattai.pdf, September 13th, 2006, pp. 1-36.

GRAHAM, Edward M. and Erika WADA (2001). "Foreign Direct Investment in China: Effects on Growth and Economic Performance", *IIE Working Paper Series*, WP01-3, (online) <http://ideas.repec.org/p/iie/wpaper/wp01-3.html>, September 15th, 2006, pp. 1-30.

HU, Albert G. and Robert F. OWEN (2005). "Gravitation at Home and Abroad: Regional Distribution of FDI in China", (online) http://www.aeaweb.org/annual_mtg_papers/2006/0107_0800_0503.pdf, September 13th, 2006.

HUANG, Jikun and Scott ROZELLE (2006). "The Emergence of Agricultural Commodity Markets in China", *China Economic Review*, Vol. 17, No. 3, pp. 266-280.

HUANG Yasheng (2000). "Why is Foreign Direct Investment Too Much of a Good Thing for china?", *Modern Asia Series, Harvard University Asia Center*, (online) www.fas.harvard.edu/~asiactr/Archive%20Files/Huang%20MAS%20FEB%202000.pdf, September 5th, 2006, pp. 1-4.

JIAGI, Yan and Gao Gao (1996). *Turbulent Decade: A History of the Cultural Revolution*, edited and translated by D. W. KWOK, Honolulu, HI, USA: University of Hawaii Press.

JOHNSON, D. Gale (1998). "China's Rural and Agricultural Reforms in Perspective", Office of Agricultural Economics Research, The University of Chicago, No. 98:01, pp. 1-8.

KAFKA, Franz (1992). *The Great Wall of China*, London, UK: Penguin Books.

KRUSEKOPH, C. Charles (2002). "Diversity in Land-Tenure Arrangements under the Household Responsibility System in China", *China Economic Review*, Vol. 13, issue 2-3, pp. 297-312.

LEMOINE, Olga W. (2005). "Organizational Business Models in International Operations - The Logistics Service Provider Industry", *Center for Anvendt Logistik og Transportforskning*, notat nr. 9, (online) <http://www.calt.dk/notater/CALT-Notat9.pdf>, pp. 1-93.

MOORE, Thomas G. (2001). *China in the World Market: Chinese Industry and International Sources of Reform in the Post-Mao Era*, Port Chester, NY, US: Cambridge UP.

MOOSA, Imad A. (2002). *Foreign Direct Investment: Theory, Evidence and Practice*. New York, USA: Palgrave Macmillan.

MORTON, Scott W. (2004). *China: Its History and Culture*, Blacklick, Ohio, US: McGraw Hill Companies.

OBSTFELD, Maurice and Alan M. TAYLOR (2002). "Globalization and Capital Markets", *National Bureau of Economic Research*, Working Paper, N8846, Cambridge, MA, pp. 1-69.

OECD Directorate for Financial, Fiscal and Enterprise Affairs (2000). "Main Determinants and Impacts of Foreign Direct Investment on China's Economy", *Working Papers on International Investment*, No. 4, (online) <http://www.oecd.org/dataoecd/57/23/1922648.pdf>, Septemebr 15th, 2006, pp. 1-38.

PEARSON, Margaret M. (1992). *Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment under Socialism*, Ewing, NJ, USA: Princeton University Press.

PERSHIN, Vitaly (2003). *Essays In The Economics Of Foreign Direct Investment*, unpublished doctoral dissertation, The University of Western Australia, (online) http://www.ecom.uwa.edu.au/research/research_centres/economics_research_centre, September 21st, 2006.

PINGYAO, Lai (2002). "Foreign Direct Investment in China: Recent Trends and Patterns", *China & World Economy*, Vol. 10, No. 2, p. 25-32.

Porter, Michael (1990). "The Competitive Advantage of Nations", *Harvard Business Review* March-April: 73-93, New York, US.

QIREN, Zhou (2000). "Property Rights and New Commercial Organizations: A Comparison of Agricultural Reform in China and Russia", in *The Chinese Economy under Transition*, ed. by Sarah COOK, Shujie YAO and Juxong ZHUANG, New York: St. Martin's Press, London: Macmillan Press, pp. 150-157.

SAKAKIBARA Eisuke and Sharon YAMAKAWA (2003). "Regional Integration in East Asia: Challenges and Opportunities, Part Two: Trade, Finance and Integration", *Policy Research Working Paper*, WPS. 3079, pp. 1-160.

TAUBE, Markus and Mehmet ÖĞÜTÇÜ (2002). "Main Issues on Foreign Investment in China's Regional Development: Prospects and Policy Challenges" in

In *Foreign Direct Investment in China: Challenges and Prospects for Regional Development*. Paris: OECD, (online) www.oecd.org/dataoecd/30/23/1939560.pdf pp. 1-37

United Nations Conference on Trade and Development (2005). *World Investment Report: Transnational Corporations and the Internationalization of R&D*, United Nations, New York and Geneva.

United Nations Conference on Trade and Development (2004). *World Investment Report: The Shifts towards Services*, United Nations, New York and Geneva.

United Nations Conference on Trade and Development (2002). *World Investment Report: Transnational Corporations and Export Competitiveness*, United Nations, New York and Geneva.

United Nations Conference on Trade and Development (1999). *World Investment Report: Transnational Corporations and Export Competitiveness*, United Nations, New York and Geneva.

ROSEN, D. (1999). "Behind the Open Door: Foreign Enterprise Establishment in China", Washington, DC: Institute for International Economics, (online) www.iie.com/publications/chapters_preview/23/2iie2636.pdf, pp. 17-83.

VAN KEMENADE, Willem (1997). *China, Hong Kong, Taiwan, Incorporated*, Westminster, MD, USA: Alfred A. Knopf Incorporated.

VICTOR David G., Thomas C. HELLER, Joshua HOUSE, and Pei Yee WOO (2004). "Experience with Independent Power Projects (IPPs) in Developing Countries: The Introduction and Case Study Methods", *Program on Energy and Sustainable Development Working Paper*, No: 23, (online) http://iis-db.stanford.edu/pubs/20528/wp23_19_April_04.pdf, pp. 1-62.

WILKINS, Mira. (1970). *The Emergence of Multinational Enterprise*, Cambridge, MA, UK: Harvard University Press.

WRIGHT, David C. (2001). *History of China*, Westport, CT, US: Greenwood Publishing Group, Incorporated.

YIN, Xiangkang and Chongwoo CHOE (2000). "Contract Management Responsibility System and Profit Incentives in China's State-Owned Enterprises", *China Economic Review*, Vol. 11, issue. 1, pp. 98-112.

YUSSOF Ishak and Rahmah Ismail (2002). "Human Resource Competitiveness and Inflow of Foreign Direct Investment to the Asian Region", *Asia-Pacific Development Journal*, Vol. 9, No. 1, pp. 89-107.

ZHANG, Kevin H. (2002), "Why Does China Receive So Much Foreign Direct Investment?" *China & World Economy*, Vol. 10, No. 3. pp. 49-58.

ZHANG, Wei-wei (1999). *Transforming China*, New York, NY USA: Palgrave Publishers.

ZHANG Xiabo (2006), "Asymmetric Property Rights in China's Economic Growth", *DSGD Discussion Paper*, No. 28, Washington, D. C.: International Food Research Institute, Development Strategy and Government Division, (online) www.aeaweb.org/annual_mtg_papers/2006/0108_1300_0204.pdf, September 15th, 2006, pp. 1-29.

ZHANG, Xiaobo, Tim D. MOUNT and Richard N. BOISVERT (2006). "Industrialization, Urbanization, and Land Use in China", *EPTD Discussion Paper*, No. 58, (online) www.ifpri.org/divs/eptd/dp/papers/eptdp58.pdf, September 15th, 2006, pp. 1-46.

ZWEIG, David and Bi JIANHAI (2005). "China's Global Hunt for Energy", *Foreign Affairs*, Vol. 84, No. 5, pp. 25-38.

e-sources;

10th European Country of Origin Information Seminar, *China*, 2005, (online)
<http://www.unhcr.org/cgi-bin/texis/vtx/home/opendoc.pdf?tbl=RSDCOI&id=4451d8c64#search=%22china%2C%20square%20km%2C%209%20596%20960%22>, September 13th, 2006.

BBC News, *China's Rural Millions Left Behind*, 2006, (online)
<http://news.bbc.co.uk/2/hi/asia-pacific/4782194.stm>, September 15th, 2006.

Business Week Online, *China's Dirty Face*, 2005, (online)
http://images.businessweek.com/ss/05/08/environment/index_01.htm, September 13th, 2006.

China Business Review, *China Data: A Macro Snapshot on China*, (2005), (online)
<http://www.chinabusinessreview.com/public/0505/chinastats.pdf>, September 13th, 2006.

China Council for International Cooperation on Environment and Development (CCICED) (2004). *Sustainable Agricultural and Rural Development; In the New Era of Development: Preparing for the Future*, (online),
http://www.harbour.sfu.ca/dlam/_ftn1, September 13th, 2006.

China Daily, *Central China Sees Rapid FDI Inflow*, 2006, (online)
http://www.chinadaily.com.cn/bizchina/2006-06/24/content_625113.htm, September 13th, 2006.

China Internet Information Center, *Total Production of Energy and Its Composition*, 2004, (online) <http://www.china.org.cn/english/en-shuzi2004/jj/biao/7-1.htm>, September 13th, 2006.

China National Tourism Administration. *Industry*, (online)
<http://old.cnta.gov.cn/lyen/brief/industry/introduction.htm>, September 13th, 2006.

Index-china-com, (online)
http://images.google.com.tr/imgres?imgurl=http://www.index-china.com/index-english/images/CHINA%2520map.gif&imgrefurl=http://www.index-china.com/index-english/china_map_index.htm&h=482&w=508&sz=59&hl=tr&start=1&tbnid=iUTm1xXQnlDnEM:&tbnh=124&tbnw=131&prev=/images%3Fq%3Dchina,%2Bmap,%2Btoday%26svnum%3D10%26hl%3Dtr%26lr%3D, September 13th, 2006).

Chinability, *FDI Inflows in US\$ Billion – 1984-2003*, (online)
<http://www.chinability.com/FDI.htm>, September 13th, 2006.

Chinability, *GDP growth 1952-2006*, 2006, (online)
<http://www.chinability.com/GDP.htm>, September 13th, 2006.

COHEN, Benjamin. “Bretton Woods System”, *University of California, Santa Barbara, Department of Political Science*, (online)
<http://www.polsci.ucsb.edu/faculty/cohen/inpress/bretton.html>, September 13th, 2006

HENG, Li (2001). *How Wide Is the Gap of China's Individual Income?*, 2001, (online) http://english.people.com.cn/200108/31/eng20010831_78962.html, September 13th, 2006.

Hkust Business School, *Why Some FDI's Do Better than the Others*, autumn 2000, (online) <http://www.bm.ust.hk/newsletter/autumn2000/autumn00-09.html>, September, 22nd 2006.

Invest in China, *China's Absorption of Foreign Investment*, (online)
<http://www.fdi.org.cn/lteconomy/index.jsp?currentPage=1&category=10&app=00000000000000000005&language=en>, September 13th, 2006.

KERINS William F. (2004). *Privatization and Public Offerings – Instilling Good Governance Early*, 2004, (online)

http://www.acga-asia.org/public/files/Presentation_BillKerins_ACGAconference.pdf#search=%22privatization%20success%20in%20china%22, September 13th, 2006.

LAHMAYER, Jan (2003). *China Historical Demographical Data of the Whole Country*, 2003, (online) <http://www.library.uu.nl/wesp/populstat/Asia/chinac.htm>, September 13th, 2006.

MINXIN Pei, *China's Precarious Balance: Political and Social Cohesiveness and Stability in a Fast-Changing Society*, 2000, (online)

<http://www.comw.org/cmp/fulltext/0003minxin.htm>, September 13th, 2006.

SHEA, Marilyn, *Ting - The Chinese Experience about Money*, University of Maine at Farmington, 2001, (online)

<http://web.archive.org/web/20020213161435/http://hua.umf.maine.edu/Chinese/Faq/money.html>, September 15th, 2006.

The China Business Forum, *US-China Trade in Perspective: Asia's Emerging Union and Implications for the United States*, 2005, (online)

<http://www.chinabusinessforum.org/pdf/gresserreport.pdf>, September, 22nd 2006, pp. 1-12.

The Consulate General of Switzerland in Shanghai, *Economic Situation of China and the Yangtze River Delta for the First Half of 2005*, 2005, (online)

<http://www.sinoptic.ch/shanghai/flash/2005/200505.htm>, September 13th, 2006.

The Hindu Business Line, *FDI to China and India: The Definitional Differences*, 2004, (online)

<http://www.thehindubusinessline.com/2004/05/15/stories/2004051500081000.htm>,
September, 23rd 2006.

The US-China Business Council. *Toward WTO: Highlights of PRC Implementation Efforts to Date June 2001*, 2001, (online)
<http://www.uschina.org/prcwtocompliance.pdf>, September 13th, 2006.

The US-China Business Council. *Toward WTO: Highlights of PRC Implementation Efforts to Date September 2001*, 2001, (online)
<http://www.uschina.org/wtocompliance2.pdf>, September 13th, 2006.

United Nations Conference on Trade and Development, *FDI Indices*, 2002, (online)
<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2469&lang=1>,
September 13th, 2006.

United Nations Conference on Trade and Development, *FDI Indices*, 2002, (online)
<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3241&lang=1>,
September 13th, 2006.

United Nations Conference on Trade and Development, *FDI Indices*, 2002, (online)
<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3242&lang=1>,
September 13th, 2006.

United Nations Conference on Trade and Development, 2004, (online)
http://www.unctad.org/sections/dite_dir/docs/matrix_2001-2003_en.pdf#search=%22matrix%20of%20inward%20fdi%20and%20potential%20%202001%20-%202003%22, September 13th, 2006.

US Department of State, *Backroud Note: China*, 2006, (online)
<http://www.state.gov/r/pa/ei/bgn/18902.htm>, September 13th, 2006.

US Department of State, *2005 Investment Climate Statement – China*, 2005, (online)

<http://www.usconsulate.org.hk/uscn/trade/sprpt/2005/ics.htm>.

WINGFIELD-HAYES, Rupert. *Satisfying China's Demand for Energy*, 2006, (online) <http://news.bbc.co.uk/1/hi/world/asia-pacific/4716528.stm>, September 13th, 2006.

Xinhua News Agency, *New Technology to Help Curb Black Earth Erosion*, 2001, (online) <http://www.china.org.cn/english/2001/Sep/19787.htm>, September 13th, 2006.