

From East to West: The Evolution of China's FDI Preferential Policies

From East to West: The Evolution of China's FDI Preferential Policies Shaoming Cheng, George Mason University

Introduction

Since 1978, China has gradually opened up and has successfully used its foreign direct investment (FDI) preferential policies to steer FDI into its desired locations and industries in order to facilitate its uneven development strategy. The unbalanced strategy initially gave development priority to China's eastern coastal region in hopes of establishing viable and strong economic "engines" along the coast and thus spreading out positive effects into its vast interior areas. China's FDI favored policies, reflecting this strategy, were accordingly skewed to the eastern region in the first 20 years, from 1978 to 1997. This uneven growth distribution has been clearly manifested by the disproportionate FDI concentration in China's coastal area. It is estimated that over 85% of FDI in the period of 1978-1998 has been located in the eastern coastal region while merely 3% in the western area.¹

This spatially skewed focus of FDI policy initiatives, however, has created increasing regional disparity between China's eastern and western regions and thus resentments toward the FDI measures in the interior areas. In order to reduce the regional inequality, in 1997, the Chinese government began its new wave of FDI special treatment focusing primarily on the western region in order to "jump start" its economy and to catch up. One of the paramount policy goals of the recent "western development initiatives" is to prevent uneven growth pattern from jeopardizing China's long-term economic and social stability as well as regional and ethnic cohesion.

The purpose of this paper, therefore, is to thoroughly review the evolution of China's FDI preferential policies from China's eastern coast to its vast inland areas. Emphasis will be laid on how the policy has been initiated and adjusted to accommodate various economic goals and to meet imminent challenges.

This paper is organized along with the four phases of the evolution of China's FDI regulations under the "open door" policy. The essence of China's "open door" policy is to harness FDI in order to implement and realize China's uneven development strategy.² This has been done typically through the gradual but steady geographic expansion of successful FDI preferential policies across the nation. In the first phase from 1978 to 1984, efforts were devoted to laying down the policy and legal foundations of China's FDI regulation framework. The second phase from 1984 to 1992 experienced the great spatial expansion of China's preferential FDI policies and both structural and geographic changes of China's "open door" policy. The third phase from 1992 to 1997 witnessed the reaffirmation of the coastal-oriented development approach and limited action taken to address the widening regional disparity. The fourth phase, from 1997 to present, is a crucial stage in which China's government needs to adjust to its "open door"

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¹ State Statistical Bureau. *Statistical yearbook of China*. Hong Kong, China: Economic Information and Agency, 2002.

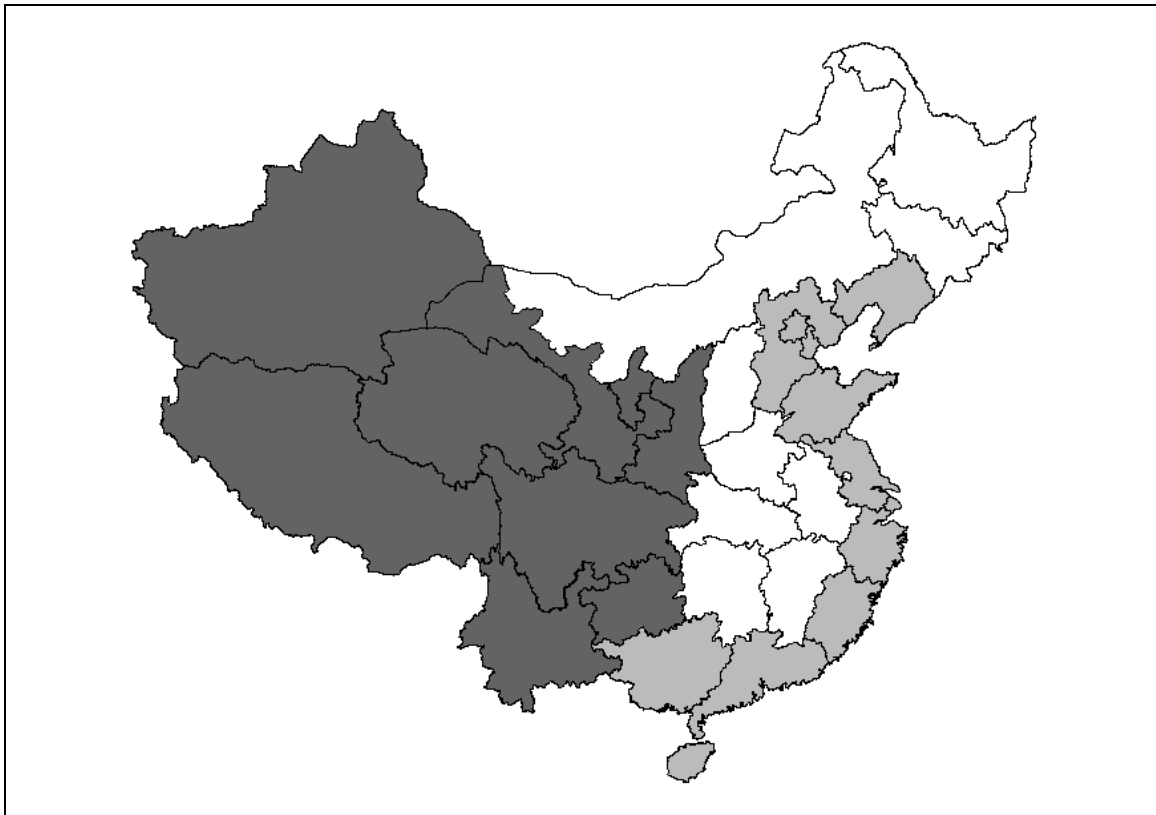
² Fu, J. *Institutions and investments: Foreign direct investment in China during an era of reforms*. Ann Arbor: University of Michigan Press, 2000.

policy to solve increasingly severe regional disparity between its coastal and interior areas.

Legal and Policy Foundations: 1978-1984

The “open door” policy and its associated unbalanced development strategy arose from the critique to Maoist egalitarianism ideology and massive redistribution measures in the late 1970s. Maoist development paradigm, oriented by engrained socialist ideology, treated equality as its paramount goal, as equality is the critical hallmark of socialism.³ This obsession of equality was clearly shown in terms of both uniform income distribution and regional development levels across the nation.⁴ Consequently, China's central government redistributed and channeled huge amounts of investment, most of which were from the coastal region, into the less developed interior middle and western regions in hopes of creating a “balanced” and thus “even” development scenario by accelerating economic growth in those inland areas.⁵

Figure 1: Spatial Division of China's Three Mega-Regions



³ Simon, D. (Ed.). *Third world regional development*. London: Paul Chapman, 1990.

⁴ Fan, C. C. “Uneven development and beyond: Regional development theory in post-Mao China”. *International Journal of Urban and Regional Research*, 21(4), 621-639, 1997. Yang, D. “Patterns of China's regional development strategy”, *China Quarterly*, 122, 230-257, 1992.

⁵ China is traditionally divided into three regions, namely eastern (coastal), middle, and western areas. The eastern region includes Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Guangxi, and Hainan; the middle one includes Shanxi, Neimenggu, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, and Hunan; and the western one includes Chongqing, Sichuan, Guizhou, Yunnan, Xizang, Shaanxi, Gansu, Ningxia, and Xinjiang.

The performance of Maoist balanced development strategy, however, was far from satisfactory. This approach was heavily criticized in light of its overemphasis on equity at the expense of economic efficiency. It was widely held that this interior-favored strategy was unrealistic, if not erroneous, as this strategy intentionally ignored the coastal region's comparative advantage in industrialization and economic growth.⁶ This comparative advantage was derived from superior factor endowments, a strong and established industrial base, and a well-educated labor force in the coastal area. This anti-comparative advantage approach, therefore, broadened regional disparities and suppressed economic growth because it undermined the role of market mechanism in mitigating economic disparities.⁷

China began its transition from an isolated and planned economy to an open and market-oriented one in the late 1970s. One of the most salient characteristics of this transition is that local and regional comparative advantage has become the fundamental driving force of China's economic growth. Previous equality-oriented redistributive and balanced development strategy was replaced by an efficiency-determined unbalanced paradigm. In addition, FDI has been regarded as a vital vehicle to capitalize the comparative advantage into tangible economic growth, and public policies have been tailored to attract FDI.⁸

In 1978, the "open door" policy was first proposed and endorsed as an integral part of China's economic reform. The main purpose of China's "open door" policy is to harness FDI to promote economic growth, consistent with China's uneven development strategy.⁹ In addition, a series of regulations specifically governing FDI practices were enacted in this period. The first law on FDI since 1949, "*Law of the People's Republic of China on Sino-Foreign Joint Ventures*" was promulgated in 1979. In 1980, the "*Income Tax Law of the People's Republic of China on Sino-Foreign Joint Ventures*" was also taken into effect. These path-breaking laws legitimized the existence and operations of FDI in China and paved the road for China's legal and regulatory framework for foreign investment, though they were fairly rudimentary on many operational issues.

The primary policy measure to recruit FDI in this period was the four special economic zones (SEZs),¹⁰ which were established in 1980. The four SEZs were carefully planned to take advantage of geographic closeness and historical bonds to overseas Chinese in Hong Kong, Taiwan, and Singapore. These SEZs served essentially as "policy laboratories," or "policy windows." New FDI policies were first tried out in these SEZs.

⁶ Liu, G. *Zhongguo jingji fazhan zhanlue wenti yanjiu* [On China's economic development strategy], Shanghai, China: Shanghai People's Press, 1984. Shao, Q. "The issues in regional planning in China". In K. Hottes, D. R. Diamond, & C. Wu (Eds.), *Regional planning in different political systems* (pp. 100-108). Stuttgart, Germany: Erdmann, 1985. Xue, M. *Current economic problems in China*. Boulder, CO: Westview Press, 1982. Yang, D. "Patterns of China's regional development strategy", *China Quarterly*, 122, 230-257, 1992.

⁷ Lin, J. Y., Cai, F., & Li, Z. "Social consequences of economic reform in China: An analysis of regional disparity in the transition period". In M. Renard (Ed.), *China and its regions* (pp. 194-220). Northampton, MA: Edward Elgar, 2002.

⁸ Sit, V., & Lu, D. *China's regional disparities: Issues and policies*. Huntington, NY: Nova Science Publishers, 2001.

⁹ Jia, W. *Chinese foreign investment laws and policies: Evolution and transformation*. Westport, CT: Quorum Books, 1994.

¹⁰ The four SEZs are Shantou, Shenzhen, Zhuhai, and Xiamen. The first three are located in Guangdong province while the last one is in Fujian province.

It was believed that successful policies then could later be introduced and applied to other cities and provinces, while problematic aspects could still be kept within bounds and their negative impacts on the whole economy thus confined. In this period, preferential policies tested in these SEZs included administrative decentralization and flexibility, and a wide range of tax concessions.¹¹

In this period, the volume of FDI inflows every year was very limited. Only about half billion of FDI in U.S. dollars was attracted to China in 1983, while over \$24 billion in 1995 and about \$41 billion in 2001 (see Table 1). The majority of the FDI inflows in this period came from overseas Chinese communities, particularly from Hong Kong, resulting from the aforementioned location strategy of China's SEZs. It would be natural to expect that overseas Chinese played a dominant role initially in investing in China as they were more familiar, if not comfortable, with China's economic, policy and cultural environment, which may be intimidating to investors from other origins.¹² In addition, available FDI was disproportionately concentrated in Guangdong province which had three out of the four initial SEZs. This is simply because FDI was generally attracted into the SEZs, as the approval of FDI projects was highly centralized and areas opened up for incoming FDI were extremely restricted at that time.¹³ The dominant role of Guangdong province in FDI recruitment diminished as other Chinese provinces, especially those also in the coastal region, joined the competition for foreign investors and projects as China's "open door" policy experiment progressed.

Rapid Geographic and Structural Expansion: 1984-1992

The second phase witnessed the tremendous expansion of FDI preferential policies both geographically and structurally. Policy experiments, which used to be confined within SEZs, were expanded into broader geographic areas. This is partly because these SEZs had successfully played such a substantial role in recruiting FDI and absorbing its embedded advanced technology.¹⁴ As a result, in 1984, 14 open coastal cities (OCCs)¹⁵ joined the four SEZs to implement FDI preferential policies. In 1988, the Hainan Island became a separate province and, at the same time, China's fifth SEZ. In 1986 and 1988 respectively, Liaoning and Shandong peninsulas became "coastal economic open areas." In 1989, Shanghai "Pudong New Area" was set up. The 14 OCCs, the two peninsulas, and the five SEZs constituted a massive coastal corridor for FDI, linking the Korean peninsula in the north to the South China Sea in the south.

Complementary to the "coastal line" of FDI attraction initiatives, China spread them along its major rivers. In 1985, three open delta areas were designated, namely, the Yangtze Delta Region, the Pearl Delta Region, and the Minnan Delta Region. All of the three "Delta regions" enjoyed the same preferential policies applicable to the 14 OCCs.

¹¹ Fu, J. *Institutions and investments: Foreign direct investment in China during an era of reforms*. Ann Arbor: University of Michigan Press, 2000. Ma, J. *The Chinese economy in the 1990s*. New York: St. Martin's Press, 2000.

¹² Fu, J. *Institutions and investments: Foreign direct investment in China during an era of reforms*. Ann Arbor: University of Michigan Press, 2000.

¹³ Wei, Y. *Regional development in China: States, globalization, and inequality*. New York: Routledge, 2000.

¹⁴ Wei, Y., & Liu, X. *Foreign direct investment in China: Determinants and impact*. Northampton, MA: Edward Elgar, 2001.

¹⁵ The 14 coastal cities are, from north to south, Dalian, Qinhuandao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai.

These delta regions and other special investment areas were strategically situated for FDI from various origins on the basis of geographic distances and kinship ties. For example, the Pearl Delta and Minnan Delta regions are the primary location for FDI from Hong Kong and Taiwan respectively because of their close economic, ethnic and cultural ties. Similarly, Shandong and Liaodong peninsulas are also targeting Korean and Japanese investors.

In addition to the geographic expansion of FDI preferential policies in China, structural changes and industrial priorities were also incorporated into these policies. High-technology industries replaced traditional labor-intensive sectors and took priority. Advanced technology investments were entitled to the same preferential policies even when they were not in the special investment areas.¹⁶ Development zones specifically aimed at high-technology industries were also set up primarily in the OCCs in 1984, including Economic and Technological Development Zones (ETDZs) and Hi-Tech Industrial Development Zones (HTIZs).

These special investment areas, by implanting the proven preferential policies from the initial SEZs, significantly expanded the magnitude of China's FDI favored policies. They were also an integral part of China's coastal-oriented developmental strategy, which was announced and legitimized in China's Seventh Five-Year Plan (1986-1990) and associated "*Provisions for Encouraging Foreign Investment*."¹⁷ This strategy emphasized the growth of the coastal region and utilized it as the economic engine for national development, as exemplified by growth pole theory.¹⁸ These open investment areas, covering more than one fifth of China's total population, clearly manifested China's determination to implement its "three-region" or "ladder-step" strategy.¹⁹ The "ladder-step" strategy, a Chinese version of growth pole theory, intends to first establish a well developed coastal region via concentrated resources, and then stimulate economic growth in the central and western areas through the "trickle down" effects, *i.e.*, through the diffusion of the development momentum from the coastal center.²⁰

FDI distribution in this period, consequently, was significantly skewed toward the coastal area, even though the central region did slightly pick up its FDI share. As shown in Table 1, the coastal region alone still accounted for 87.5% of all incoming FDI, in spite of a 5.4 percentage point drop in its total FDI share in 1993. The central area successfully increased its FDI share from 1.1% in 1983 to 8.8% in 1993, while the western area unfortunately further lost its FDI share. In contrast to the slight FDI share changes among

¹⁶ Jia, W. *Chinese foreign investment laws and policies: Evolution and transformation*. Westport, CT: Quorum Books, 1994.

¹⁷ The Provisions are often referred as the "Twenty-Two Articles."

¹⁸ The growth pole theory was first introduced in Perroux (1950). The essence of the growth poles theory is that economic development, or growth, is not uniform over an entire region, but instead takes place around a specific center or pole. This pole is often characterized by a key industry around which linked industries develop. Economic benefits generated in the pole will be gradually spread out into its surrounding areas or related industries, even though the benefits accrued initially to the growth pole are at the relative expense of other parts of the economy. For an extended discussion on the growth pole theory, please refer to Higgins and Savoie (1988).

¹⁹ Fan, C. C. "Uneven development and beyond: Regional development theory in post-Mao China". *International Journal of Urban and Regional Research*, 21(4), 621-639, 1997.

²⁰ Wei, Y. *Regional development in China: States, globalization, and inequality*. New York: Routledge, 2000.

different Chinese regions, there was a considerable catch-up among provinces within the coastal region. Guangdong province lost its predominant position in attracting FDI, with a precipitate drop in FDI share from 69.4% in 1983 to 27.7% in 1993, due to the rising FDI recruitment capabilities and performance of other coastal provinces, particularly Shanghai (11.7%), Jiangsu (10.5%), Fujian (10.6%), and Shandong (6.8%).

Table 1: FDI Distributions among Chinese Provinces (US\$ million)

| Provinces | 2003 | | 2001 | | 1997 | | 1993 | | 1983 | |
|------------------------|--------------|---------------|--------------|---------------|--------------|---------------|--------------|---------------|------------|---------------|
| Eastern | 45806 | 81.88% | 40748 | 87.80% | 38579 | 88.60% | 23711 | 87.50% | 536 | 92.90% |
| Beijing | 2192 | 3.92% | 1768 | 3.80% | 1593 | 3.70% | 667 | 2.50% | 76 | 13.10% |
| Tianjin | 1535 | 2.74% | 2133 | 4.60% | 2511 | 5.80% | 541 | 2.00% | 5 | 0.80% |
| Hebei | 964 | 1.72% | 670 | 1.40% | 1101 | 2.50% | 397 | 1.50% | 1 | 0.20% |
| Liaoning | 2824 | 5.05% | 2516 | 5.40% | 2205 | 5.10% | 1263 | 4.70% | 7 | 1.20% |
| Shanghai | 5468 | 9.77% | 4292 | 9.36% | 4225 | 9.70% | 3160 | 11.70% | 11 | 1.90% |
| Jiangsu | 10564 | 18.88% | 6915 | 14.90% | 5435 | 12.50% | 2844 | 10.50% | 9 | 1.50% |
| Zhejiang | 4981 | 8.90% | 2212 | 4.80% | 1503 | 3.50% | 1032 | 3.80% | 3 | 0.40% |
| Fujian | 2599 | 4.65% | 3918 | 8.50% | 4197 | 9.70% | 2867 | 10.60% | 16 | 2.80% |
| Shandong | 6016 | 10.75% | 3521 | 7.60% | 2493 | 5.70% | 1843 | 6.80% | 3 | 0.50% |
| Guangdong | 7823 | 13.98% | 11932 | 25.70% | 11711 | 26.90% | 7498 | 27.70% | 400 | 69.40% |
| Guangxi | 419 | 0.75% | 384 | 0.80% | 8806 | 2.00% | 872 | 3.20% | 6 | 1.10% |
| Hainan* | 421 | 0.75% | 467 | 1.00% | 706 | 1.60% | 707 | 2.60% | 0 | 0.00% |
| Central | 8921 | 15.95% | 4209 | 9.10% | 4748 | 10.90% | 2381 | 8.80% | 6 | 1.10% |
| Shanxi | 214 | 0.38% | 234 | 0.50% | 266 | 0.60% | 86 | 0.30% | 0 | 0.00% |
| Neimenggu | 89 | 0.16% | 107 | 0.20% | 73 | 0.20% | 85 | 0.30% | 3 | 0.60% |
| Jilin | 191 | 0.34% | 338 | 0.70% | 402 | 0.90% | 238 | 0.90% | 0 | 0.00% |
| Heilongjiang | 322 | 0.58% | 341 | 0.70% | 735 | 1.70% | 232 | 0.90% | 1 | 0.20% |
| Anhui | 367 | 0.66% | 337 | 0.70% | 434 | 1.00% | 258 | 1.00% | 0 | 0.00% |
| Jiangxi | 1612 | 2.88% | 396 | 0.90% | 478 | 1.10% | 208 | 0.80% | 0 | 0.00% |
| Henan | 539 | 0.96% | 457 | 1.00% | 692 | 1.60% | 303 | 1.10% | 0 | 0.00% |
| Hubei | 4569 | 8.17% | 1189 | 2.60% | 750 | 1.70% | 538 | 2.00% | 0 | 0.00% |
| Hunan | 1018 | 1.82% | 810 | 1.80% | 917 | 2.10% | 433 | 1.60% | 2 | 0.40% |
| Western | 1214 | 2.17% | 1431 | 3.10% | 196 | 0.50% | 1014 | 3.70% | 34 | 5.90% |
| Chongqing ^a | 261 | 0.47% | 256 | 0.60% | 35 | 0.10% | n/a | n/a | n/a | n/a |
| Sichuan | 412 | 0.74% | 582 | 1.30% | 62 | 0.10% | 560 | 2.10% | 19 | 3.30% |
| Guizhou | 45 | 0.08% | 28 | 0.10% | 14 | 0.00% | 43 | 0.20% | 0 | 0.00% |
| Yunnan | 84 | 0.15% | 65 | 0.10% | n/a | 0.00% | 97 | 0.40% | 0 | 0.00% |
| Xizang | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | 0 | 0.00% |
| Shaanxi | 332 | 0.59% | 352 | 0.80% | 10 | 0.00% | 234 | 0.90% | 3 | 0.40% |
| Gansu | 23 | 0.04% | 74 | 0.20% | 10 | 0.00% | 12 | 0.00% | 13 | 2.20% |
| Qinghai | 25 | 0.04% | 36 | 0.10% | 8 | 0.00% | 3 | 0.00% | 0 | 0.00% |
| Ningxia | 17 | 0.03% | 17 | 0.00% | 37 | 0.10% | 12 | 0.00% | 0 | 0.00% |
| Xinjiang | 15 | 0.03% | 20 | 0.00% | 20 | 0.10% | 53 | 0.20% | 0 | 0.00% |
| Total | 55941 | 100% | 46387 | 100% | 43522 | 100% | 27106 | 100% | 577 | 100% |

Sources: China's statistical yearbook, various years.

Figure 2: FDI Spatial Distribution among Chinese Provinces in 1993



However, as with all unbalanced development strategies, the parts of the country not possessed with a growth pole are impatient with the relatively slow trickle of spillover benefits and may later resent the strategies. This resentment mainly comes from widening regional development gaps and income disparity between the areas with and without growth poles. Regional disparities, as predicted by the growth pole theory, started to emerge in this period.²¹ The increasing regional disparity raised discussions on the validity of regional development bias inherent in China's development strategy, and posed issues on whether it would harm social stability.

The widening regional disparity can be well captured by the gap of income per capita among Chinese provinces. It is evident that, as indicated in Table 2, inter-regional inequality had increased since 1978 up to 1992. Location quotient (LQ) for income per capita for China's eastern region rose from 129 in 1978 to 136 in 1992, while LQ for the western area fell from 70 in 1978 to 68 in 1992.²² Unlike the slightly widening income gap between regions, the intra-regional disparity within the coastal area declined. The largest difference in income per capita among coastal provinces dropped from 654 in

²¹ Liu, W. Assessing total regional development in China. In V. Sit & D. Lu (Eds.), *China's regional disparities: Issues and policies* (pp.39-83). Huntington, NY: Nova Science Publishers, 2001.

²² Location quotient is a measure of the relative significance of an economic activity or phenomenon in a region compared with its significance in a larger area, e.g. a country. LQ is able to show the extent to which a specific region departs from the overall spatial entity or other regions within it.

1978 to 318 in 1992. Both the increased inter-regional and decreased intra-regional income inequality were attributed to China's economic reform and associated with FDI preferential policies, which combined together provided the eastern coastal region with unprecedented economic growth momentum.²³

Table 2: Provincial LQ in Income Per Capita Based on National Average

| Provinces | 1952 | 1978 | 1992 | 1997 | 2003 | 52-78 | 78-92 | 92-97 | 97-03 |
|------------------------|------------|------------|------------|------------|------------|------------|-----------|-----------|-----------|
| Eastern | 119 | 128 | 136 | 148 | 169 | 9 | 8 | 12 | 21 |
| Beijing | 268 | 331 | 270 | 275 | 277 | 63 | -61 | 5 | 2 |
| Tianjin | 269 | 330 | 220 | 227 | 267 | 61 | -110 | 7 | 40 |
| Hebei | 112 | 100 | 89 | 100 | 116 | -12 | -11 | 11 | 16 |
| Liaoning | 198 | 194 | 155 | 140 | 157 | -4 | -39 | -15 | 17 |
| Shanghai | 601 | 714 | 383 | 424 | 403 | 113 | -331 | 41 | -21 |
| Jiangsu | 97 | 114 | 144 | 154 | 185 | 17 | 30 | 10 | 31 |
| Zhejiang | 104 | 92 | 148 | 173 | 221 | -12 | 56 | 25 | 48 |
| Fujian | 97 | 75 | 111 | 152 | 165 | -22 | 36 | 41 | 13 |
| Shandong | 87 | 87 | 115 | 125 | 150 | 0 | 28 | 10 | 25 |
| Guangdong | 90 | 102 | 162 | 172 | 189 | 12 | 60 | 10 | 17 |
| Guangxi | 63 | 60 | 65 | 72 | 62 | -3 | 5 | 7 | -10 |
| Hainan* | n/a | n/a | n/a | 94 | 91 | n/a | n/a | n/a | -3 |
| Central | 97 | 86 | 85 | 82 | 86 | -11 | -1 | -3 | 4 |
| Shanxi | 96 | 90 | 80 | 78 | 82 | -6 | -10 | -2 | 4 |
| Neimenggu | 154 | 82 | 82 | 77 | 100 | -72 | 0 | -5 | 23 |
| Jilin | 146 | 106 | 101 | 91 | 103 | -40 | -5 | -10 | 12 |
| Heilongjiang | 214 | 155 | 114 | 119 | 128 | -59 | -41 | 5 | 9 |
| Anhui | 78 | 70 | 67 | 72 | 68 | -8 | -3 | 5 | -4 |
| Jiangxi | 105 | 77 | 70 | 68 | 73 | -28 | -7 | -2 | 5 |
| Henan | 77 | 65 | 67 | 73 | 80 | -12 | 2 | 6 | 7 |
| Hubei | 85 | 94 | 87 | 97 | 99 | 9 | -7 | 10 | 2 |
| Hunan | 79 | 79 | 72 | 76 | 77 | 0 | -7 | 4 | 1 |
| Western | 69 | 70 | 68 | 63 | 67 | 1 | -2 | -5 | 4 |
| Chongqing ^a | n/a | n/a | n/a | 73 | 79 | n/a | n/a | n/a | 6 |
| Sichuan | 59 | 67 | 67 | 66 | 69 | 8 | 0 | -1 | 3 |
| Guizhou | 56 | 50 | 47 | 36 | 39 | -6 | -3 | -11 | 3 |
| Yunnan | 64 | 64 | 69 | 66 | 62 | 0 | 5 | -3 | -4 |
| Xizang | n/a | n/a | n/a | 53 | 75 | n/a | n/a | n/a | 22 |
| Shaanxi | 77 | 82 | 69 | 61 | 72 | 5 | -13 | -8 | 11 |
| Gansu | 96 | 93 | 68 | 52 | 55 | -3 | -25 | -16 | 3 |
| Qinghai | 97 | 107 | 80 | 67 | 81 | 10 | -27 | -13 | 14 |
| Ningxia | 109 | 90 | 73 | 66 | 73 | -19 | -17 | -7 | 7 |
| Xinjiang | 161 | 89 | 109 | 97 | 107 | -72 | 20 | -12 | 10 |
| Average | 100 | 100 | 100 | 100 | 100 | 0 | 0 | 0 | 0 |

*Hainan did not become an independent province until 1988.

^a Chongqing used to belong to Sichuan province and became an autonomic municipality in 1997.

Sources: China's statistical yearbook, various years.

²³ Wei, Y. *Regional development in China: States, globalization, and inequality*. New York: Routledge, 2000.

Reaffirmation of Coastal-Oriented Strategy: 1992-1997

The third period, from *Deng Xiaoping's* southern tour in 1992 to 1997, witnessed the reaffirmation of coastal-oriented development approach and limited action taken to address the widening regional disparity. Since the late 1980s, increasingly widening income gaps between coastal and inland provinces had created widespread public concerns toward the unbalanced strategy. In light of the increasing resentments from the interior areas toward economic inequality, Deng took his historical tour to a number of cities in southern China in early 1992 and reaffirmed the necessity of the uneven development approach.²⁴ Deng pointed out that a prosperous coastal region serves as the “driver” or “dragon head” of national economic growth and that it can eventually diffuse its economic dynamics into the inland areas and help them catch up. Deng also called upon patience to and confidence in the unbalanced development strategy as international experience does indicate that regional disparity would be inevitable for a country to economically take off, especially for a huge country like China.

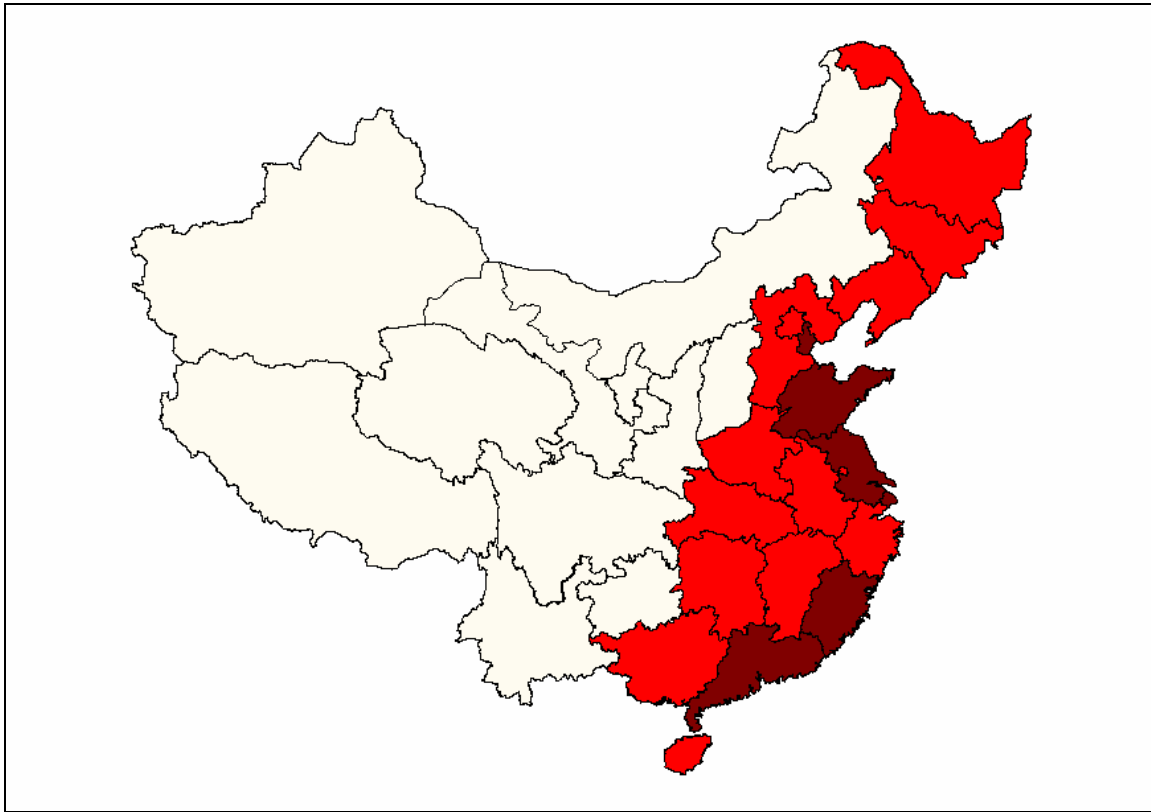
Favorable policy measures, however, were introduced to the interior areas during this period. The primary purpose of these measures was to lessen political pressures rather than to truly reduce regional inequality due to the dominant emphasis on the eastern corridor.²⁵ In 1992, all the capital cities of inland provinces, 13 border cities, and 10 interior cities along the Yangtze River became the new recipients of China's FDI favorable policies, which had been implemented in the eastern coastal cities. A variety of small development zones were established to accommodate different local situations and needs, including ETDZs, HTIZs, Free Trade Zones (FTZs), and Border and Economic Cooperation Zones (BECZs), Export Processing Zones (EPZs), and Tourist and Holiday Resorts (THR).²⁶ Unlike earlier development zones that cover a whole city or province, these were established within a city. The primary consideration for these small development zones was that these were less costly and therefore any city was able to mobilize and concentrate its resources to take advantage of the positive effects of these zones.

²⁴ Hu, A. *China regional disparity report*. Liaoning, China: Liaoning People's Press, 1995.

²⁵ Wong, J., & Zheng, Y. (Eds.). *The Nanxun legacy and China's development in the post-Deng era*. River Edge, NJ: World Scientific, 2001.

²⁶ All of these varied economic zones offer slightly different FDI preferential treatment. For an extended discussion on specific preferential policies or comparisons of the policies in these zones, please refer to the China Association of Development Zones at <http://www.cadz.org.cn/en/zgkfq/yhzc.asp>.

Figure 3: FDI Spatial Distribution among Chinese Provinces in 1997



Financial assistance was also provided to the interior, including generous poverty relief funds, low-interest or interest-free loans, and various investment projects. Poverty relief funds targeting at economically depressed regions and disadvantaged population had been an important policy means. It is estimated that every year 10 billion *yuan* RMB²⁷ were allocated from the central government to about 70 million residents in the central and western regions.²⁸ Also, the State Development Bank was founded in 1994. The Bank managed to arrange 33.5 billion *yuan* RMB interest-free loans, about 65% of its total loan amount, to the central and western areas in 1995. In addition, massive investment was channeled into the interior areas in the improvement of infrastructure capabilities, the rejuvenation of traditional industrial strengths, the creation of new agricultural bases, and the full utilization of natural resources. All of these policy measures did not change China's interior areas' disadvantaged status in the competition of FDI or in the overall implementation of uneven development strategy, though they may, to some extent, have prevented the regional inequality from being further enlarged.

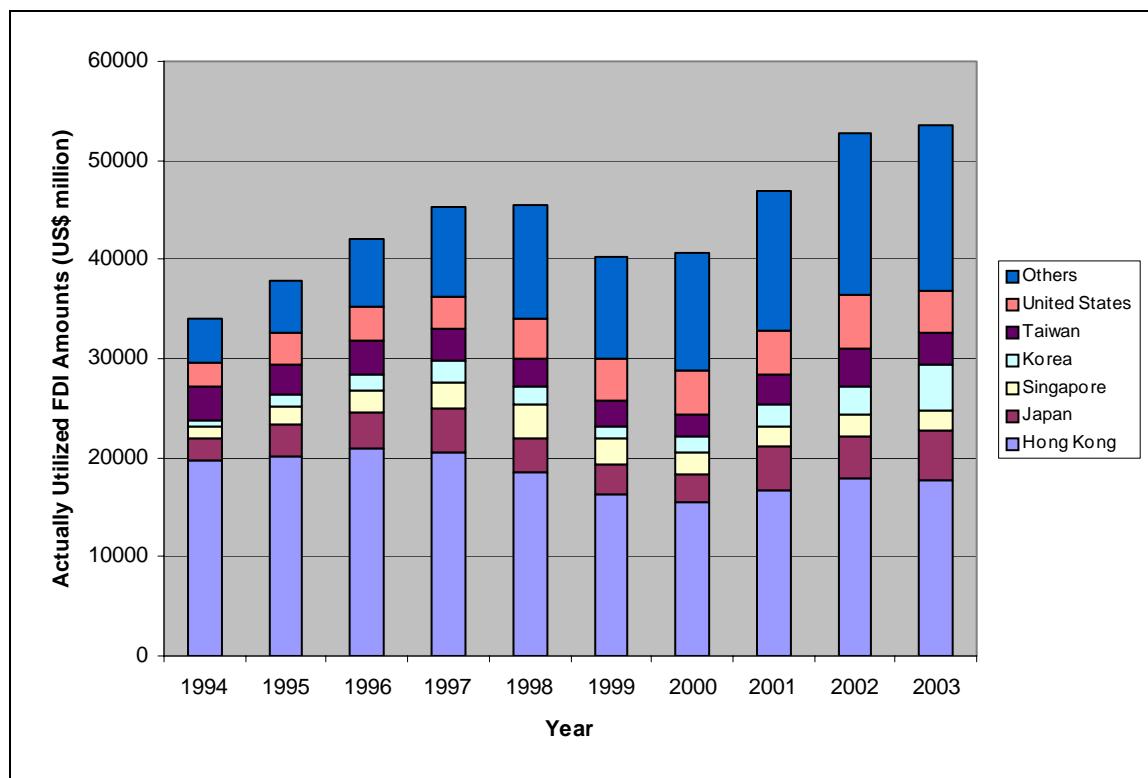
The huge gap in FDI attraction was not narrowed despite the fact that various policy measures were implemented. China's western area was further lagging behind in competing against its coastal and even central counterparts (see Table 1). In 1997, the western region's FDI share dropped once again from 3.5% in 1993 to merely 0.5%, in contrast to both the coastal and the central areas' continuous, even though slight,

²⁷ RMB, standing for *renminbi*, is Chinese currency. One U.S. dollar equals to approximately eight Chinese *yuan* RMB.

²⁸ Sit, V., & Lu, D. *China's regional disparities: Issues and policies*. Huntington, NY: Nova Science Publishers, 2001.

increases in their FDI proportions. Similar persistent inequality can also be found in inter-regional income per capita. The LQ in income per capita for the western region fell again from 68 in 1992 to 63 in 1997, accompanied by the rise in LQ in income per capita for the coastal area from 136 to 148 during the same period (see Table 2). In this period, the absolute amounts of FDI from overseas Chinese communities remained stable, while their shares declined continuously. In other words, the countries that were investing in China were more diversified. Figure 4 clearly showed that FDI from Hong Kong alone accounted for over 55% of China's entire FDI inflows in 1994, yet merely 45% in 1997. During the same period, from 1994 to 1997, the total incoming FDI increased from \$35 billion to \$45 billion (see Figure 4).

Figure 4: Major FDI Origin Economies in China: 1994-2003



Sources: China's statistical yearbook, various years.

In sum, since the launch of China's "open door" policy in 1978 to 1997, China's eastern region has always had higher income per capita than national average and than those in the middle and western regions. Coastal region's superior position in income is further strengthened as China's economic reform and its FDI-led and coastal-oriented development strategy proceeds. The continuous rise of inter-regional income disparity, however, was concurrent with the rapid decline of inter-provincial income differences within the coastal region. This, to a great extent, further fueled Chinese interior areas' resentment toward their coastal counterparts and the "open door" policies under the unbalanced development framework. Widening regional differences and associated growing resentments also raised widespread concerns that regional inequality would jeopardize China's economic reform and even social stability if it were not handled immediately and carefully.

Challenges: 1997-present

The fourth period saw the reorientation of the uneven development strategy, with a clear emphasis addressing regional disparity between China's coastal and interior areas. China's interior and western areas, which are lagging behind in economic growth, are enormous. Specifically, the provinces in the western region²⁹ account for over 50% of the land surface and over 20% of total population.³⁰ Since the early 1990s, efforts had been devoted to China's vast middle and western areas in order to intentionally help them recruit FDI and boost their economic growth. These positive efforts, however, were pale compared to the continuous attentions and endeavors in the coastal regions. This lack of attention and effective policy assistance to the middle and western areas, to a great extent, has resulted in the broadened eastern-western development and income gaps. In 1997, the emphasis of China's development policy started to be shifted to the western region, the most remote area in China. This emphasis shift has been clearly manifested by the declaration of the autonomic municipality status of Chongqing from Sichuan province in 1997. Since then, Chongqing has become one of the four autonomic municipalities in China.³¹ In addition, a new series of comprehensive preferential policies have been implemented to encourage economic development in China's central and western areas. These policies consist of increased government investment, enhanced infrastructure improvements, and enlarged fiscal transfers.³² In terms of FDI favored policies in the western area, the China government extended its successful development zones and emphasized resource- and labor-intensive industries by virtue of its great reserve of resources and labor.

Besides, in early 2000, the "Office of the Leading Group for Western Region Development of the State Council" was established in order to implement the "go west" development strategy.³³ The goal of this strategy is to promote economic growth in the western area and narrow the increasing gaps between coastal and western regions. Attracting incoming FDI is then regarded as an integral part of the strategy. In light of the success of ETDZs in coastal cities, 17 new ETDZs, most of which are in the western area, were established between 2000 and 2002.³⁴ The criticism of these measures argued that they divert China's limited resources and may jeopardize its ongoing social and economic reforms; that they did not resolve all aspects of obstacles for foreign investors to "go west;" and that it would take a long time to realize its actual or real effects.³⁵ Despite these criticisms, this program, as an integral part of China's Tenth "Five-Year"

²⁹ The western region includes six provinces, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, and Qinghai; five autonomous regions, namely, Tibet, Ningxia, Xinjiang, Guangxi, and Neimenggu; and one municipality directly under the State Council, namely, Chongqing.

³⁰ Ögütçü, M., & Taube, M. "Getting China's regions moving". *Observer*, 231/232, 13-15, 2002.

³¹ The other three autonomic municipalities are Beijing, Tianjing, and Shanghai, which are all in the coastal area.

³² Jiang, X. "The new regional patterns of FDI inflows in China: Policy orientation and expected performance". In OECD (Ed.), *Foreign direct investment in China: Challenges and prospects for regional development* (pp. 53-70). Paris: OECD Publications, 2002.

³³ "Go west" development program (*xi bu da kai fa*) is also referred as western development initiative.

³⁴ Hefei, Zhengzhou, Xi'an, Changsha, Chengdu, Kunming, Gunyang, Nanchang, Shihezi, Xining, Huhhot, Taiyuan, Nanning, Yinchuan, Lanzhou, Lasa, and Lanzhou.

³⁵ Taube, M., & Ögütçü, M. "Main issues on foreign investment in China's regional development: prospects and policy challenges". In OECD (Ed.), *Foreign direct investment in China: Challenges and prospects for regional development* (pp.17-52). Paris: OECD Publications, 2002.

plan (2001-2005), clearly demonstrates China's determination to implant successful coastal development experience into the western region by channeling FDI, domestic investments, and advanced expertise and skills into it. This program also ushers the beginning of a new wave of FDI special treatments and preferential policies that particularly aim at China's inland provinces.

China's accession to the World Trade Organization (WTO) in 2001 at the Doha Ministerial Conference has posed another challenge to China's existing FDI legal system and the ongoing FDI policy adjustments. The essential WTO principles of non-discrimination, transparency and trade liberalization require China undertake a fundamental reform in its FDI legislative domain. In the meantime, the relevant agreements under the WTO, such as the Agreement of Trade-Related Investment Measures (TRIMs) outline specific and detailed revisiting and revisions in the relating provisions of China's existing legislation.

Special efforts have been taken to sort through existing FDI laws and regulations in compliance to the WTO principles. Specifically, consistent with the requirements of TRIMs, China has amended its "*Sino-Foreign Equity Joint Ventures Law*," "*Sino-Foreign Contractual Joint Ventures Law*," "*Wholly Foreign-Owned Enterprises Law*," and their corresponding implementing rules. These are the underlying laws and regulations that directly govern the establishment, operation, and management of the foreign enterprises in China. The amendments were primarily intended to eliminate any relevant requirements of foreign exchange balance, local content, and export performance, which are prohibited by TRIMs. Besides, China has also issued in 2002 the "*Provisions for Guiding the Directions of Foreign Investments*" and the "*Guiding Catalogues of Foreign Investments*." These two pieces of legislation, not only further emphasize the key role of the WTO principles, but also lay down detailed time frames and plan to open China's service sectors, like banking, insurance and telecommunications, to foreign investors, as promised upon the entry into the WTO. Meanwhile, these two pieces of legislation also greatly encourage foreign investments, particularly those in the preferential industries, into China's western and central areas, in line with the "go west" strategy.

The initiation and implementation of the "go west" strategy also raised serious issues on what kind of policies, particularly FDI policies, should be applied. This daunting policy question has been further challenged by China's entry to the WTO and associated compliance to relevant WTO principles and requirements. Due to the significantly distinctive natural and economic conditions between the coastal and interior areas, simply implanting policies, even though they were successful in the coastal area, from the eastern to the western region may not work.³⁶ Furthermore, the "*Office of the Leading Group for Western Region Development of the State Council*" is a fragmented institution for studying and recommending policies and it does not have any practical authority over resources or individual province to implement recommended policies.³⁷ This lack of central authority in China's traditionally hierarchical policy making and

³⁶ Lu, D., & Neilson, W. A. (Eds.). *China's west region development: Domestic strategies and global implications*. River Edge, NJ: World Scientific Publishing, 2004.

³⁷ Chin, G. T. "The politics of China's western development initiative". In D. Lu & W. Neilson (Eds.), *China's west region development: Domestic strategies and global implications* (pp. 137-174). River Edge, NJ: World Scientific Publishing, 2004.

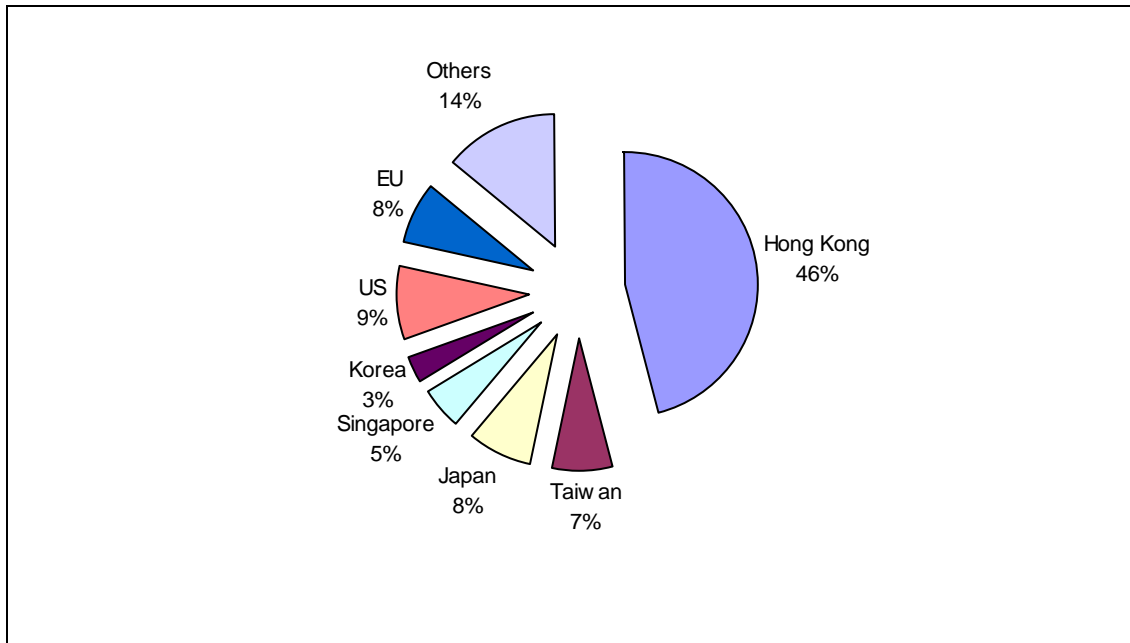
implementing system would intensify the economic and political tension between China's coastal and interior areas, because it would be very difficult to persuade the coastal provinces to sacrifice their economic interests in order to promote economic growth in the interior provinces.³⁸

To date, the "go west" strategy has not been impressive in helping the inland areas attract FDI or reduce income inequality. As shown in Table 1, the amount of FDI that was recruited by the coastal region has continued to increase from \$38 billion in 1997 to \$40 billion in 2001 and to \$45 billion in 2003. The eastern region's FDI share, however, dropped by approximate eight percentage points in 2003, from 89% in 1997 and 88% in 2001 to 82% in 2003. The majority of the share lost by the coastal region was picked up by the central region, with a significant increase in the absolute amount of FDI into the central region. The western region, the main target of the "go west" strategy, did not gain much in terms of either its FDI share or its absolute FDI amount. The deployment of the "go west" strategy, at least at its early stage, has not yet improved the income inequality between coastal and western regions either. The LQs in income per capita for the western and central regions rose moderately from 1997 to 2003, in contrast to the considerable increase in LQ in income per capita for the eastern coastal region. As a result, despite the rise in LQs in income per capita for all the three regions, the income gap between the coastal and interior regions actually widened in 2003.

FDI in this period was still mainly from the overseas Chinese communities or economies. It is clearly shown in Figure 5 that, over the past 15 years, Hong Kong alone has accounted for about 46% of the total incoming FDI to China, compared with merely 9% from the United States and 8% from the European countries. However, the share of FDI from non-overseas-Chinese communities or economies has increased continuously and significantly. It is shown in Figure 4 that, starting from 1997 to 2003, both the absolute terms and relative share of FDI from Hong Kong decline. This decline is accompanied by the significant increase of FDI from countries that have not been major FDI origin countries in China (i.e., "others" in the Figure), thus indicating growingly diversified FDI investing sources in China. Sectorally, manufacturing FDI grew considerably in 2002 and 2003 on top of its already dominant share, despite the fact that China has relaxed many restrictions on service FDI in compliance with WTO requirements (see Figure 6).

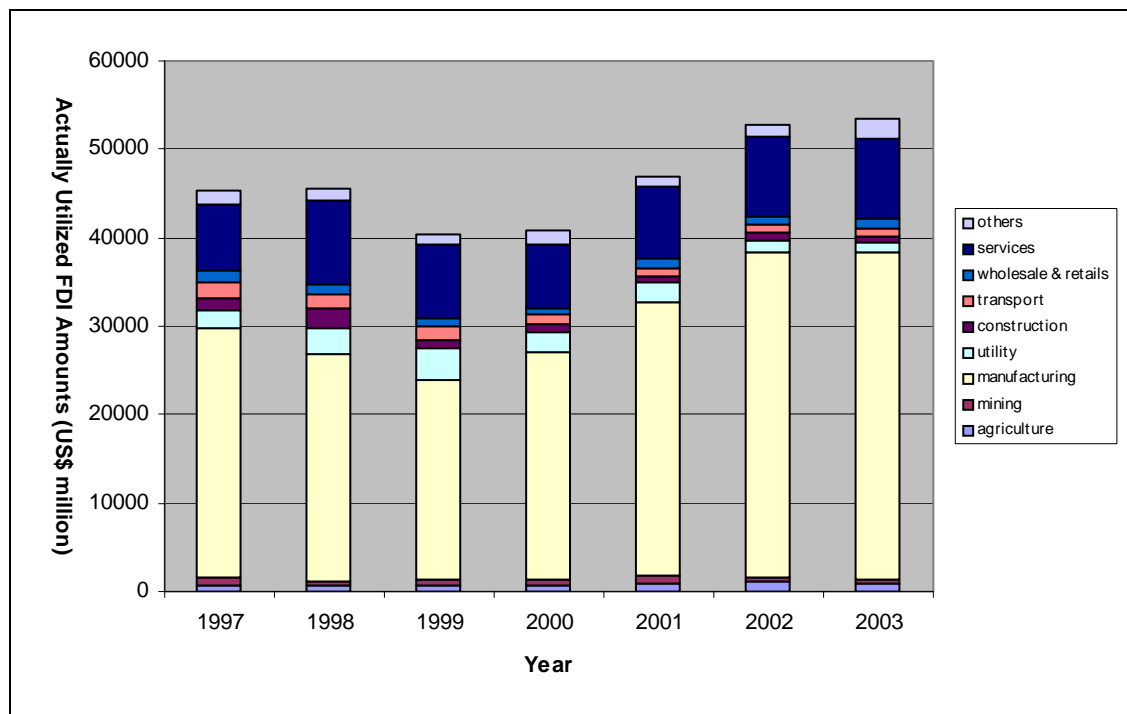
³⁸ Chin, G. T. "The politics of China's western development initiative". In D. Lu & W. Neilson (Eds.), *China's west region development: Domestic strategies and global implications* (pp. 137-174). River Edge, NJ: World Scientific Publishing, 2004.

Figure 5: The Composition of Major FDI Origin Economies in China: 1978-2002



Source: <http://fdi.gov.cn/common/info.jsp?id=ABC0000000000014161>.

Figure 6: Sectoral Composition of FDI in China



Sources: China's statistical yearbook, various years.

Conclusions and Discussion

This paper presents a thorough historical development of China's "open door" policy that intentionally treated FDI as its primary tool for regional economic growth. The development of the policy has a significant spatial characteristic. The "open door" policy was initially applied only to the coastal area, by virtue of this area's superior comparative advantages, in hopes of establishing vigorous economic growth centers in the coastal area. This unbalanced and economic efficiency determined economic growth strategy differs sharply from previous Maoist balanced and equity obsessed growth paradigm.

In addition to enact relevant FDI laws and regulations, one of the critical policy measures taken at the beginning of the implementation of FDI preferential policies was to establish special economic zones (SEZs) in the coastal area. These SEZs served as the "test ground" for proposed FDI preferential policies, allowing them to be implemented at a manageable and experimental scale. FDI favorable policies that were tested and proven effective in the SEZs were then expanded into a greater spatial dimension and eventually covered the entire coastal area. This policy support, together with this area's superior comparative advantage, resulted in rapid FDI-led growth in the coastal area.

In the meantime, this spatially uneven developmental focus has, unfortunately, resulted in huge regional disparity between the coastal and interior regions and hence called upon increasing policy attention and initiatives to deal with the disparity. One of the recent grand policy initiatives, the "go west" development program, has been intended to implant the successful FDI favorable policies and consequently FDI-led economic growth from the coastal area to its inland counterpart. Despite the ambition of this program, it lacks a clear understanding on the advantages and disadvantages of the western region in attracting FDI or concrete policy designs accordingly. This western development program also lacks a strong central authority in policy implementation in China's traditionally centralized system, thus leaving much room for unnecessary resistance from the coastal provinces.

China's accession to WTO raised another challenge to China's FDI preferential policies and recent "go west" development program. The essential WTO principles of non-discrimination, transparency and trade liberalization require China undertake a fundamental reform in its FDI legislative domain, which has been dominated by preferential treatments. Despite the tremendous efforts that have been taken to comply with the WTO requirements, the initiation and implementation of the "go west" strategy also raised serious issues on what kind of specific policies, particularly FDI policies, should be applied. Both the compliance to the WTO principles and requirements and the identification of effective policies favoring the western interior would then be the two most critical issues in China's ongoing adjustment of FDI preferential policies.

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