

# China's FDI Policy and Taiwanese Direct Investment (TDI) in China

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## 1. Introduction

As we begin the new millennium, there can be no doubt that Asia will be one of the most economically vibrant areas in the world. Indeed, this has been a continuous development for the past four decades. Since the resurrection of Japan in the 1960s-70s, Asia (especially East Asia) has shown the uncanny ability of almost unbridled growth and development. In the 1980s, the Four Small Tigers took-off and created a new terminology, newly industrialize countries (NICs),<sup>1</sup> while the spectacular growth of China has made her the second largest economy in the world. In between, we also see the emergence of the successors of the Four Small Tigers; be it Thailand, Malaysia, Indonesia, Philippines, or Vietnam.

Though the area has seen some hard times recently, from the burst of Japan's bubble economy to the Asian Financial Crisis, recovery is well on its way and most economists would agree that Asia will emerge stronger than before as their economic institutions have undergone significant reform (for the better). Nowhere in the world can one see the bustling markets and the vibrant demonstration of entrepreneur spirit.

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<sup>1</sup> The Four Small Tigers, along with Israel, were reclassified as "advanced economies" in 1997 by the International Monetary Fund (IMF).

These are all well documented and have contributed to the phenomenal success of the growth in the region, especially in terms of trade (Hou, *et al*, 1995). What is perhaps less understood or emphasized is the unique multilateral interdependency of the economies that is continuously accelerating. This is not just trade of goods and services, but increasing in terms of capital movements, especially in foreign direct investment (FDI). Japan has always been the largest investor, but recently the NICs are also exhibiting significant capital outflow. For example, Hong Kong is the largest “foreign” investor in China, while Taiwan is the largest investor in Malaysia, and among the top three FDI providers for Vietnam, and the second largest investor in China.

The main driving force for such behavior is the fact that Asia has a very complete system of economies in the sense that on the top we have the fully mature industrialized countries like Japan, flanked by the NICs (Hong Kong, Singapore, South Korea, and Taiwan), complemented by the rest of the “upward mobile” economies of the region (Indonesia, Malaysia, Philippines, Thailand, Vietnam, etc.). Much like the tropical forests of the Amazon River Basin, Asia is almost a complete ecosystem economically speaking. This is absent in most of the other regions in the world, with the exception of perhaps EC and the former socialist economies, though the intimacy in their interdependence is still at a much earlier stage of development.

Just as it is hopeless for any individual biologist to unravel the interdependencies of the Amazon ecosystem, it is impossible for any economists to fully characterize the multilateral trade/investment relationship between the Asian economies. In this study, with this big picture in mind, we take a small first step by examining the causal effect of the capital flows from Taiwan to Mainland China. More specifically, we will focus on Taiwan firm’s direct investment in China.

We will term such investment as TDI (Taiwanese Direct Investment), so as to differ from the broader FDI in China.

Over the last two decades (1979-98), China has emergence as the largest FDI recipient among the developing countries and, next to the United States, second in the world (UNCTAD, 1999). TDI in China has contributed significantly to the China's FDI boom. In fact, Taiwan was the second largest investor in China in most of years in the 1990s, next to Hong Kong (SSB, 1998). There is some suspicion that Taiwan may indeed be the largest "true" FDI, as a non-trivial portion of Hong Kong FDI in China may be a form of "money-laundering"; i.e. funds that belong to the China's state-owned-enterprises being diverted to Hong Kong and then returned to China as Hong Kong FDI.

While there is a growing literature on determinants of aggregate FDI flows in China (for example, Pearson 1991; Pompret 1991; Kueh 1992; and Zhang 2000), the studies on TDI in China have been limited. The purpose of the paper is to investigate the influences of both macroeconomic and microeconomic factors of TDI in Mainland China and salient characteristics of TDI. The study shows that the direct investment flows cross the Taiwan strait have been motivated by different factors given different macroeconomic conditions in both sides of the strait. It was found that TDI has been attracted most to the other side by China's huge market size, low labor costs, and cheap-abundant resources such as raw materials and land.

We will pay special attention towards the evolution process of China's attitude towards FDI as reflected in her economic policies. At the same time, we will acknowledge the parallel economic development of Taiwan during China's changing disposition towards foreign capital and market economic reform in general. The switch in China's FDI policy was a perfect match in terms of timing as far the TDI was concerned. This seemingly accidental timing is no coincidence. Much

like the fusion of two hydrogen atoms and an oxygen atom into the molecule called water is no accident, the complementarity between China's FDI policy and the influx of TDI is caused by a complex interactive dynamics that warrants much attention. This paper, however, is not an attempt to understand this dynamism. Rather, its intention is modest: to characterize the sequence of events (both in China and in Taiwan), and the effects on TDI location choice. As TDI is on the rise, such understanding is paramount to the complete comprehension of economic dynamics the Greater China and may shed light for the development of similar inter-dependencies in other regional economic blocs.

The remainder of the paper is organized as follows. Section 2 discusses TDI in a broad background in which key macroeconomic factors in both Taiwan and China that influence TDI are identified. Section 3 explores microeconomic factors that contribute large TDI flows into China, and discusses main characteristics of TDI in China. Section 4 provides a brief summary and conclusions.

## **2. Capital Flows Across the Taiwan Strait: Pull and Push Forces**

The recent development of TDI in Mainland China may be indicated by the number of investment projects and the value of the investment in Table 2. It should be noted that two sources of statistics on TDI, the official data from Taiwan and China, differ substantially. The main reason for the differences is the restrictions imposed by Taiwanese government on TDI such that many Taiwanese investors did not report their cases to their government. Table 2 shows the gap to be so large that the numbers of cases and realized investment amounts from official data of China in 1991-98 almost double that based on Taiwanese statistics. The significant fluctuation of TDI over time also reflects such restrictions from Taiwanese government, in addition to the troubled

political and military relationship between Taiwan and China. Nevertheless, the cases and magnitude of TDI flows into China are substantially large, and the shares of both cases and amount of TDI in entire China are around 10%, following Hong Kong, close to the U.S. and Japan (SSB, 1999).

The broad background of TDI in China may be summarized the pull force of China that made China to be more attractive to Taiwanese investors and the push force from Taiwan that stimulated growing capital outflows. Prior to the comprehensive economic reform, China was essentially a closed economy with the bulk of its international trade with other fellow communist nations. Under the leadership of Deng Xiaoping, China embarked on the historical journey towards a socialistic market system with Chinese characteristics (Fei and Hou 1994, Hou 2002). To date, we have witnessed over two decades of such effort, and the economic result is impressive by any standard.

One of the main objectives of China's reform is to open the Chinese economy to both international trade and foreign investment. To this end, and to further the degree of reform, China formally requested the membership reinstatement to GATT (now WTO) in July of 1986, and petitioned the WTO in November of 1995. However, both organizations have strict guidelines in terms of market access, both in trade and in capital investment. It is this latter issue that this paper concentrates on. Table 1 summarizes the evolution of China's main FDI policy. In terms of inward FDI flows, China's first steps were ginger and cautious (Zhang 2000). Foreign investors appeared modestly in China after the passage of the "Law on Joint Venture" in 1979. While permitting entry of foreign firms, the law did not create a clear legal framework to facilitate the complicated issues involved in foreign direct investments. As a result, problems like the lack of currency convertibility and the over-bearing red tape caused many would-be-investor to hesitate.

In 1986, new provisions (called the "Twenty-Two Provisions") was introduced. The timing, in terms of China's petition to be reinstated into GATT, is unmistakable. The main theme was the use of preferential tax policies to encourage or induce FDI. The goal is to attract export-oriented ventures, with the exception of offshore oil exploration and the real estate sector (hotels and other tourism-related projects in particular). Under such an export-promotion FDI regime, the biggest difficulty facing most foreign firms is how to reconvert their investment and repatriate their earnings, as Chinese currency (the RMB) was not a convertible currency.

Indeed, many of the FDI that are at least partially market-oriented (e.g. the tourist hotels, etc.) were unable to earn sufficient foreign exchange to cover their obligation at home, including distribution of profits to investors. On the other hand, Taiwan (and perhaps Hong Kong) firms were almost 100% export-oriented, and were hence able to directly earn foreign exchange and had been the most successful in avoiding serious foreign exchange deficits. Not to mention the common culture and language provided links for "connections" and back-door channels to by-pass many of the official restrictions. As a result, TDI and others with export-orientation rose steadily but Western investors, for the most part, did not view China as attractive relative to other developing countries.

This "export promotion" FDI regime persisted till 1992. That was when China exhibited a shift in paradigm and began to gradually open certain sectors of its domestic market to multinational firms, including services such as telecommunication, transportation, banking, and insurance. This change in regime is due to many reasons. Among them was that China's economy had reached a stage of maturity and confidence by 1992, as the real GDP was over five times as large as in 1979, and its annual GDP growth rate was 11% during the period 1992-97 (SSB, 1998). Years of export-orientation have led to significant accumulation of foreign exchange which

allowed partial convertibility of the RMB. The most important consideration is undoubtedly to send a signal of sincerity and commitment to the WTO. This, and the increasing pressure from the West, China finally allowed FDI firms to access (though only partially) her domestic. This institutional change, along with the increased purchasing power of the general population, led to a dramatic rise in TDI and the broader FDI.

Now let us turn our attention briefly towards the other side of the Taiwan Strait. During this same period, Taiwan has taken great strides both in terms of her economic development and political pluralism. It is not the intention of this paper to examine the political climate. The focus is on economic issues. It is generally believed that Taiwan achieved economic takeoff in terms of Rostow's terminology in the mid 1980s. Undoubtedly, the economic and industrial structure of Taiwan must have undergone major transformations as the old "sunset" industries gave way to the new generation of technology oriented industries. Three macroeconomic factors have been identified to be important to the TDI boom: (1) Taiwan's currency appreciated sharply in the late 1980s; (2) Wages rose substantially and at the same time there were labor shortages; and (3) Since 1987 Taiwanese government has become increasingly liberalized toward FDI outflows.

Taiwan appears to be the fastest-growing overseas investor in the developing world. Its outward FDI stock grew at an annual rate of 42% over 1980-91. The latest investment surge started in 1987, when the Taiwanese dollar appreciated by about 20% over the previous year and foreign exchange regulations were liberalized. In the 1980s TDI was distributed in roughly equal proportions between developing countries (South east Asia) and developed countries (the US). After that TDI was substantially biased to China and other Asian developing economies. About 60% of TDI stock had gone into manufacturing by 1991; electrical equipment and chemicals

ranked as the largest industries, together accounting for 70% of manufacturing investments (UNCTAD, 1992).

The bulk of TDI is undertaken by its small- and medium-size enterprises. Many factories have been established in China and Southeast Asia; most are labor-intensive small- and medium-size enterprises targeted at the low end of the market. Small- and medium-size enterprises are the norm in Taiwanese industry, spreading over a broad base from simple labor-intensive activities to high-skill, technology-intensive processes. The lead in TDI recently has been taken by a broad cross-section of small- and medium-size enterprises in traditional industries. Rising cost pressures at home, currency appreciation, small size and the consequent handicaps in adjusting to competitive pressures are now leading low-technology small- and medium-size enterprises to shift part of their production overseas.

Many firms in Taiwan have been facing with the need for industrial upgrading and have taken to promoting TDI actively, because they were unable to upgrade domestically in the face of rising costs. Investments by small- and medium-size enterprises are one of salient features of TDI. Another characteristic is investments made by large enterprises with differentiated products, advanced technological capabilities and far-flung sales networks. Such TDI have been invested partly in developing countries (China and Southeast Asia) to take advantage of cheaper labor or natural resources, and partly in developed countries (mainly in the US) to establish market positions, promote brand products, gain access to advanced technologies.

Growing faster than the FDI from other countries, TDI in China has risen substantially since 1987 when the New Taiwan dollar started to appreciate against the U.S. dollar. The amount of cumulative TDI approved in China was merely \$20 million before 1987, but TDI in 1987 alone was \$100 million (clearly the effect of Twenty-Two Provisions) and reached \$420 million the

next year (SSB, 1994). Under pressure from Taiwan's business communities and industrial organizations, the Taiwan government finally allowed TDI in China via a third country in 1990 (MOFERT, 1987-1997). The amount of TDI approved in 1993 reached 9,965 million U.S. dollars, equivalent to 4.6% of Taiwan's GDP (SSB, 1997). Up to the end of 1998, the contract amount of TDI was \$40 billion, and the realized TDI in China totaled \$21.3 billion (SSB, 1999). Taiwan has become the second biggest source of foreign direct investment in China.

Several features characterize TDI in China. In addition to the small- and medium-size of TDI projects relative to FDI from industrial countries (the U.S., Japan, and European Union), the industrial distribution of TDI in China is characterized by domination of electronics, food/beverage processing, metals and plastic products (Table 3). The four sectors constitute 46.55% of total TDI in value in the period of 1991-98. Investments in chemicals, non-metallic minerals, and textiles, and precision instruments are also significant (together making up 24.11% in total). Table 4 provides a picture of regional distribution of TDI within China by provinces over 1987-1998. Coastal areas (Guangdong, Jiangsu including Shanghai, Fujian, Hebei including Beijing and Tianjin, Zhejiang, Shandong, and Liaoning) received a lion share of TDI (91.21% in total), and the vast inland areas hosted only less than 10% of total TDI. Both industrial and regional distributions reflect the fact that TDI is strongly export-oriented, which we will discuss in detail in the following section. The changes in regional pattern of TDI over time in the three periods (Table 4) suggest that in the 1990s TDI exhibited a trend toward rising market-orientation, as more TDI took place at large cities (Shanghai, Beijing, and Tianjin) rather than export-promotion-base provinces (Guangdong and Fujian).

### 3. Seeking for Explanations to TDI in China

FDI arises from activities of multinational firms that operate across countries. A firm that goes multinational must possess some special advantages to overcome the inherent disadvantages and high costs of foreign production. The orthodox theory on the existence of FDI, the “OLI” paradigm that emanates from Hymer’s work (1960), asserts that a firm with certain *Ownership* advantages (patent or brand name) would open a subsidiary in a foreign country with *Location* advantages (cheap labor or growing market) to maximize its profits. Both advantages of ownership and location can best be captured by the *Internalization* of production (not exporting or licensing) via direct investment in the foreign country (Dunning 1981).

The OLI theory is based primarily on the behavior of large multinational firms from developed countries. FDI from these countries thus has been associated with such intangible assets as leading-edge technology and brand names. Taiwan multinationals may not be on world frontiers of technology and organizational sophistication. In fact, the ownership advantages of TDI might be derived from either marketing skills that make investors specialize in delivering timely, international marketing networks, uniform quality products to Western markets (Wells 1993), or the adaptation of mature technologies to more labor intensive contexts and to local raw materials (Vernon 1979). Another unique ownership advantage is Taiwan’s ethnic connections with China: both share the same language and culture that enables TDI much easier in the negotiation and operation.

Table 5 shows distribution of approved TDI among host countries over 1952-1998. The pattern of TDI destinations reveals motives of Taiwanese investors. Except investments in the US (12.95% in total) and Japan (0.57%) which are driven by market access, all other investments take place in developing countries like China (41.57%) that are encouraged by cheap labor and raw

materials and market access. Cultural and linguistic affinity between Taiwan and China made it much easier for TDI to cross the straits than investments from industrial countries. In fact, linguistic and cultural affinity, along with labor and land costs was recognized to the top three motivations for most TDI in China. More importantly, Taiwan's economic structural adjustment (Fuess and Hou 2000) may have played an important role in TDI boom in China. Combined, Taiwan's changing industrial specialization and loss of certain international comparative advantage has led her to shift many production operations over-seas. The geographic proximity, cultural/linguistic linkages, and the relative stages of development between two economies have led to Taiwanese firms preference towards investing in China.

In general there are five main motives for understanding FDI: market-seeking, export-oriented, resource-seeking, technology-seeking, and efficiency-seeking. These motives apply to all investors, but first three are of particular relevance to FDI made by Taiwanese investors. The three motives are related to three types of FDI: export-oriented, market-oriented, and resource-oriented investment. The export-oriented FDI, motivated by foreign cheap labor, fragments the production process across countries by production stages based on labor intensities, while market-oriented FDI that are induced by foreign market access build plants in multiple countries to serve local markets. The export-oriented FDI is more likely to be attracted to host regions with cheap labor (Zhang and Markusen 1999). Due to its "footloose" feature, this type of FDI is also attracted to countries that offer favorable incentives such as tax holiday.

The export-oriented FDI has been the most salient feature of investments by Taiwanese firms. The main motive behind such TDI is the classic location edge of low-cost labor in China, with investors being forced to seek more economical bases to service established export markets (mainly the U.S.) as costs rise at home. The main activities that experience such relocation are

relatively simple, labor-intensive manufacturing where skills are easily transferred and facilities are relatively small-scale. Garments, footwear, light electronics and similar consumer goods are the prime candidates.

In addition to cheap labor, China also needs to offer more. The labor must be productive {disciplined, literate, easily trainable}; physical infrastructure must be excellent to facilitate low-cost import and export; bureaucratic impediments to offshore processing activity must be minimal; and the investment climate must be conducive {competitive tax incentives, political stability etc.}. In the garments industry, there has been another strong location factor-the existence of underutilized quotas under the Multi-fiber Arrangement, which has proven an important incentive to firms from countries whose quotas are fully used up.

The dominant position of the export-oriented FDI in China can be seen from the fact of the growing share of exports by foreign-invested enterprises in China's total exports. In 1999, foreign-invested enterprises in China produced exports of US \$88.6 billion (45.5% of total exports); most of such foreign affiliates are from Hong Kong and Taiwan. Tables 6 and 7 present the pattern of trade across the Taiwan Strait. The most prominent feature revealed in the tables is large and growing trade surplus of Taiwan. Such surplus is simply a result of relocating assembling plants from Taiwan to Mainland China, since Taiwanese firms moved their labor intensive production to the other side of the Taiwan Strait. The huge Taiwanese exports are mainly mid-products used for final assembling stages of production and equipments. Since large portion of final products are re-exported to the third markets (mainly the U.S.), Taiwan has switched its trade surplus with the U.S. to China because of the small value-added in the assembling plants. As a result, China trade surplus with the U.S. rose substantially in the 1990s.

The market-oriented FDI involves building up similar production facilities abroad for scale economies to gain an access to local markets. The size of local market plays a key role in attracting this type of FDI because the larger market offers greater opportunities to realize economies of scale (Zhang, 2000). Since this type of FDI involves relatively advanced technology, it generally has higher requirements for human capital and infrastructure in the host regions. The resource-oriented FDI needs no explanation: it goes where the resources are located if the conditions in the sector call for vertical integration.

The particular motive of TDI in China depends on a number of factors and is greatly influenced by macro- and micro-economic conditions in both sides of the Taiwan Strait. The main force driving TDI in China, at least in the early stages, is the rise in Taiwan's labor costs and the apparent industrial policy of upgrading from labor-intensive to capital-technology-intensive production. This has forced the "sun-set" industries to relocate their labor-intensive production to regions like China with lower labor costs. These old industries have been the driving force in Taiwan's exports in the 70s and early 80s. By the mid 1980s, Taiwan had lost the comparative advantage in such labor-intensive manufacturing to other emerging economies such as Thailand, Malaysia. To maintain their profitability, these firms have only two options, one is to rely on cheap imported foreign labor (Hou 1997), and the other is to move the production plants overseas.

This type of TDI is export-oriented and the timing was perfect in the sense that the Chinese policy towards foreign investment was precisely limited to export-only ventures, so as to increase China's foreign exchange. This type of TDI represent the first generation, and due to their export-oriented nature, will obviously choose to located in the areas with good excess to port or good transportation conditions. In addition, geographic proximity and similarities in regional Chinese culture promote TDI in Fujian and other provinces in which the hometowns of Taiwanese

investors are located. This is especially important in the early stages, as many of the TDI are still in a somewhat tentative trial-and-error mode.

With the increased liberalization of China's FDI regime in 1990s (and that of Taiwan's), combined with the fact that the experience of the TDI is now much more confident, the second generation of TDI tends to differ from the first generation of old "sun-set" industries. The TDI tends to be larger, newer (in technology), and slightly more capital intensive (e.g. Acer computers). In addition, besides export-orientation, some of TDI started to aim at China's domestic market (or market-oriented). Which would suggest a change in decision criteria.

Some surveys of reasons for Taiwanese firms to invest in China provide the pattern of TDI motivations through collecting answers to questionnaire from individual firms. Table 8 shows results of survey with 2311 firms in 1988 (Chen, 1992). The comparison of two-firm groups (before and after 1987) suggests the relative importance of each TDI motivations measured by a percentage. It is quite obvious that the predominant reason for TDI before 1987 was to expand market base and the second is to secure supplies of raw materials. After 1987, however, importance of low-labor costs rose significantly and the weight of market expansion (although still remains to be important) fell to less than half. Tax incentives became more attractive to investors over time.

Another survey is more recently and more specific in both motivations and industries (electronics, textiles and food processing) (CIER, 1994). The survey outcome in Table 9 shows what aspects are most attractive to firms to invest in China. According to the survey, China's abundant supply of cheap labor, cultural and linguistic affinity with Taiwan, low-land costs, and large domestic markets were the top four reasons for TDI in China. The results are quite consistent with predictions of FDI theory in general and widely held beliefs. The same cultural and linguistic

across Taiwan Strait have made Taiwanese firms much easier in making decisions and operating business. For the industry of electronics, tax breaks such as tax holiday are also attractive. Expanding production capacity and making use of redundant equipments are also major reasons for investors in textiles. Accessing to China's raw materials also encouraged firms in food processing industry.

A recent study by Hou and Zhang (2001) employed conditional logit model to examine factors that influence the regional distribution of TDI within China. The main TDI determinants and regression results are summarized in Table 10. As succinctly summarized in the Introduction section, there has been a natural evolution of China's FDI policy. This is matched with the changing need of Taiwanese firms, and also has caused (as we suspect) a shift in the decision structure of TDI location choice. To best capture this change in the decision structure, we propose to decompose the time series into three different stages. The first stage (1987-90) represents the effect of the Twenty-Two Provisions; the third stage (1995-98) captures the second generation of TDI which is relatively more technology/capital intensive, and has been allowed to sell to China's domestic market; while the second stage (1991-94) is deemed as a transitional period between the two FDI policy regimes of China.

The estimating results in Table 10 indicate that Taiwanese investors prefer the provinces with superior infrastructure and basic industrial activities, along with steady supply of skilled labor and growing market size. This conclusion is quite consistent with widely held belief that TDI in China is in general export-oriented based on cross-strait comparative advantages. Taiwanese cultural proximity with Fujian province is a key motivation for large amount of TDI flows to that region. Favorable FDI incentives provided by Chinese government in coastal areas have made significant differences in regional distribution of Taiwanese manufacturing branch-plants. While

labor cost has been recognized as one of major motives for TDI in China, cross-province differentials in manufacturing wages seem not affect the site-selection of Taiwanese firms.

#### **4. Conclusions**

This paper attempts (a) to provide the pattern of Taiwanese direct investment in Mainland China through identifying main characteristics of such capital flows; and (b) to assess main factors that influence the pattern of investment across the Taiwan Strait. Taiwanese direct investment has been not only one of major source but also the most dynamic source of FDI received in China during the period of 1987-99. The TDI boom in China has been shown to be a result of interaction between Taiwanese push force and Chinese pull forces. This is a typical story of conventional comparative advantages plus cultural and linguistic affinity across the Taiwan Strait. On the one hand, China is on the stage of lower development, with abundant cheap labor and vast land and other raw materials, which are attractive to foreign investors. On the other hand, Taiwan has already industrialized, with supplicated technology and well-established international marketing network, but seeking industry-up-grading due to rising wages and limited supplies of cheap labor and raw materials. Such economic complementarities can easily lead to large capital flows from Taiwan to China as long as governments in both sides do not restrict such movement.

The structural changes in Taiwanese economy in the last two decades created a push force for outward investment flows. The push force was a result of three factors: sharp appreciation of Taiwanese currency in the late 1980s, rising wages and labor shortage due to rapid economic growth for three decades, and graduate liberalization of government policy on capital outflows.

The push force largely encourages outward investment flows to Mainland China as well as developing countries in Southeast Asia.

The open-door policy and outstanding performance in economic growth in China since 1979 have formed a strong pull force to attract foreign investors in all around the world including Taiwan. China perhaps has become the most liberalized country in hosting foreign direct investment. In addition to advantages of cheap labor and huge markets, Chinese government has provided foreign investors with many favorable incentives to help them to succeed in doing business. As a result, China has been the largest recipient of FDI among the developing world and the second globally. More than half of TDI flows went to China in the 1990s and a larger share is expected in another 10 years if political and military accidents do not take place.

TDI in China so far is characterized by the dominant export-oriented investment, with a tendency toward market-seeking investment projects. Within China Taiwanese investors prefer a region with superior infrastructure for exporting and basic industrial activities, along with steady supply of skilled labor and growing market size. Cultural proximity of individual investors with a host region is also a key motivation TDI flows to that region. Favorable FDI incentives provided by Chinese government in coastal areas have made significant differences in regional distribution of Taiwanese manufacturing branch-plants.

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**Table 1**      **The Evolution of China's FDI Policy**

July 1979	The "Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign investment" ("Law of Sino-Foreign Joint Ventures") was adopted, granting foreign investment a legal status in China.
August-October 1980	Four special economic zones (SEZs) were established in the southeast coast to attract foreign capital and advanced technology. One of them is Xiamen in Fujian province, which was not only intended to attract TDI but also to facilitate the eventual reunification of

	China.
October 1986	New provisions (called “Twenty-two Provisions on the Encouragement of Foreign Investment”) were established. The new incentives included: reducing fees for labor and land use; establishing a limited foreign currency market for joint ventures; and extending the maximum duration of a joint-venture agreement beyond 50 years
March 1990	Amendments to the 1979 “Joint-Venture Law” were passed, greatly improving the investment climate in China. The stipulation that the chairman of the board of a joint venture should be appointed by Chinese investors, for example, was abolished. Also significant was the provision of protection from nationalization.
April 1990	The concept of SEZs was extended to the Shanghai Pudong New Development Area, which is about the size of Singapore.
January 1997	Shenzhen (the most important SEZ) allowed foreign-invested enterprises with advanced technology to sell 100% of their products on the domestic market.

Sources: based on what has been compiled by the author.

**Table 2 Taiwanese Investment in Mainland China: 1991-98 (Millions of UD Dollars)**

Year	Approved by Taiwan			Official Data from Mainland China				
	Cases	Amount	Average Amount	Cases	Contracted Amount	Average Amount	Realized Amount	Realization Ratio
1991	237	174	0.73	3446	2783	0.81	844	30.33
1992	264	247	0.94	6430	5543	0.86	1050	18.94
1993	9329	3168	0.34	10948	9965	0.91	3139	31.50
1994	934	962	1.03	6247	5395	0.86	3391	62.85
1995	490	1093	2.23	4778	5777	1.21	3162	54.73
1996	383	1229	3.21	3184	5141	1.61	3475	67.59
1997	8725	4334	0.50	3014	2814	0.93	3289	116.88
1998	1284	2035	1.58	2970	2982	1.00	2915	97.75
1991-98	21646	13243	0.61	41017	40400	0.98	21265	52.64

Notes: The figure for 1991 includes investments in years before 1991. Due to political reasons, Chinese figures are in general larger and more accurate than Taiwanese figures because many Taiwanese investors did not report their investment to their government.

Sources: *Taiwan-China Economic Statistics Yearbook* (liangan jingji tunji nianbao), Taipei: Chunghwa Institute for Economics Research, 1999.

**Table 3 Industrial Distribution of Taiwanese Investment in China: 1991-98**

Industry	Cases	Amount	Percentage (%)
Electronic and Electric Appliances	3078	2793819	21.10
Food and Beverage Processing	2180	1178391	8.90
Basic Metals & Metal Products	1848	1134556	8.57
Plastic Products	1999	1056349	7.98

Chemicals	1411	862703	6.51
Non-Metallic Minerals	1137	832704	6.29
Textile	983	753067	5.69
Precision Instruments	2137	743869	5.62
Transport Equipment	664	638815	4.82
Rubber Products	472	461251	3.48
Others	5737	2787134	21.05
<b>Total</b>	<b>21646</b>	<b>13242658</b>	<b>100.00</b>

Notes: Cases indicate number of investment projects, and amount is in thousands of US dollars.

Sources: Taiwan-China Economic Statistics Yearbook (liangan jingji tunji nianbao), Taipei: Chung-hwa Institute for Economics Research, 1999.

**Table 4 Regional Distribution of Taiwanese Direct Investment in Mainland China 1987-98 (Value in millions of US Dollars)**

Provinces in China	1987-98		1987-90		1991-94		1995-98	
	Value	%	Value	%	Value	%	Value	%
Guangdong	4310	33.41	328	43.50	1464	32.17	2518	33.16
Jiangsu	4053	31.42	25	3.32	1284	28.21	2744	36.13
Fujian	1498	11.61	179	23.74	656	14.41	663	8.73
Hebei	780	6.05	4	0.53	281	6.17	495	6.52
Zhejiang	572	4.43	15	1.99	205	4.50	352	4.64
Shandong	363	2.81	18	2.39	124	2.72	221	2.91
Liaoning	191	1.48	10	1.33	102	2.24	79	1.04
Sichuan	182	1.41	2	0.27	94	2.07	86	1.13
Hubei	156	1.21	5	0.66	66	1.45	85	1.12
Hunan	116	0.90	2	0.27	61	1.34	53	0.70
Others	678	5.26	166	22.02	214	4.70	298	3.92
<b>Total</b>	<b>12899</b>	<b>100.00</b>	<b>754</b>	<b>100.00</b>	<b>4551</b>	<b>100.00</b>	<b>7594</b>	<b>100.00</b>

Notes: Regarding to regional distribution of TDI within China, only Taiwanese statistics are available, although TDI is understated in the statistics in general.

Source: Taiwan-China Economic Statistics Monthly Bulletin (liangan jingji tunji yuebao) (various issue, Taipei: Taiwan Institute for Economics Research.

**Table 5 Distribution of Approved Taiwanese FDI Destinations: 1952-1998**

Area	Cases	Amount	Share in Total (%)
Mainland China	21646	13243	41.57
USA	1683	4123	12.95
Malaysia	229	1388	4.36
Hong Kong	477	974	3.06
Thailand	258	881	2.77

Singapore	257	847	2.66
Vietnam	171	709	2.23
Philippines	130	533	1.67
Indonesia	160	529	1.66
United Kingdom	78	327	1.03
Japan	172	181	0.57
British Central America	523	5583	17.53
Others	1129	2534	7.95
<b>Total</b>	<b>26298</b>	<b>31853</b>	<b>100.00</b>

Notes: Figures are based on official data of Taiwanese government. Cases indicate number of investment projects, and amount is in millions of UD dollars.

Sources: Taiwan-China Economic Statistics Yearbook (liangan jingji tunji nianbao), Taipei: Chunghwa Institute for Economics Research, 1999.

**Table 6 Trade between Taiwan Strait: 1990-97 (Millions of US Dollars)**

Year	Based on Chinese Statistics			Based on Taiwanese Statistics		
	Exports	Imports	Total	Exports	Imports	Total
1990	2255.0	319.7	2574.6	4394.6	765.4	5160.0
1991	3639.0	594.8	4233.9	7493.5	1125.9	8619.4
1992	5881.0	698.0	6579.0	10547.6	1119.0	11666.6
1993	12933.1	1461.8	14394.9	13993.1	1103.6	15096.7
1994	14084.8	2242.2	16327.0	16022.5	1858.7	17881.2
1995	14783.9	3098.1	17882.0	19433.8	3091.4	22525.2
1996	16182.2	2802.7	18984.9	20727.3	3059.8	23787.1
1997	16441.7	3396.5	19838.2	22455.2	3915.4	26370.6

Sources: Taiwan-China Economic Statistics Yearbook (liangan jingji tunji nianbao), Taipei: Chunghwa Institute for Economics Research, 1998.

**Table 7 Taiwan's Trade Surplus with China: 1990-97 (Millions of US Dollars)**

Year	Taiwan net trade to China through Hong Kong				Taiwan net trade to Hong Kong		Taiwan net trade to the world
	Based on Hong Kong		Based on Taiwan		Amount	%	Amount
	Amount	%	Amount	%			
1990	2512.9	20.11	3629.2	29.04	7110.4	56.90	12495.2
1991	3541.2	26.63	6367.6	47.88	10436	78.47	13299.1

1992	5169.0	54.53	9428.6	99.47	13635.1	143.80	9479.3
1993	6481.9	82.36	12889.5	163.78	16726.8	212.54	7869.8
1994	7224.9	93.86	14163.8	184.01	19730	256.33	7697.2
1995	8308.6	102.37	16342.4	201.35	24278.6	299.13	8116.3
1996	8135.2	55.32	17667.5	120.15	25100.1	170.70	14704.4
1997	7971.3	104.34	18539.9	242.68	26711.6	349.66	7639.4

Sources: Taiwan-China Economic Statistics Yearbook (liangan jingji tunji nianbao), Taipei: Chunghwa Institute for Economics Research, 1998.

**Table 8**      **Reasons Cited for Taiwanese Outward Foreign Direct Investment**

<b>Reasons for Outward FDI</b>	<b>After 1987 (%)</b>	<b>After 1987 (%)</b>
(1) Expansion of Markets	25.1	56.0
(2) Low -Cost of Labor	21.3	3.5
(3) Raw Material Supplies	9.1	8.2
(4) Tax Incentives	6.6	1.6
(5) Avoidance of Trade Barriers	5.5	6.6
(6) Collection of Market Information	2.1	6.9
(7) Others	30.3	17.2
Total	100.0	100.0

Source: Adopted from Chen (1992).

**Table 9**      **Key Motivations for Taiwanese Direct Investment in Mainland China**

<b>Motivations</b>	<b>Electronics Manufactures</b>	<b>Textiles Manufactures</b>	<b>Food Processing Industry</b>
(1) Abundant Supply of Cheap Labor	95.12	100.00	100.00
(2) Cultural and Linguistic Affinity	95.12	88.23	87.10
(3) Low -Cost Land	73.17	76.47	80.65
(4) Domestic Markets	46.34	70.58	67.74

(5) Expanding Production Capacity	34.15	44.11	25.81
(6) Making Use of redundant equipment	26.83	41.17	16.13
(7) Spreading Risk	34.15	23.52	29.03
(8) Access to Raw Materials	19.51	17.64	38.71
(9) Tax Breaks	41.36	14.71	25.81
(10) Favored Nation Treatment and Quota	21.95	11.76	6.45
(11) Low Cost Research	9.76	5.88	6.45
(12) Others	2.44	2.94	16.13

Notes: Figures represent the percentage of the total firms surveyed that chose each listed motivation for direct investment in Mainland China.

Source: *Taiwan-China Economic Statistics Yearbook* (liangan jingji tunji nianbao), Taipei: Chunghwa Institute for Economics Research, 1994, page 160.

**Table 10 Effects of TDI Determinants: 1987-98**

TDI Determinants	1987-90	1991-94	1995-98
Labor Cost	Significant	Not	Not
Market Size	Not	Significant	Significant
Transportation	Significant	Significant	Significant
Education	Not	Significant	Significant
Agglomeration	Significant	Significant	Significant
Research & Development	Not	Not	Not
FDI Incentive	Significant	Significant	Significant
Cultural Links	Significant	Significant	Significant

Notes: Each of the determinants is defined as follows. Labor costs are measured the average annual real wage of manufacturing workers in a province of China. Market size is GDP of a particular region. Transportation is defined as railroad length adjusted for region size is used as a proxy for transportation linkages. Labor productivity is measured by the share of secondary-school-students in total population in a province will be used to measure education levels that proxies labor productivity. Agglomeration for a province in this study is measured by the share of manufacturing output in the province's GDP. Research and development is proxied by the share of spending on science care in total fiscal expenditures in a province will be proxy of the variable. FDI incentives are defined as a dummy variable for coastal provinces which enjoyed favorable FDI policies. Cultural links are a dummy for Fujian province that not only is geographically adjacent to Taiwan, but also speak the same dialect (Minnan dialect).

Source: Adopted from Hou and Zhang (2001).