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Foreign Direct Investment in China: Its Impact on the Neighboring Asian Economies

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China's vertiginous growth after 1978 has not only enhanced its regional presence, but also influenced regional institutions and economic structure. Regional economies, in particular the NIAEs and the ASEAN-4, have been significantly affected, particularly in their trade and investment patterns. This article focuses on the far-reaching domestic and regional ramifications of China's emergence as a large trading economy. China's WTO accession and trade expansion should have favorable welfare implications for both China and the regional economy. Vertical specialization was a key causal factor behind China's strong increase in regional imports; importing for processing, and exporting the final product, has been growing steadily. Foreign direct investment (FDI) has been a vital element of China's reform and growth strategy, and foreign-invested enterprises (FIEs) has played a crucial role in China's growth and globalization endeavors. FDI flows to neighboring Asian economies have been influenced by China's success. However, closer scrutiny reveals that China, the second largest economy in Asia, did not receive a level of FDI incompatible with the size and performance of its economy.
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Introduction

Extensive and far-reaching reform of the external sector was the principal focus of the broad-based macroeconomic reform and restructuring program adopted by the People's Republic of China's (hereinafter China) in 1978. With vertiginous GDP growth, China's global shares of trade, investment and production have risen in just two decades. Productivity levels, production standards and quality of life for some 400 million of its population in its southern and eastern coastal provinces have been steadily rising.

China's rapid growth has had a great deal of impact on surrounding Asian economies. Its regional presence has grown markedly over the last quarter-century,

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so much so that it is influencing regional institutions and economic structure. This includes the emergence of a noteworthy sub-group called the ASEAN-Plus-Three (APT)[1] as an important part of the regional architecture (another name for this sub-set of economies is 'JACK'. short for 'Japan, ASEAN, China and Korea'). This article *inter alia* asserts that the APT/JACK has an Asian identity and enormous future potential and could well become the kernel for an EU-like regional structure in future, an Asian Economic Community (Das, 2005). Since the late 1990s, China has consistently taken the initiative in persuading, beseeching and thereby drawing together the 13 member economies together to form the APT, in order to collaborate and synergize the regional economy.[2]

The establishment and continuance of certain trends in the Chinese economy has become conspicuous. In the early 2000s, China continued to be the most attractive destination for foreign direct investment (FDI). Although FDI had played a large and meaningful role in modernization and industrialization, China's domestic private sector still does not lead the economy. A large proportion of this FDI went into, though was not limited to, production of low- and medium-technology products. Secondly, the trend towards China's importance as the regional export platform continued to strengthen, contributing to both income and employment generation in the domestic economy, particularly in the southern and eastern provinces, which were relatively more successful in attracting FDI. Thirdly, the trend towards strengthening the trade sector also continued. With exports of \$693.3 billion, China was the third largest exporter in the world in 2004, accounting for 8.9 per cent of total multilateral exports (WTO, 2005). Particularly important has been China's trade with surrounding Asian high-performing (AHP) economies, growing at a rate of 20 per cent per annum, or higher, and contributing to the emergence of a new division of labor in the region. Fourth, China has continued to be a major export destination for the regional economies, particularly the newly industrialized Asian economies (NIAEs)[3] and ASEAN-4 economies.[4] China has been running trade deficits *vis-à-vis* the majority of the regional economies, which has turned it into a locomotive for regional growth. A significant proportion of regional imports were intended for producing exportable products, but those intended for domestic consumption were also on the rise. During the early 2000s, when global economic growth weakened, China also assumed a new role, locomotive of global growth.

High Growth Environment and Deflation

High GDP growth and inflation frequently go together. Since the launch of the reform program, there have been four serious bouts of inflation in China. The last occurred in the early 1990s, peaking at 27 per cent in late 1994. Thereafter, inflation began easing and in 1998 turned into a deflation that continued until 2000. The lowest rate of deflation was in 1999, at 2.2 per cent. The second episode of deflation occurred in the last quarter of 2001 and continued until the end of 2002 (Feyzioglu, 2004). The annual deflationary rate during 2002 was 0.8 per cent. The next year prices recorded a small increase of 1.2 per cent, increasing to 3.9 per cent in 2004.

An examination of disaggregated prices revealed an interesting pattern; prices of tradable consumer goods declined consistently between 1997 and 2002. In particular, domestic prices of clothing and housing, two items that have heavy weighting in the consumer price index (CPI), recorded a sharp decline during this period. Similarly, foodstuffs prices, also heavily weighted in the CPI, recorded a sharper decline. The deflationary phase ended in late 2002, when prices of food and energy began to rise. This was a turning point, after which tradable goods prices began to show a moderate increase (Feyzioglu, 2004).

During the central-planning period, China practiced price control or administered price system, but eliminated most price controls in 1993; although most prices in China are now market-determined, some are still controlled and administered by the state. The most important of these is the interest rate, which is slowly being liberalized. Administratively determined prices — euphemistically referred to as ‘guidelines’ by the State Development and Reform Commission — include pharmaceuticals, and health and education services, and take the form of price or fee ceilings. These components have approximately 10 per cent weighting in the CPI. Promoting social stability was the basic objective of keeping price increases in these sectors under control.

Saving and Investment Rates

A characteristic feature of contemporary Chinese economic growth is its high saving and investment rates, both in comparison to its past and to that in other emerging-market economies. In fact, even calling saving rates high is a euphemism, as they are among the highest in the world, averaging during the reform era (post-1978) 37 per cent of GNP. This was far superior to that during the central-planning period, when it averaged 27 per cent of GDP and was essentially ‘engineered by state fiat’ (Kraay, 2000). In 2003, the household saving rate in China was 42.5 per cent of GDP, compared to 14.3 per cent for the United States, 20.7 per cent in France and 25.5 per cent in Japan (Das, 2005).

During the pre-reform (pre-1978) era, relative prices were distorted and favored industries, which led to profit accumulation or operating surpluses in the SOEs. These engineered profits were subsequently deployed into state-determined sectors. As household incomes were low, the saving of the household sector was infinitesimal, and also exceedingly low as a proportion of total savings in the economy. Once reform was set in motion, consumption and savings decisions of households became voluntary, transforming the structure of public and private savings. Reform of the pricing system and the onset of competition eroded the large contrived profits of the SOEs. Public sector savings declined in quantity and importance and household saving soared with rising household incomes, and soon grew to half of total savings in the economy. With the collapse of the commune system in rural areas and the emergence of property rights to land and housing, a boom was ignited in rural savings. Rural savers were eager to save and invest in land and property. The spread of banking services in the rural areas facilitated a large build-up of rural savings. Other reasons behind the strong saving performance were high real GDP growth rates, healthy prospects for future growth, and the one-child-per-couple policy. The last improved the ratio of employed persons to total population in the economy.

Annual gross capital formation data from national accounts shows that since the early 1980s, investment in China has remained exceedingly high. Peaking at 43.3 per cent of GDP in 1993, cyclical slowdown brought it down to 36.3 per cent in 2000, but investment continued strong thereafter; it increased monotonically to 38.5 per cent of GDP in 2001, 40.2 per cent in 2002, 43.8 per cent in 2003 and 45.6 per cent in 2004, when concerns regarding overheating became an issue among policy-makers. Bringing investment under control, with a soft landing for the economy, became government's priority objectives (Kuijs, 2005). In late 2004 and early 2005, policy measures had to be taken to rein in investment. Government consolidated its own spending with the intention of paring deficit. Other policy measures taken to slow down investment included changing banks' reserve ratio to slow bank credit expansion, intensifying borrowing operations to sterilize foreign currency inflows and adopting policies to promote outflows of foreign exchange.

A crucial macroeconomic characteristic of the Chinese economy is that national savings and investments are more or less in balance, that is, the current account tends to remain by and large in balance. Domestic savings have been the dominant source of investment. Moreover, though household saving contributed to the economy's strong saving performance, the contribution made by high government savings and rising levels of enterprise saving were equally significant (Kuijs, 2005). In this context, it should be pointed out that China's fiscal position has also remained relatively sound, with budget deficits remaining close to 3 per cent of GDP and the debt-to-GDP ratio in the vicinity of 25 per cent. It compares well with the fiscal deficits and debt situation in other emerging-market economies.

As China Emerges as a Large Trading Economy

China's World Trade Organization (WTO) accession procedure took 15 years (1986–2001) of arduous and thorough negotiations, longer than any other WTO member (Das, 2001a). China became the 143rd member in November 2001.[5] The post-accession period has so far been smooth. Many negative effects of accession that were apprehended did not materialize. China has been commended by the General Council of the WTO for meeting its obligations and abiding by its commitments. Also, the report of the Transitional Review Mechanism, an annual procedure established by the WTO for critically examining compliance, did not find any deviations in compliance for 2002 and 2003, although there were some areas where technical problems existed.

The preparatory phase for WTO accession began in the early 1990s. During this period and after accession, China lowered its tariffs and dismantled non-tariff barriers (NTBs). Trade reforms and commitments made by China as a part of the Protocol of Accession were instrumental in integrating the economy with regional and global economies, a process that proceeded rapidly and is still on-going (Das, 2001a).

Two significant policy measures from the perspective of the domestic economy were the unification of the dual exchange rates in 1994, and removal of exchange controls on current account transactions in 1996. Future implementation of commitments made during the accession negotiations continued to further regionalize and globalize the Chinese economy. Tariff exemptions were granted for imports for processing for export. Thus, a greater proportion of imports were completely duty-free. Average tariffs declined from 55.6 per cent in 1982 to 12.2 per cent in 2002, while the weighted average came down from 40.6 per cent in 1992 to 6.4 per cent in 2002. Under the WTO commitments, average tariffs in China were set to fall to 10 per cent by 2005.[6]

Agriculture had been a sticking point during the prolonged negotiations. China agreed to binding[7] on all tariffs and to reduce them from an average of 31.5 to 17.4 per cent over the 1990–2005 period. Such a large tariff cut exceeded all expectations. China also committed to eliminating export subsidies and increasing the volume of tariff-rate quotas, which are two-tier tariffs. As regards industrial products, average tariff reduction from 24.6 to 9.4 per cent by 2005 was agreed. China also signed the Information Technology Agreement of the WTO, covering tariffs on telecommunications equipment, semiconductors, computers and computer equipment, and other information technology products.

The accession negotiations in the areas of services were the first ever such reforms negotiated by the WTO. China agreed to liberalize within an agreed timeframe key services sectors, including telecommunications, financial services and insurance, in which foreign participation either did not exist or was marginal. Foreign providers are eventually to have full access to these sectors. Licensing procedures were to be transparent. Also agreed was the elimination of restrictions on foreign participation in domestic trade and distribution. In addition, China made significant commitments in the areas of Trade-Related Investment Measures (TRIMs) and Trade-Related Aspects of Intellectual Property Rights (TRIPs) and undertook to follow the principles of national treatment and non-discrimination in TRIPs and TRIMs. As China complies with these commitments, it will have a decisive and extensive ramification for the domestic economy.

Rapid expansion of export from and import into China has contributed a great deal to sustained growth in multilateral trade. The growth rates of its exports and imports were much faster than the world average for over two decades. The latter half of the 1990s was a period of exceptionally high trade expansion. Both exports and imports grew at twice the global rate. Notably, since 2000 China has been the single largest contributor to multilateral trade expansion.

According to WTO statistics, China has developed an imposing presence in global trade. In 2003, it was the fourth largest exporter, after Germany, the US and Japan. Its total exports were $437.9 billion, 5.8 per cent of total multilateral exports. China cannot be a large exporter without being an equally large importer; it was the third largest importer after the US and Germany, with total imports of $413.1 billion, 5.3 per cent of total multilateral imports. The United Kingdom, France and Japan, in that order, were smaller importers than China. In 2003, its imports and exports grew by 34 and 40 per cent, respectively[8] — the highest growth rates in the world.

While these macro trade statistics establish China's growing stature in the arena of international trade, they do not reveal a great deal regarding the regional and global impact of China's trade expansion. While China's trade penetration into the large industrial economies has deepened, its trade with surrounding Asian economies has become dynamic and vigorous. China's importance as a trading partner has markedly increased for neighboring Asian economies. This emerging trade dynamic is meaningful for them as well as for the Chinese economy. One of the reasons for it is the strengthening trend towards vertical trade specialization in Asia, which has gone on increasing China's regional imports. In addition, increasing imports for domestic consumption have made it a key export destination for regional economies, and for several China had become the most important trade partner by the early 2000s. In 1980, 15 per cent of China's imports originated from neighboring Asian economies; in 2000 it was 53.5 per cent (although there was a marginal decline to 52.8 per cent in 2003: WTO, 2005). This is the newest structural change in Asian trade.

FDI Flows

There is a general consensus that liberal policies related to FDI inflows spur growth, that FDI works as a catalyst for development and that it is a real force in integrating a developing economy into the global economy (World Bank, 2005). FDI has been vitally important in China's contemporary reform and growth strategy, and China has been a categorical success in attracting it. FDI was instrumental in engendering thousands of foreign-invested enterprises (FIEs), which in turn played an exceedingly important role in China's growth and globalization endeavors. Little wonder that China is riding the front wave of current globalization.

Conscious, calculated and concerted measures by policy professionals for increasing FDI inflows have made China the most important and attractive destination for FDI in the world[9] (GBPC, 2004). Beginning with the 1979 promulgation of the Equity and Joint Venture Law, China has since progressively liberalized its foreign investment regime, reduced restrictions on FDI, opened more and more sectors to foreign investment and considerably improved the overall investment environment. FDI played an increasingly important role in terms of creating positive externalities by enhancing fixed capital formation, employment creation, labor training, export promotion and better access to high technology. FDI-induced technology transfer and spillover takes place not only to domestic firms in an industry, but also to domestic firms in other industries (Okabe, 2002). Indirect benefits to China included productivity gains through increased competition in the domestic market. Over the years, FDI brought substantial gains as thousands of transnational corporations (TNCs) invested billions of dollars in China.

Liberalization and Policy Reforms for Promoting FDI

There were three essential phases in China's policy liberalization for FDI. The first phase entailed gradual and limited liberalization, while the second phase involved active promotion through preferential treatment. The third and final phase was more comprehensive and included alignment of FDI promotion with domestic industrial objectives. One of the first important steps in this direction was China's assumption of responsibility for relations with the International Monetary Fund (IMF) in April 1980. A number of reform measures, both pragmatic and objective-oriented, were taken in quick succession. In 1982, the decision to open the economy for FDI was formally incorporated in the constitution and adopted by the Sixth National People's Congress. In 1983 Regulations for the Implementations of the Law of the People's Republic of China on Joint Ventures were formulated and domestic markets were further liberalized for foreign investment. More liberalization and reform measures were taken in 1984 by extending the special economic zone (SEZ) concept from the original four to 14, in coastal cities and Hainan Island. In 1985, 12 of these 14 were designated as Technology Promotion Zones, with the express objective of attracting FDI for the purpose of state-of-the-art technology transfer (Das, 2001a, b).

The regulatory framework was increasingly liberalized. In 1986, the Foreign Exchange Balance Provisions Act and the Encouragement Provisions Act were passed, helping to resolve foreign-exchange-related problems of the FIEs. More favorable regulations were adopted to encourage FDI in 1986. Export-oriented joint ventures and high-technology joint ventures were given higher priority. The idea of wholly foreign-owned enterprises was given official approval. During the same year, the State Council promulgated another law for encouraging FDI.[10] This law, famous as the '22 Article Provisions', provided for joint ventures with preferential tax treatment, freedom to import raw material and capital equipment, and the right to retain and swap foreign exchange. Licensing procedures were also simplified and streamlined (Fung *et al.*, 2002). The largest proportion of FDI went to the manufacturing sector and consisted of greenfield investment.

As the objectives of export promotion and import of advanced technology were assigned high priority by policy makers, an improved package of tax benefits was offered to joint ventures producing exportables and those utilizing advanced technology. A new set of reform measures was again instituted in 1994 to further facilitate foreign exchange management by the FIEs. Yet another new set of reforms was announced in late 1996, when China accepted the obligations of Article VIII of the IMF, eliminating all restrictions on foreign exchange transactions. This long sequence of thoughtful reforms enhanced investors' confidence in the Chinese economy, which was reflected in the brisk inflow of FDI.

Expansion in FDI Commitments and Realization

A slow trickle of FDI began in 1979, when $109 million were received. The very next year it increased to $195 million. The contracted value of FDI as well as actual realized value remained small until 1990. Initially a good part of this came from the large- and medium-sized businesses in Hong Kong and was focused in Guangdong Province, particularly Shenzhen, which used to be a small town north of and sharing the border with Hong Kong. Initially only export-oriented industries were the focus of foreign investment. In 1990, $3.4 billion were received as FDI. However, sharp increases in FDI flows began in 1992. During 1992 and 1993 China recorded an increase of approximately 150 per cent each year; FDI surged from $4.4 billion in 1991 to $28 billion in 2003. This is regarded as the 'take-off' point of FDI in China (Lai, 2003).

There were several reasons behind FDI picking up such heady momentum in 1992. First was Deng Xiaoping's symbolic visit to Guangdong Province and Shenzhen in the summer of 1992, which confirmed the direction of the 'socialist market economy', future economic reforms and the commitment of the political leadership.[11] Second, post-1992 acceleration in GDP growth, together with political stability, strengthened the confidence of foreign investors. Third, perhaps most important, was the significant reform in the foreign investment regime. In an endeavor to improve the investment environment, several restrictions on FDI were eliminated from previously banned sectors, which provided a strong boost to FDI in 1992. A reform and liberalization package to attract FDI was applied to the four SEZs. Based on experience, it was refined and improved and then extended elsewhere, the most important being the Yangtze River Delta Area (Lai, 2003).

Since 1996, China has become the largest developing country recipient of FDI. However, it was surpassed by industrial economies like the US, Germany and France in terms of volume of FDI receipt. By 2000, the cumulative contractual amount of FDI received by China had reached \$676.1 billion and the actual or realized amount had reached \$348.3 billion (MOFTEC, 2001). Four noteworthy changes took place in 2002. First, global FDI flows went into a sharp decline, at 27 per cent the largest drop in 30 years. The principal reasons for this were global economic deceleration, followed by weak recovery, which was not picking up momentum. Second, the US, traditionally the highest recipient of FDI inflows, recorded the largest decline (65 per cent) in FDI commitments. Continuing weak performance on the stock market precluded any new cross-border merger and acquisition (M&A) activities. An unprecedented string of corporate and accounting scandals in the US tarnished the image of US business corporations as well as the business environment. Third, FDI flows to Asia also recorded a small decline (12 per cent) in 2002, though China resisted this trend, its FDI inflows increasing from \$46.8 billion in 2001 to \$52.7 billion in 2002. Fourth, for the first time, China overtook the US, which received \$44.0 billion in 2002. This made China the largest global recipient of FDI in 2002, accounting for 9.88 per cent of the global flows for that year (UNCTAD, 2004; Das, 2006).

One factor favoring China in 2002 was that it began the year with a bright new feather in its cap, WTO membership. China promised not only market access to investors but also policy transparency and better governance, making it a more attractive destination for FDI. This was a consequential achievement that accelerated FDI inflows. Furthermore, FDI started going into many previously closed sectors, like services. Second, a large number of manufacturing firms and TNCs underwent restructuring during this period, which made them increase their commitment and FDI to China. Third, in a volatile global economy the investment climate in China seemed placid, serene and lucrative, making it a more attractive location for FDI than ever. These unique structural characteristics made China a bigger magnet for FDI beyond 2002; in 2003, FDI increased to \$53.2 billion and in 2004 to \$60.6 billion. This, the highest ever level, raised concerns about overheating in the investment cycle. A fair amount of these funds took the form of property investment. Ploughing back of profits by FIEs also contributed to this large amount of FDI, as many past investment projects had proved to be 'highly profitable and investors have been in no hurry to repatriate their profits' (Christiansen and Bertrand, 2005). According to one estimate, the stock of actual or realized FDI in China stood at \$505.5 billion in 2003 (UNCTAD, 2004).

The Impact of the Transitional Chinese Economy on Asian Economies

In the early 2000s, was China's dynamic expansion having a beneficial influence on neighboring Asian economies? A large dynamic economy generally works in the interest of smaller economies in the vicinity; Mexico benefits from the presence of the US and Asian high performing (AHP) economies from a dynamic Japan. Rapid real GDP growth and improvements in investment climate made China a strong magnet for global and regional FDI. The early 1990s was a period of strong expansion of FDI receipts in ASEAN economies as well as in China. The former did well in attracting FDI and had a global reputation for aggressive and attractive FDI regimes. This observation applied particularly to Indonesia, Malaysia, Singapore, the Philippines and Thailand. For each year between 1991 and 1998, Malaysia, Singapore and Thailand received more FDI than larger regional economies like Japan, Korea and Taiwan. However, the Asian crisis radically changed the *mise-en-scene*. FDI inflows plummeted dramatically in several neighboring Asian economies and never recovered. Financial media in Korea, Malaysia, Singapore, Taiwan and Thailand frequently raised the issue of China's success being at the expense of its Asian neighbors in the local and regional media. The Asia director of the World Economic Forum, Frank J. Richter, warned Asian economies regarding their investment climate in their domestic economies (*New Straits Times*, 2002).

China's growing FDI flows, even in periods of downturn in global FDI, caused anxiety among rival Asian economies, particularly ASEAN economies. In 1990, the ASEAN economies had received 51 per cent of total Asia-bound FDI; in 2001, only 11 per cent. In the early 1990s, China was receiving close to 18 per cent of the total FDI bound for Asian developing economies; by 2000, it accounted for 30 per cent. Statistical evidence of diversion is clearly present. Some of the ASEAN economies even blamed China for 'intercepting' FDI destined for them. One valid reason for decline in FDI to Asian economies was slowing outflows from the EU and the US. Secondly, the Asian crisis exposed the structural weaknesses of the ASEAN and other Asian economies, rendering them less attractive to global investors.

An increasing amount of FDI has been flowing into China because its labor costs are lower than in competing Asian economies, so any foreign investor interested in producing labor-intensive and low- or medium-technology products for sale in the industrial economies would logically prefer China. A large number of such foreign investors and TNCs already producing such products in China saw fit to reinvest their profits there because by so doing they could also avoid further geographical diversification of their production facilities, which can potentially affect cost structure adversely. Japan has been a vocal critic of China eating the share of other Asian economies, but it is interesting that even Japanese firms have increased their investment substantially because of its significant advantages over other Asian economies — the most important being lower labor costs.

Impact of WTO Accession

Recent FDI increases in China were caused by WTO accession, which was a structural factor. WTO membership earned China most-favored-nation (MFN) status, an invaluable gain for an economy that attracts large FDI in its export industries. The pre-WTO membership environment had risked important trade partners not renewing China's MFN status, and in the process obstructing exports originating from China. Accession brought the risk premium in the export-oriented industries down to zero, in the process enhancing China's appeal as a FDI destination. A related factor was that WTO accession also increased China's reliability as a source economy for trading partners. Thus, this one important development caused some loss of FDI flows to rival Asian economies.

That investors' preference for China after WTO accession increased was apparent from the annual survey that Japan's Bank of International Cooperation (JBIC) conducts among large Japanese firms and TNCs. One question asked respondents to indicate in order of preference their 10 most-favored countries for locating manufacturing industries. Between 2000 and 2001, the proportion of large Japanese firms and TNCs naming China increased from 65 to 82 per cent. Concurrently, mention of ASEAN economies steadily declined between 1996 and 2000. Also, the gap between China and the US, in terms of favorite destinations for FDI, improved in China's favor. Ranked first and second, respectively, in 2000 and 2001 by the Japanese firms, this ratio was 65:41 in 2000, while in 2001 it became 82:32. That is, the gap widened from 24 to 50 percentage points, assigning China a higher position on their scale (Woo, 2004).

Compatibility with the Size of the Chinese Economy

I have mentioned above that when global averages are compared, China does not appear to be a dominant recipient of FDI. China is the second largest economy in Asia. Its FDI receipts so far are compatible with its size and domestic market. If anything, they are somewhat lower than justified by the size of Chinese economy and natural and human resources. As noted above, FDI is barely 10 per cent of its fixed investment, which is much lower than the global average. In the *World Investment Report 2002* (UNCTAD, 2002), a benchmarking tool was devised — the Inward FDI Performance Index. It is simply the ratio of a country's share in global FDI flows to its share in global GDP, an instrument comparing the relative performance of countries attracting FDI. A value of unity means that the shares of global FDI flows and global GDP are equal. A country with an index that is greater than unity is reckoned to have received more FDI than justified by the size of the GDP. This index is an indicator of a country having advantages in production, or better growth prospects, or superior investment environment. Lower than unity values imply that the country in question is protectionist, or technologically backward, or has a political or social system that is not conducive to investment, including FDI. Index values were computed for two periods, 1988–1990 and 1998–2000. Table 1 provides the values and ranks for the Inward FDI Performance Index for the Asian economies for both periods.

As FDI tends to be uneven by nature, these ratios were computed as 3-year averages. During the first period, Singapore topped the index value, with its

Table 1 Inward FDI performance index for Asian high-performing economies

Country	*1988–1990*		*1998–2000*	
	Value	*Rank*	*Value*	*Rank*
Singapore	13.8	1	2.2	18
Hong Kong SAR	5.4	4	4.9	2
Malaysia	4.4	8	1.2	44
Thailand	2.6	25	1.3	41
The Philippines	1.7	39	0.6	89
Taiwan	0.9	58	0.3	112
China	0.9	61	1.2	47
Indonesia	0.8	63	−0.6	138
Korea (Republic of)	0.5	93	0.6	87
Japan	0.0	128	0.1	131
Average for Asia	1.07	—	0.85	—

Source: UN Conference on Trade and Development (UNCTAD), 2002: Table II.1, 25.
NB: 'Value' in the above table does not have a denomination because it is a number.

share of FDI 13.8 times the share of its GDP in the global economy. Hong Kong SAR also did extremely well. Malaysia, Thailand, the Philippines and Taiwan were all in the first half of the index list computed for 170 countries. However, the post-Asian crisis values of the index were markedly lower. Their rankings dropped precipitously in a short period of a decade. Singapore lost its top position and was ranked 18th, although Hong Kong SAR was one economy that recorded improvement during the second period by improving its ranking to 2nd. Conversely, Malaysia and Thailand slid sharply downward with rankings of 44th and 41st; while the Philippines, Taiwan and Indonesia slipped even further, into the lower half of the table at 89th, 112th and 138th. This demonstrates a dramatic reversal (as seen in Table 1) in the capability of ASEAN economies to attract FDI.

Both China and Korea managed to improve their rankings over the two periods. Of the two, China recorded an improvement from 61st to 47th, whereas Korea improved its rank for 93rd to 87th. However, according to the Inward FDI Performance Index, China's performance cannot be rated as high or impressive, like that of Singapore and Hong Kong SAR during the first period. While there was certainly an improvement in its ranking, its performance in attracting FDI has been merely above average. China's index value was 1.2 in the second period, a small improvement over the first period when it was 0.9, which was even less than unity. Even after the jolt of the Asian crisis, China was ranked below Malaysia, Singapore and Thailand. Computation and comparison of the Inward FDI Performance Index vividly demonstrates that China's share of global FDI flows has not been out of proportion. Notwithstanding the fact that FDI flows to China dramatically spurted in early 1992 and again in the 2000s, they only kept pace with China's strong GDP growth performance. Relative to size of GDP, during the 1990s, many neighboring Asian economies performed better than China in attracting global FDI.

Zero-Sum-Game Assumption

The general perception of the antagonists that China's increasing FDI has been at the expense of its Asian neighbors is based on 'the assumption that FDI is a zero-sum game' (Wu *et al.*, 2002: 101). If this assumption is correct, every time there is a rise in FDI to China, there should be a corresponding decline in flows to ASEAN and other Asian economies. Causal empiricism fails to establish such a correspondence. Such an assumption is anyway flawed because there were periods when both ASEAN economies and China both received higher FDI at the same time. One such period was 1989–1997, when both shared an increasing FDI trend. In China's case it soared from \$3.4 billion to \$44.0 billion, whereas for ASEAN economies it soared from \$7.6 billion to \$27.0

billion during the period under consideration. This does not justify the assumption that China benefited at the expense of its neighboring economies.

Regression analysis by Chantasasavat *et al.* (2004) attempted to estimate the impact of inward FDI flows into China on Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand for data for the 1985–2001 period. Their strategy was to control for all the standard explanatory variables of FDI in the Asian economies. To proxy for China's effect, they chose the level of FDI inflows in China. Their estimates found that the value of the coefficient for inward FDI into China was positive and highly significant in all the specifications. They concluded that a 10 per cent increase in FDI inflows into China would raise the level of FDI inflows into the eight Asian economies they considered for their empirical study by about 2 per cent, to 3 per cent. Thus, increasing FDI in China is not at the expense of the Asian economies but, if anything, they benefit from it.

One explanation for this increase could be the production networks among the Asian economies, of which China is an integral part. In addition, Asian economies are heavily involved in vertical trade specialization with China, which could lead to increasing FDI in them when FDI flows into China increase. Another detailed empirical exercise concluded that the changing direction of FDI in Asia would lead to welfare losses in the ASEAN-4 economies 'only if the ASEAN-4 economies fail to absorb new foreign technologies quickly and to engage in indigenous technical innovation' (McKibbin and Woo, 2003: 22). In the past, the ASEAN-4 economies were decidedly and amply technology-conscious and one can see no reason why they should not continue to be so in the face of the Chinese challenge.

China's neighbors are regarded as high-performing economies and have earned global accolades for their post-war economic dynamism. Many of them have created successful niches for themselves in the global economy (Das, 2005). Sensitive to allegations of disrupting and dislocating the performance of its neighbors, China endeavored to manage its economic relations with them by proposing a free-trade agreement (FTA) with ASEAN economies in 2000. Although an FTA is yet to be born, a trade accord was signed during the 10th ASEAN Summit of 2004.[12] This may well be a precursor to an FTA in the near future (Yu and Cheng, 2004). This lack of insouciance demonstrated China's commitment not only to good neighborliness, but also to responsible conduct in the community of nations.

Summary and Conclusions

Rapid economic growth has markedly enhanced China's regional presence, so much so that it is swaying regional institutions and economic structure, even to the emergence of a noteworthy sub-group, the APT. Following removal of price controls, except in a few key areas retained under state control, prices are now largely market-determined. Inflation, which often accompanies rapid growth, has seen four serious bouts since the launch of the reform program, and was followed by deflation until 2000, as described above. China's saving and investment rates have been among the highest in the world.

In anticipation of WTO accession, China began lowering tariffs and dismantling non-tariff barriers (NTBs) in 1993, which it integrated with other regional and global economies. Two policy measures important for the domestic economy were the unification of the dual exchange rates and removal of exchange controls on current account transactions. Rapid expansion of export from and import into China has contributed a great deal to sustained growth in multilateral trade, and growth rates in exports and imports well exceeded the world average for over two decades, especially in the latter half of the 1990s, when both exports and imports grew at twice the global rate. Since 2000, China has been the single largest contributor to multilateral trade expansion, and WTO statistics indicate its commanding position on the global trade scenario.

There are far-reaching domestic, regional and global ramifications to China's emergence as a large trading economy. Its rapid trade expansion will materially affect its developing and industrial country partners, and analysts concur that its WTO membership and trade expansion has favorable welfare implications for both China and the global economy. Vertical specialization is an important causal factor behind China's strong increase in regional imports; importation for processing into exportable products continues to increase.

The NIAEs have a complementary trade pattern with China and therefore stand to gain from its growing trade. They have become important suppliers of intermediate goods, components and sub-assemblies to China, because it needs them for its exports to industrial economies. China's export composition is evolving and moving up the value-added chain. ASEAN economies are also benefiting, as their exports to the large Chinese market have markedly expanded.

China's strategy of attracting FDI, its most important source of foreign capital, has been a decided success; FDI has been vitally important in its reform and growth strategy, and the combination of FDI and FIEs has been crucial for its growth and globalization. It is largely because of FDI inflows that China is riding the front wave of contemporary globalization. Through three phases of policy liberalization, each focussed on a different industrial sector, China became the largest developing country recipient of FDI, and then the largest global recipient of FDI. There is, however, still a long way to go in cross-border M&As, which have barely started, and skepticism regarding FDI statistics is not new. It has been argued that statistics have tended to overstate

China's ability to attract FDI, either through foreign investors ploughing back their profits, and counting it as FDI, or through its WTO MFN status, an invaluable asset for an economy attracting large export-related FDI.

For much of the 1990s, Malaysia, Singapore and Thailand received more FDI than larger regional economies like Japan, Korea and Taiwan, but this all changed after the Asian crisis. China was blamed by neighboring economies for the protracted loss of their FDI, but closer investigation reveals that as China is the second largest economy in Asia, its FDI was not incompatible with its economic weight.

Antagonists perceive FDI as a zero-sum-game. If this assumption is correct, every time there is a rise in the FDI flows to China, there should be a corresponding decline in flows to ASEAN and other Asian economies. However, causal empiricism fails to establish such a correspondence, and as there were periods when both ASEAN economies and China both received higher FDI simultaneously, the assumption is not borne out. In addition, regression analysis provided evidence of a 10 per cent increase in FDI inflows into China, raising the level of FDI inflows into its eight neighboring Asian economies by about 2–3 per cent. Thus, increasing FDI in China is not at the expense of the Asian economies but, if anything, to their benefit.

Notes

1 The ASEAN-Plus-Three (APT) grouping comprises the 10 members of ASEAN, and the three NE Asian economies, China, Japan and Korea.
2 By the early 2000s, the formal activities of ATP or JACK had expanded and included periodic meetings of finance, trade and foreign ministers of these 13 Asian countries. The 10th ASEAN Summit of 2004, which took place in Vientiane, Laos, was also the eighth annual meeting of the APT economies. During this summit the long-awaited FTA between ASEAN and China was signed.
3 Hong Kong SAR, Republic of Korea, Singapore and Taiwan.
4 The Association of South East Asian Nations (ASEAN) has 10 members; ASEAN-4 also comprises Indonesia, Malaysia, the Philippines and Thailand.
5 China was one of the original 23 contracting parties (CPs) of the General Agreement on Tariffs and Trade (GATT), a status it relinquished in 1950.
6 See Rambaugh and Blancher (2004), Table 2.7.
7 Tariff binding implies commitment not to increase rates of duty beyond an agreed level. Once a rate of duty is bound, it may not be raised without compensating affected parties.
8 See Table 1.5, WTO, 2004: 19.
9 According to an index prepared on the basis of a survey of 2000 chief executive officers (CEOs) conducted by the Global Business Policy Council (GBPC, 2004). In the survey China was the most favored country among the CEOs surveyed, one step ahead of the US.
10 Promulgated in October 1986 and called the Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment.
11 These reforms were officially reiterated in the 14th National Congress of the Chinese Communist Party, 1992.
12 29–30 November 2004 in Vientiane, Lao People's Democratic Republic.

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