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## **China as a Host of Foreign Direct Investment: Facts, Fallacies, and Prospects**

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### **Abstract**

The transition of China from a land of almost no foreign direct investment (FDI) in the 1970's to now a significant host of FDI is remarkable and has been well-remarked. Indeed, China presents a puzzle. This is a country that is supposed to be riddled with corruption and red tape, why do foreign investors keep coming?

The first half of the answer is that half of those investors are not truly "foreign." More than half of the FDI recorded in China's official statistics comes from Hong Kong, which should be regarded as "quasi-foreign." Part of this Hong Kong investment, in turn, is mainland capital in disguise (the so-called "round-tripping" investment).

The second half of the answer is that as far as the investment from the world's leading FDI source countries is concerned, China is not doing as well as popular impression suggests. Using a cross-country data on bilateral stock of FDI from 17 most important source countries, one can estimate the potential amount of inward FDI for a host country such as China as a function of its economic and policy characteristics. Compared with the model-predicted potential, China is found to be a significant under-achiever as a host of FDI. Corruption, red tape as well as domestic financial repression are significant impediments to FDI.

In the 21<sup>st</sup> Century, if China can manage to substantially improve its quality of public governance, including reducing corruption and red tape, it can dramatically accelerate its attraction to FDI from the major source countries.

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## 1. Introduction

A little bit of euphoria is a good thing. A little bit too much is a separate story. China has made a remarkable transformation from a land of almost no foreign direct investment (FDI) in the 1970's to now a significant host. In fact, the FDI numbers now look so impressive that some observers call China "the world's strongest magnet for overseas investment<sup>1</sup>," or use the phrase "China fever"<sup>2</sup> to describe the inflow of FDI into the country. This presents a puzzle. Previous studies (Wei 1997a and 1997b) have shown that corruption in host countries significantly deters inward FDI. By most accounts, China is riddled with corruption and red tape. Is China special?

This paper has two objectives. First, it will show that as far as FDI from the world's leading source countries is concerned, China is not a special case. Contrary to the impression one gets from the popular media, China continues to be an under-achiever, rather than an over-achiever. What is unusual about China is that more than half of its inward FDI comes from Taiwan, Macao, Singapore, and particularly Hong Kong, which are otherwise not significant international investors.

Second, the paper will examine whether corruption by government officials, excessive burden of regulation, and other institutional characteristics may have contributed to the relatively low volume of inward FDI from the major source countries.

In an earlier (1995) paper using data from the United Nations Council of Trade and Development (UNCTAD), I fitted a linear regression on direct investment during the 1987-90 period from the world's five largest source countries to a number of host countries, and compare China's actual reception of FDI with its potential as predicted by the regression. Based on that methodology, I found that the FDI into China was significantly below its potential, both in economic and statistical sense.

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1 The Economist (US edition), March 1, 1997 p38.

2 P.T. Bangserg, Journal of Commerce, December 27, 1996, p3A.

A number of factors could possibly explain that finding. First, given that China's opening up to foreign investment started relatively late (from 1980), and that the Tiananmen Square Incident temporarily diminished the FDI over 1989-90, the 1987-90 may not be a good period to judge China's appeal as a host country. FDI in China has grown exponentially recently. For example, the total FDI in China in 1997 was 1200% more than that in 1990 (See Table 2 below).

Second, the econometric specification was perhaps overly simplified. This could bias the result to exaggerate the potential amount of FDI that China could receive.

Third, while the earlier paper examines the host country size, level of development, and relationship with the source country as determinants of FDI, it neglects the importance of business environment, particularly the extent of corruption by government officials in the host country. Recent papers by Hines (1995) and Wei (1997a) suggest that severe corruption in a host country could significantly deter foreign investors from investing in the country.

The current paper seeks to advance our understanding of the FDI into China in a number ways. We will use more recent data with more source countries, i.e., bilateral stock of direct investment up to 1996 from the OECD. We will employ fixed-effects, random-effects and Tobit regressions to check for robustness of the results. And we will explicitly examine whether corruption and red tape have deterred foreign direct investment.

The paper is organized in the following way. Section 2 reviews the recent trend in FDI into China, and the source country composition of the FDI. Section 3 looks into the question whether China has attracted enough FDI from the world's major source countries, and whether corruption has impeded the FDI in a significant way. Section 4 concludes with a discussion on the prospect for China to attract more FDI in the new century.

## **Section 2: Evolution of China as a Host of FDI**

### **2.1 The overall picture**

The transformation of China from a country with virtually no foreign investment before 1979 to “the world’s strongest magnet for overseas investment” is remarkable and has been well documented.

Before 1979, to say that foreign investors were viewed with suspicion is a serious understatement. The Chinese government was downright hostile to private enterprises, including if not especially foreign-owned private enterprises. Under Deng Xiaoping, the promulgation of the 1979 “Law on Chinese-foreign equity joint ventures” together with the establishment of four special economic zones formally signaled the adoption of the “open-door” policy by the central government.

Typical with the Chinese characteristics of cautious reforms, the welcome mat for foreign direct investment was extended gradually in the early stage. At the beginning, only equity joint-ventures or contractual joint-ventures were allowed. No wholly-owned foreign firms were allowed. Foreign exchange use was tightly regulated. In fact, what is needed to import raw materials in principle should be raised by the firm themselves (when no open-market existed). There was tight export performance requirement. Sometimes, 100% of the output was required to export. On each of this, the restriction has been relaxed over time. For example, by now, the annual value of inflow to establish wholly-owned foreign firms (US\$16.5 billion in 1998) has exceeded that of contractual joint ventures (US\$9.3 billion in 1998), and is close to that of the equity joint ventures (\$US\$18.8 billion in 1998, MOFTEC, 1999).

Table 1 lists the evolution of all the major laws/regulations that are promulgated by the Chinese central government with regard to foreign direct investment. For comparison, I also list similar information for India. Two things are worth noting. First, in terms of the starting date of the reform, China was a decade ahead of India. [On the other hand, when the India government decided to open up in 1991, it chose to liberalize more quickly than China.] Second, on several occasions over the last two decades, the Chinese government promulgated laws and regulations specifically designed to attract investment from overseas-Chinese, particularly those from Hong Kong, Taiwan and Macao.

[Table 1: Evolutions of Laws/Regulations Governing FDI in China and India]

In Chinese statistics, two notions of FDI are used: the contractual amount and the realized value. The contractual amount is the amount that investors plan to invest over a period of time at the time of applying for approval for investment. The actual or realized value is not bound by the contractual amount, and indeed is typically much smaller. Because being able to attract foreign investment by local officials is often counted as a significant achievement by their superiors, government officials have an incentive to encourage foreign investors to overstate the (not legally binding) contractual amount. For this reason, all the data on FDI in this paper refer only to the realized values.

Table 2 exhibits the trajectory of the realized flow of FDI going into China every year from 1983 to 1999 (estimated amount). Up to very recently, the growth is truly exponential: the total inward FDI flow was a mere 0.64 billion dollars in 1983. It grew to 3.19 billion dollars in 1988, to 33.77 billion dollars in 1994, and then peaked at 45 billion dollars in 1997-98. The inflow of FDI did not do well in 1998 and 1999 due to the Asian crisis (and the slow adjustment of China's domestic economy). Every year since 1995, China received more foreign direct investment than any other country except for the U.S.

[Table 2: Annual FDI Inflows into China, India and Russia]

Foreign direct investment takes one of the following four forms: joint ventures, contractual joint ventures, wholly-owned foreign firms, and joint exploration (mainly for offshore oil). Joint ventures are by far the dominant form of foreign direct investment, account for roughly half of all FDIs throughout the sample. Foreign wholly-owned firms as a form of FDI are catching up fast, growing by 400% cumulatively over the 1992-96 period, as compared to the 279% growth rate for all FDI in the same period.

## **2.2 Source Country Composition of FDI**

FDI into China has a very unusual composition of source countries. According to the United Nations, the world's five most important source countries in terms of outflow in during 1990-1995 are the United States, Japan, Germany, the United Kingdom, and France. Collectively, they accounted for over 70% of all direct investment from developed countries.

If one looks at who invests in China (Table 2), one finds that Hong Kong is the dominant direct investor in China. Hong Kong's annual inflow accounts for a half or more of the total FDI into China for almost every single year during the 1992-97 period. The Hong Kong's dominance tends to be more important in earlier years. So if one looks at the stock of FDI, Hong Kong's share is close to 60%. Japan and the U.S. are the second and third largest investors in China (the relative ranking may switch between the two depending on the year one looks at). However, each invests significantly less than Hong Kong, typically less than a quarter of what Hong Kong invests. Britain, France, and Germany are important source countries. However, their investments not only lag distantly behind that of Hong Kong, but sometimes also behind Singapore and Macao.

[Table 3]

One may question whether Hong Kong's investment in Mainland China should be counted as foreign direct investment. This is particularly so since July 1, 1997, Britain has formally turned over

the territory back to China. In that connection, one can at most treat investment coming from Hong Kong as quasi-foreign<sup>3</sup>.

Part of the reported FDI from Hong Kong is in fact capital originated from the Mainland to come back to the Mainland disguised as Hong Kong investment, sometime labeled as “round-tripping” capital to take advantage of tax, tariff and other benefits accorded to foreign-invested firms. One estimate puts the round-tripping capital at 15% of the total Hong Kong investment in China in the Chinese official statistics (Huang, 1998). The round-tripping capital is best described as “false-foreign” direct investment. Using the previous estimate, the “false-foreign” investment was on the order of 3 billion U.S. dollars in 1997, or over 6% of the total FDI flow into China according to the official statistics.

To summarize, if one excludes the false-foreign and quasi-foreign direct investment in China, the “true” foreign direct investment would be 50% smaller in terms of the flows in recent years, and 60% smaller in terms of the stocks.

### **Section 3: China as a Host of Direct Investment from the Major Source Countries**

I now turn to examining whether China is an underachiever as a host of investment from the world’s major source countries, and whether corruption has deterred foreign investment. Let me first explain the data and the specifications of the statistical framework before presenting and discussing the results.

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<sup>3</sup> A part of the Hong Kong investment may be disguised Taiwanese investment to avoid political inconvenience with the Taiwanese government. If one adopts the view that Taiwan and China belong to the same country, which is the official position of the two governments on both side of Taiwan Strait, then this part of investment should also be treated as quasi-foreign.

Another part of the Hong Kong investment may truly be investment from the world’s major source countries such as the U.S. and U.K. This is not likely to be big. We will return to this discussion in the later part of the paper.

### 3.1 Data

#### Foreign Direct Investment

We focus on bilateral stock of foreign direct investment from 17 major source countries to forty-two host countries. To minimize the influence of year-to-year noise in the data, I use the three-year average over 1994-96. The data comes from the OECD bilateral FDI data base covering the outward FDI by destination (Table 8 for each individual country, OECD). It is based on the reports by individual source countries. The source countries include: the United States, Japan, Germany, the United Kingdom, France, Italy and Norway. The number of host countries is constrained by availability of data on corruption and tax.

The data “relies on a database developed by the OECD Directorate for Financial, Fiscal and Enterprise Affairs for comprehensive statistics on international direct investment. Data collection is based on a joint OECD/EUROSTAT questionnaire” (OECD, 1998, p9). The raw data typically come from source countries’ national statistical offices or central banks. Efforts were made by the OECD to improve the comparability of the data across countries “based on the recommendation of the *IMF Balance of Payments Manual*, Fifth Edition and the *OECD Benchmark Definition of Foreign Direct Investment*, Third Edition.” In spite of these, there are still questions about comparability of FDI definitions across reporting countries. The most notable reason for lack of comparability is that reinvested earnings are counted as part of FDI by some source countries (which is conceptually correct) but not by others (OECD, 1998, p9). For details, see the “Technical Notes” for each source country at the end of OECD(1998).

As a digression, it is useful to compare FDI into China as reported by the Chinese side versus that reported by the investing country’s side. Table 4 presents such a comparison (of annual flows) for the period 1990-1997. A striking feature is the discrepancies, sometimes quite large, on the bilateral FDI from the two reporting sources. For example, in 1996 and 1997, the Chinese source claims to have received FDI inflow from the US on the order of the US\$3.4 billion and 3.2 billion, respectively.

The US side (based on the survey of US firms by the US Commerce Department) reports only US\$ 0.9 billion and 1.2 billion, respectively. The difference is by a factor of 3. Generally speaking, the Chinese-reported inflows were much greater than the source countries' own reporting for FDI from the United Kingdom, France, Australia, and Italy as well.

The notable exceptions are FDI from Japan and Germany, where the reported numbers from the two sources were on the same order of magnitude. However, it is worth noting that the Japanese reported number refers to the approval values of FDI rather than actual realized values. Since the former is generally much bigger than the latter, it is quite possible that the Chinese reported FDI from Japan is still greater than the real amount coming from Japan. Germany-reported German investment in China is based on an annual stock survey of German firms. "[A] reporting obligation exists if a resident holds more than 20% of the shares or voting rights in a foreign enterprise." Hence, a German-Chinese joint venture in which the German share is less than 20% would not be reported in the German data but would be reported in the Chinese data.

[Table 4 ]

There are several reasons why the Chinese data may be overstated (related to bureaucrats' incentive to exaggerate their ability to attract FDI, and foreign investors' incentive to exaggerate the amount of investment in order to report lower taxable incomes). But there are also plausible reasons that the OECD numbers may be under-stated (e.g., re-invested dividends may not get properly counted). Given that the Chinese reported annual inflows were often bigger than the entire stock as reported by the source countries in the same years, it seems likely that the Chinese figures contain much fat.

In any case, in the interest of using a consistent database, all the subsequent regressions are run using the OECD data. I will, however, discuss the implication of measurement errors on the interpretation of the statistical results.

### Corruption measure

By its very nature, corruption is very difficult if not infeasible to measure objectively. Researchers have relied on corruption perception indexes based on surveys of experts or firms. For example, the Business International (BI) index, based on surveys conducted during 1980-83, asked the expert/consultant to rank a country that s/he was working on according to “the degree to which business transactions involve corruption or questionable payments.” Mauro (1995) and Wei (1997a) used it to examine the relationship between economic growth and corruption, and FDI and corruption, respectively. Unfortunately, the BI index does not cover China in its sample.

The corruption measure that I use in this paper is a perception index based on a survey of 2827 firms in 58 countries conducted by the World Economic Forum in 1996 for its Global Competitiveness Report 1997. Question 8.02 in the survey asks the respondent to rank the level of corruption in his/her country, on a scale of 1 to 7, according to the extent of “irregular, additional payments connected with imports and exports permits, business licenses, exchange controls, tax assessments, police protection or loan applications.” The corruption rating used in this paper is based on the country averages of individual responses. [The original rating is such that a low number implies a high corruption. I have transformed the number so that a big number means a high corruption. New rating = 8 – original rating.]

As a check, we can compare the corruption rating by the GCR index with another widely reported index -- Transparency International (TI) index. TI is an agency dedicated to fight corruption worldwide. Its index in 1998 is an average of seven surveys of perception of corruption conducted during 1996-98. The correlation between the GCR and TI indexes are ...

Regulatory Burden is based on the GCR survey question (Q2.02) that asks the respondents to rank the “pervasiveness” of “administrative regulations that constrain business.” [In the original rating, a lower number means more pervasive regulatory burden. With a transformation, the rating used in this paper = 8 –original rating.]

Interest Rate Controls is meant to be a measure of degree of domestic financial repression. It is similarly based on GCR survey question that ask the respondents the degree to which “deposit and lending interest rates I your country are freely determined by the market.” I have transformed the index so that the New value = 8 – original value. One hypothesis is that financial repression could promote FDI by lowering the cost of capital. An opposite hypothesis is that financial repression is often associated with rationing of credit (and denial of cheap domestic credits to foreign investors). So it may discourage FDI by raising the cost of capital for foreign investors.

Foreign Exchange Control is derived by adding up twelve possible restrictions on capital account transactions from the back of the IMF’s Exchange Arrangements and Exchange Restrictions Annual Report 1997. A possible hypothesis is that foreign exchange control as an impediment to the movement of capital makes it less attractive for foreign director investors to invest.

[ Table 5 ]

#### Other Data

For host countries' tax rate, I use the marginal corporate income tax (the top bracket). It is also from GCR(1998).

The GDP data comes from the International Monetary Fund's International Financial Statistics data base. In a few cases where GDP data are not available, GNP data are substituted. The wage data are obtained from the International Labor Organization.

The bilateral distance data measures the "greater circle distance" between the economic centers in source-host pairs. The dummy on linguistic tie takes the value of one if the source and host countries share a common language, and zero otherwise. Both data were used in Frankel, Stein and Wei (1995), and are available on Shang-Jin Wei's website: [www.nber.org/~wei](http://www.nber.org/~wei).

### 3.2 Econometric Specification

We perform three different specifications. We start with a fixed-effects regression that includes separate dummies for all source countries.

$$\text{Log}(\text{FDI}_{j k}) = \text{fixed effects}_{\text{source country}} + X_{j k} \Gamma + e_{j k}$$

Where  $\beta$  and  $\Gamma$  are scalar and vector parameters, respectively, and  $X_{j k}$  is a vector of determinants of bilateral FDI. For example, we start with four control variables.

$$X_{j k} = [\log(\text{GDP}_k), \log(\text{GDP}_k / \text{Population}_k), \log(\text{Distance}_{j k}), \text{Linguistic-Tie}_{j k}]$$

Later on, we will add other control variables including country  $k$ 's marginal corporate income tax rate (in the highest bracket), its (perceived) level of corruption and extent of regulatory burden.

Finally,  $e_{j k}$  is assumed to be an iid normally distributed variate with a zero mean.

The above specification assumes that the error term is uncorrelated with each other. If a particular characteristic of host country that is relevant determinant of FDI is missing from the specification, it would induce a host-country-specific component of the error term leading to correlated errors across observations for the same host country. As a second specification, we also implement a random effects regression that assumes a host-specific error term:

$$\text{Log}(\text{FDI}_{j k}) = \begin{matrix} \text{source country} \\ \text{fixed effects} \end{matrix} + X_{j k} \Gamma + u_k + e_{j k}$$

where  $u_k$  is host-specific normal variate with zero mean,  $e_{j k}$  is the same as before (iid across all observations), and  $u_k$  and  $e_{j k}$  are uncorrelated from each other.

Some host countries receive no direct investment from certain source countries. A potential drawback of the pervious specifications is that zero FDI observations are dropped by this specification. Therefore, we also implement Tobit version of the fixed-effects regression:

$$\begin{aligned} \text{Log}(\text{FDI}_{j k} + A) &= \begin{matrix} \text{source country} \\ \text{fixed effects} \end{matrix} + X_{j k} \Gamma + e_{j k} && \text{if } \text{FDI}_{j k} > 0 \\ &= \ln(A) && \text{if otherwise.} \end{aligned}$$

where  $A$  is a constant (set to be 0.1 in the reported tables though alternative values would not make a difference qualitatively),  $u$  is an i.i.d. normal variate with mean zero and variance  $\sigma^2$ . In this specification, if  $X\beta+u$  exceeds a threshold value,  $\ln(A)$ , source country “j” accumulates a positive stock of investment in host country “k”; otherwise, the realized foreign investment is zero (and the desired level could be negative).

### 3.3 Regression Results and Interpretation

#### Basic Findings

The first three columns in Table 6 implements a fixed effects, a random effects, and the Tobit regression on the benchmark specification. Aside from the source country dummies, the list of regressors include marginal tax rate, host country’s GDP and per capital GDP, both in logarithmic form<sup>4</sup>, log distance between the economic centers of the source and host countries, and a dummy if the

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<sup>4</sup> One may prefer to include  $\log(\text{GDP})$  and  $\log(\text{GDP per capita})$  instead. The coefficients on these two variables would be a linear combination of the two coefficients on  $\log(\text{GDP})$  and  $\log(\text{population})$ .

source and the host share a common linguistic tie and a historical colonial tie, and the lagged growth rate of the economy. The last three columns of Table 6 replicates these regressions with the addition of two dummies for China and India as host countries, respectively.

[Table 6 ]

The coefficient on tax rate is negative and statistically significant, indicating high tax tends to discourage foreign investment. The coefficient on  $\log(\text{GDP})$  is positive, significant but less than one, suggesting that larger economies receive more FDI, although the increment in FDI is less than proportional to the increment in country size. The coefficient on  $\log(\text{distance})$  is negative but significant. That on the linguistic dummy is positive, significant and quantitatively large.

The key variables of interest are the dummies for China and India as a host countries for FDI from the major source countries. The coefficients on both variables are  $-1.02$ , and statistically significant at the five percent level. In other words, controlling for this list of regressors, China, like India is a significant under-achiever as a host of FDI. The quantitative effect is large. Taking the point estimates on the China dummy and the tax variable literally, one needs to raise the tax rate by 30 percentage points ( $=1.02/0.037$ ), in order to reduce the inward FDI as much as to explain the negative coefficient on the China (and India) dummy.

#### Corruption and Other Measures of Public Institutions

In Table 7, we add a set of variables measuring the quality of public institutions. The new variables are corruption, regulatory burden, extent of capital controls, and the extent of domestic financial market repression.

The relative quantitative effect of corruption on FDI is also significant. A one-step worsening in the GCR corruption rating would be equivalent to raising the marginal tax rate by 5 percentage points. An increase in the host country corruption rating from the Singapore level (GCR97 value=1.6) to the

China level (GCR97 index=4.1) has the same effect on inward FDI as raising the tax rate by 12.5 percentage points (=2.5X5). In other words, the (perceived) corruption in China is likely to have significantly discouraged foreign direct investment.

### Flow of FDI

As we noted earlier, the welcome mat from the Chinese government for FDI was extended gradually. Plus, China (and India) started with an extraordinarily low level of FDI in the early 1980s.

This raises the possibility that China is a super-magnet for FDI as far as recent annual flows are concerned, even if its stock of inward FDI remains low.

Such an argument may not be valid as 20 years of liberalization seems long enough. Nevertheless, in Table 8, we replicate the key regressions in the previous table. There are three noteworthy results. First, we find that both the China and India dummies continue to be negative, implying that China underperforms relative its potential even if one only looks at the inflows. Second, we now see that the gap between actual FDI and potential is much bigger for India than for China. Third, corruption and regulatory burden continue to have a negative effect on inflows of FDI in most regressions, although relative to their (increased) standard errors, the effect is not always statistically significant.

### The Hong Kong Connection

It is often remarked that Hong Kong is a mecca for foreign direct investment. It seems possible that, in part because the investors from the major source countries loathe the corruption and red tape situation on the Mainland, they invest heavily in Hong Kong as a stepping stone to or substitute for investing in Mainland China. Indeed, part of the Hong Kong investment in China may have been made on behalf of the investors from the major source countries.

To see if the Hong Kong connection helps to solve the puzzle of China's under-achievement, I redefine all the FDI into Hong Kong from the major source countries as part of the FDI into China from the same source countries, and eliminate Hong Kong as a separate host in the regressions. Furthermore, I do not upgrade the business environment of the Chinese economy towards that of Hong Kong (e.g., reducing the rating on corruption and regulatory burden, which would have raised the potential amount of FDI and hence the gap between the actual and potential FDI). It is important to bear in mind that this is an over-adjustment since a substantially part of FDI into Hong Kong is truly destined for Hong Kong. Nonetheless, it is interesting to see if such a draconian adjustment could turn the China dummy from a significant negative to zero.

The results are reported in Tables 9 and 10. As it turns out, the coefficient on the Hong Kong dummy is now indifferent from zero but continues to be negative. This experiment has a high degree of arbitrariness. It serves to demonstrate that the gap between the actual FDI into China and the potential amount as defined by these regressions is enormous. Furthermore, while the existence of Hong Kong may have helped China to attract FDI from the major source countries, it does not fully compensate for corruption, regulatory burden and other elements of the Chinese environment that have discouraged FDI.

#### **4. Concluding Remarks**

While the absolute values of FDI into China in recent years look very impressive, it masks an unusual composition of source countries. A significant fraction (maybe 15%) of Hong Kong investment in China can be "round-tripping" mainland capital in disguise. This should be counted as false-foreign direct investment, and should be deleted from the statistics on FDI into China.

The remaining part of Hong Kong investment in China should be regarded as quasi-foreign direct investment, for Hong Kong has always been a special extension of China even under British rule, and has since July 1, 1997 legally been part of China. Taking out these two parts would reduce the annual flows of FDI into China in recent years by half, and the stock by 60%.

A comparison of FDI into China reported by the official source with that reported by the investing countries generally reveal a big discrepancy. The amount of inward FDI from US, UK, France and others as claimed by China is often two to three times larger than what is reported by the corresponding investing countries. One possible explanation is that the official Chinese statistics on FDI contains serious fat in it.

Using a cross-country data on bilateral stock of FDI from the seventeen most important source countries in the world, one can estimate the potential amount of inward FDI for a host country such as China as a function of its economic and policy characteristics. Compared with the model-predicted potential, China is found to be a significant under-achiever as a host of FDI from the major source countries. The gap is huge. There is evidence to suggest that China's relatively high corruption and regulatory burden discourage FDI by a significant amount.

If we take the estimated point estimates seriously, then, high corruption and regulatory burden has discouraged far more FDI than generous tax giveaway has helped to attract. A positive way to read the same message would be this: China has not exhausted its potential as a host for foreign investment. If it can manage to reduce corruption and red tape, it should be able to attract even more FDI in the new century.

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**Table 1: Evolution of Laws and Regulations on FDI in China and India**

	CHINA	INDIA
1979	Law on Chinese-foreign equity joint ventures	
1986	Law on foreign capital enterprises: China permits foreign enterprises, other foreign economic organizations and individuals to set up enterprises with foreign capital in China and protects the lawful rights and interests of such enterprises.	
1988	Law on Chinese-foreign contractual joint ventures	
1990	Interim provisions for the duration of Chinese-foreign equity joint ventures Regulations of the state council for encouraging investment from overseas Chinese and compatriots from Hong Kong and Macao: to encourage investment within the territory of mainland from overseas Chinese and compatriots from Hong Kong and Macao Regulations for contracted operation of Chinese-foreign equity joint ventures.  Rules for the implementation of the law on foreign-capital enterprises	
1991	Rules for the implementation of the income tax law for enterprises with foreign investment and foreign enterprises Income tax law for enterprises with foreign investment and foreign enterprises	A new industrial policy provided: Automatic approval for projects with foreign equity participation up to 51% in 35 high priority sectors. All other proposals up to US\$ 171 million and 100% equity approved by Foreign Investment Promotion Board (FIPB) or Secretariat of Industrial Approvals (SIA) on a case by case basis. Proposals for investment in excess of the above amount to be approved by the Cabinet Committee on Foreign Investment. Automatic approval of foreign technology agreements up to a lump-sum payment of US\$ 2 million net of taxes with 5% royalty on domestic sales and 8% for exports. Foreign investment up to 100% permitted in approved domestic venture capital funds/companies, with FIPB approval and for establishing asset management companies. Liberalization of the Foreign

		Exchange Regulation Act Reduced list of industries requiring industrial licensing Dilution of MRTP Reduction in the number of industries reserved for the public sector Liberalization of imports and reduction in tariffs Convertibility of the Rupee on current account Opening up of the capital market to foreign investors
<a href="#">ENote11</a> 1992		
1994	<p>Law of the People's Republic of China on the protection of investment of Taiwan compatriots: to protect and encourage investment of Taiwan compatriots, and to promote the economic development on both sides of the Straits.</p> <p>Regulations on labor management in enterprises involving overseas investment: to protect the legitimate rights and interests of both foreign-invested enterprises and the employees working in these enterprises and to establish, maintain and develop stable and harmonious work relationship between the enterprises and their staff.</p>	
1995	<p>Detailed rules for the implementation of the law on Chinese-foreign cooperative joint ventures</p> <p>Provisional regulations on the establishment of foreign-funded joint stock companies limited: foreign companies, enterprises and other economic entities or individuals are allowed to jointly set up foreign funded joint stock companies limited in China jointly with Chinese companies, enterprises and other economic entities or individuals, under the principle of mutual benefit.</p> <p>Provisional regulations on investment companies established by foreign investors: foreign investors are permitted to establish investment companies in China in accordance with relevant Chinese laws and regulations concerning foreign investment.</p> <p>Provisions on the establishment of foreign-funded construction enterprises: to meet the needs of opening up, strengthening the management of foreign-funded construction enterprises, and to safeguard the order of the construction market.</p> <p>Implementation measures for the administration on</p>	

	<p>import by foreign-funded enterprises Catalogue for the guidance of foreign investment industries recognizing encouraged projects for foreign investment Interim provisions on guidance for foreign investment: to guide foreign investment, adapt foreign investment to China's national economic and social development programs, and adequately protect the legal rights and interests of investors. Rules on the approval and control of resident representative offices of foreign enterprises: foreign enterprises, when applying to set up resident representative offices within the territory of People's Republic of China, must have the approval of the MOFTEC or its empowered foreign trade and economic cooperation commissions. Detailed Rules on the Implementation of the Law on Sino-Foreign Joint Cooperative Ventures Urgent Notice on Issues Relating to Current Examination and Approval of Enterprises with Foreign Investment</p>	
1996	<p>Regulations on the examination and approval of foreign-funded enterprises serving as agents for international cargo transport: to standardize the work to examine and approve foreign-funded enterprises serving as agents for international cargo transport, and in accordance with State laws and regulations concerning foreign-funded enterprises and the provisions of China on the management of international cargo transport agency business. Procedures for Liquidation of Foreign-Funded Enterprises: to ensure the smooth progress of the process of liquidation of the foreign-funded enterprises(FFEs),protect the rights and interests of the creditors and investors and safeguard the social and economic order related to the liquidation. Circular of the State Council Concerning the Extension of the Limits of Power Vested with the Inland Provinces, Autonomous Regions, Cities Separately Listed in the State Plan and the Departments Concerned Under the State Council in Examining and Approving Direct Foreign Investment Projects Provisional Measures on the Establishment of Sino-Foreign Joint Venture Trading Companies on A Pilot Basis Regulations Concerning the Examination and</p>	

	Approval of International Freight Forwarding Agencies With Foreign Investment: for standardizing the examination and approval of international freight forwarding agencies with foreign investment.	
1997		
1998	Preferential taxation policies for FDI included exemptions from tariffs and import value-added tax for imports of capital goods by foreign-funded high-tech projects and 50% reduction of tariffs and import value-added tax for imports of capital goods by sectors where foreign investment is encouraged.	<a href="#">ENote2</a> Indian companies no longer require prior clearances from the Reserve Bank of India for inward remittances of foreign exchange or for the issuance of shares to foreign investors. <a href="#">ENote3</a>

Notes:

1) Information on rules, regulations and laws for China are obtained from Ministry of Foreign Trade and Economic Cooperation (MOFTEC)

([http://www.moftec.gov.cn/moftec/official/html/laws\\_and\\_regulations/foreign\\_investment.html](http://www.moftec.gov.cn/moftec/official/html/laws_and_regulations/foreign_investment.html)).

2) Information on rules, regulations and laws for India is from:

<http://www.docuweb.ca/India/news/9612.html#S0135>

<http://www.linktochina.com/Invest/indexinvest.html>

<http://strategis.ic.gc.ca/SSG/da90887e.html> (U.S. Department of Commerce)

**Table 2: Realized Foreign Direct Investment in China, India, and Russia**  
**Annual Flows, 1980-1999**  
(Unit: Billions of U.S. Dollars)

Year	China	India	Russia
1980	0.15	8/ 685.0m rupees	
1981	0.38	10	
1982	0.41	65	
1983	0.64	63	
1984	1.26	62	
1985	1.66	160	
1986	1.88	208	
1987	2.31	181	
1988	3.19	287	
1989	3.39	350	
1990	3.49	97/ 173.6 Rs.crore	0 <sup>4</sup>
1991	4.37	136	0 <sup>4</sup>
1992	11.00	258	700 <sup>1</sup>
1993	27.52	569	700 <sup>1</sup>
1994	33.77	946	600 <sup>3</sup>
1995	37.52	1930	1876.9 <sup>2</sup>
1996	41.73	2420	2090.0 <sup>2</sup>
1997	45.28	3050	3897.3 <sup>2</sup>
1998	45.58	3000	
1999 (estimate)	37.13		

Sources: China: 1) 1980-1982: *World Investment Directory 1992*.

2) 1983-1996: China State Statistics Bureau.

3) 1997-1999: MOFTEC Statistics Data. 1999 estimate = \$18.566b (Jan-June) X 2.

**Table 5 Business Environment in Selected Countries**

host country	gdppc96	grow9094	corporati tax	corruptio gcr97 <sup>1</sup>	corruptio gcr98	corruptio TI index	Regulator Burden	capital control	interest rate
Canada	19370	0.05	38	1.7	1.56	0.8	3.44	1	2.31
<b>China</b>	<b>631</b>	<b>0.47</b>	<b>30</b>	<b>4.1</b>	<b>4.82</b>	<b>6.5</b>	<b>4.58</b>	<b>11</b>	<b>6.01</b>
Colombia	2092	0.17	35	5.1	4.87	7.8	4.79	10	3.41
France	26692	0.03	33	2.6	2.18	3.3	4.97	4	2.91
Germany	29869	.	45	2	1.61	2.1	4.33	2	1.95
Hong Kong	23054	0.22	16.5	1.8	3.88	2.2	2.15	0	2.65
<b>India</b>	<b>413</b>	<b>0.18</b>	<b>40</b>	<b>5.1</b>	<b>5.21</b>	<b>7.1</b>	<b>5.1</b>	<b>12</b>	<b>4.45</b>
Indonesia	1105	0.30	30	5.5	5.93	8	5.27	9	3.87
Japan	42295	0.06	37.5	2.2	2.00	4.2	4.62	3	3.64
Korea	10728	0.28	30	4.3	4.00	5.8	4.96	10	4.27
Malaysia	4488	0.33	30	4	3.67	4.7	3.63	11	4.15
Mexico	3245	0.14	34	4.4	4.22	6.7	4.67	8	3.56
Philippines	1092	0.06	35	5.5	5.65	6.7	4.1	9	2.58
Russia	2271	-0.43	38	5.3	5.05	7.6	4.8	10	4.37
Singapore	29894	0.33	26	1.6	1.56	0.9	2.08	1	2.96
Taiwan	12861	0.26	25	3.3	2.62	5.3	3.34	.	2.84
Thailand	2957	0.33	30	5.5	4.42	7	4.25	9	4.83
United Kingdom	19263	0.04	24	1.5	1.47	1.3	2.89	1	2.5
United States	27471	0.08	35	1.9	1.74	2.5	3.78	3	2.16

1. The one used in regressions.

2. Sources: GDP, GDP per capita from World Bank/WDI; others from GCR

**Table 6: China as a FDI as Compared With Its Potential**

Dependent variable	Fixed <sup>4</sup> effects OLS	Fixed <sup>4</sup> effects Tobit	Random <sup>5</sup> effects	Fixed effects OLS	Fixed effects Tobit	Random effects
log of FDI stock <sup>1</sup>						
China				-1.021** (0.461)	-1.070** (0.543)	-1.522* (0.821)
India				-1.018** (0.472)	-1.421** (0.548)	-1.184# (0.803)
log (GDP) <sup>2</sup>	0.829** (0.052)	0.961** (0.060)	0.909** (0.084)	0.885** (0.056)	1.023** (0.064)	0.978** (0.092)
log (Per Capita GDP) <sup>2</sup>	0.209** (0.056)	0.144** (0.065)	0.134# (0.092)	0.095 (0.070)	0.010 (0.080)	0.000 (0.113)
log (distance)	-0.654** (0.072)	-0.835** (0.084)	-0.930** (0.076)	-0.692** (0.073)	-0.876** (0.085)	-0.961** (0.076)
linguistic tie	1.609** (0.220)	1.910** (0.258)	1.091** (0.202)	1.626** (0.220)	1.938** (0.258)	1.068** (0.201)
lagged growth rate	0.536# (0.368)	0.981** (0.430)	1.297** (0.582)	0.844** (0.388)	1.306** (0.451)	1.674** (0.625)
corporate tax rate	-0.037** (0.009)	-0.029** (0.010)	-0.036** (0.014)	-0.038** (0.009)	-0.028** (0.010)	-0.037** (0.015)
No. of Obs.	580	620	580	580	620	580
R2 <sup>6</sup>	0.72	0.26	0.72	0.72	0.26	0.73

\*\*5% significant, \*10% significant, #15% significant. Standard errors in parentheses.

1. FDI stock: average of FDI stock 94-96.

2. GDP = average GDP 94-96 if dependent variable is log FDI stock;

GDP = average GDP 90-95 if dependent variable is log FDI flow.

3. Log(GDP94)-log(GDP90) if dependent variable is log FDI stock;

Log(GDP90)-log(GDP85) if dependent variable is log FDI flow;

4.  $Y(i,j) = a(i) + BX(i,j) + e(i, j)$ , where  $i$  is source index and  $j$  is host index.

All regressions include a source country dummy. Not reported to save space.

5.  $Y(i,j) = \text{source dummy} + BX(i,j) + e(i, j)$

6. Adjusted R2 for fixed effects, overall R2 for random effect, and pseudo R2 for tobit.

**Table 7: Adding Public Policies and Public Institutions**

Dependent variable	Fixed effect OLS	Fixed effect Tobit	Random effect	Fixed effect OLS	Fixed effect Tobit	Random effect
log of FDI stock						
China				-1.314** (0.508)	-1.660** (0.593)	-1.458# (0.894)
India				-1.567** (0.458)	-2.034** (0.528)	-1.580** (0.786)
log (GDP)	1.022** (0.059)	1.155** (0.068)	1.108** (0.094)	1.086** (0.061)	1.230** (0.069)	1.169** (0.100)
log (Per Capita GDP)	-0.043 (0.100)	-0.140 (0.115)	-0.037 (0.159)	-0.282** (0.118)	-0.441** (0.136)	-0.257 (0.190)
log (distance)	-0.780** (0.077)	-0.950** (0.089)	-1.003** (0.078)	-0.812** (0.076)	-0.985** (0.088)	-1.021** (0.078)
linguistic tie	1.313** (0.219)	1.592** (0.256)	0.994** (0.204)	1.305** (0.219)	1.579** (0.254)	0.979** (0.203)
lagged growth rate	0.446 (0.373)	0.693# (0.433)	1.008* (0.611)	0.763** (0.382)	1.083** (0.442)	1.327** (0.645)
corporate tax rate	-0.028** (0.009)	-0.018* (0.010)	-0.028* (0.015)	-0.027** (0.009)	-0.017* (0.010)	-0.027* (0.015)
corruption	-0.050 (0.081)	-0.058 (0.094)	-0.031 (0.128)	-0.146* (0.087)	-0.174* (0.099)	-0.112 (0.138)
administrative regulations	-0.302** (0.113)	-0.374** (0.131)	-0.283# (0.189)	-0.317** (0.112)	-0.395** (0.129)	-0.315# (0.195)
capital controls	0.008 (0.027)	-0.029 (0.031)	0.017 (0.043)	-0.006 (0.027)	-0.048# (0.031)	0.005 (0.045)
interest rate control	-0.391** (0.102)	-0.289** (0.118)	-0.457** (0.167)	-0.309** (0.111)	-0.186# (0.128)	-0.367** (0.187)
OECD	-0.647** (0.190)	-0.771** (0.219)	-0.894** (0.294)	-0.594** (0.189)	-0.694** (0.218)	-0.810** (0.305)
No. of Obs.	570	608	570	570	608	570
R2	0.75	0.28	0.76	0.75	0.28	0.76

**Table 8: Inflow of FDI**

Dependent variable	Fixed effect OLS	Fixed effect Tobit	Random effect	Fixed effect OLS	Fixed effect Tobit	Random effect
log of FDI flow						
China				-1.325# (0.830)	-1.636# (0.993)	-0.949 (1.310)
India				-2.068** (0.680)	-2.400** (0.813)	-1.715# (1.120)
log (GDP)	0.791** (0.083)	0.951** (0.097)	0.870** (0.142)	0.851** (0.084)	1.017** (0.099)	0.925** (0.150)
log (Per Capita GDP)	-0.026 (0.160)	-0.235 (0.188)	-0.067 (0.244)	-0.373* (0.204)	-0.646** (0.240)	-0.298 (0.303)
log (distance)	-0.865** (0.100)	-0.955** (0.118)	-0.868** (0.102)	-0.876** (0.099)	-0.965** (0.116)	-0.872** (0.102)
linguistic tie	0.897** (0.273)	1.017** (0.321)	0.828** (0.263)	0.964** (0.273)	1.080** (0.321)	0.841** (0.264)
lagged growth	1.044 (0.840)	1.986** (0.998)	1.196 (1.371)	1.150 (0.830)	2.102** (0.984)	1.325 (1.397)
corporate tax rate	-0.020* (0.011)	-0.026* (0.014)	-0.031# (0.020)	-0.020* (0.011)	-0.025* (0.013)	-0.030# (0.021)
corruption	-0.061 (0.128)	0.060 (0.151)	0.009 (0.199)	-0.227# (0.145)	-0.139 (0.172)	-0.077 (0.218)
administrative regulations	-0.234# (0.160)	-0.342* (0.190)	-0.230 (0.282)	-0.169 (0.159)	-0.265 (0.189)	-0.226 (0.288)
capital controls	0.027 (0.041)	-0.032 (0.048)	0.016 (0.064)	-0.001 (0.042)	-0.067 (0.049)	0.001 (0.067)
interest rate control	-0.242* (0.147)	-0.349** (0.174)	-0.311 (0.244)	-0.178 (0.159)	-0.264 (0.189)	-0.268 (0.274)
OECD	-0.728** (0.288)	-0.607* (0.338)	-0.687# (0.426)	-0.747** (0.284)	-0.622* (0.332)	-0.663# (0.433)
No. of Obs.	267	274	267	267	274	267
R2	0.66	0.21	0.69	0.67	0.22	0.70

**Table 9: Hong Kong Connection for FDI Stock**

Dependent variable	Fixed effects	Fixed effects	Random effects
log of FDI stock			

	OLS	Tobit	
China	0.087 (0.518)	-0.650 (0.604)	-0.056 (0.917)
India	-1.542** (0.461)	-2.018** (0.538)	-1.567* (0.803)
log (GDP)	1.087** (0.061)	1.233** (0.071)	1.173** (0.102)
log (Per Capita GDP)	-0.287** (0.119)	-0.442** (0.138)	-0.261 (0.193)
log (distance)	-0.818** (0.077)	-0.971** (0.090)	-1.039** (0.079)
linguistic tie	1.239** (0.224)	1.554** (0.263)	0.882** (0.208)
lagged growth rate	0.742* (0.387)	1.039** (0.452)	1.348** (0.661)
corporate tax rate	-0.029** (0.009)	-0.018* (0.010)	-0.028* (0.016)
corruption	-0.147* (0.087)	-0.179* (0.101)	-0.115 (0.140)
administrative regulations	-0.328** (0.115)	-0.409** (0.134)	-0.316# (0.203)
capital controls	-0.010 (0.028)	-0.051# (0.033)	0.005 (0.048)
interest rate control	-0.299** (0.113)	-0.174 (0.132)	-0.367* (0.194)
OECD	-0.623** (0.194)	-0.705** (0.227)	-0.830** (0.320)
No. of Obs.	555	593	555
R2	0.75	0.28	0.76

**Table 10: Hong Kong Connection for FDI Flow**

Dependent variable	Fixed effect	Fixed effect	Random effect	Fixed effect	Fixed effect	Random effect
log of FDI flow	OLS	Tobit		OLS	Tobit	
China	-0.615	-0.678	-0.345	-0.339	-0.672	0.024

	(0.705)	(0.745)	(1.029)	(0.828)	(0.992)	(1.327)
India	-0.971*	-1.041*	-0.758	-2.058**	-2.416**	-1.696#
	(0.588)	(0.621)	(0.878)	(0.677)	(0.810)	(1.132)
log (FDI90)	0.487**	0.495**	0.498**			
	(0.051)	(0.054)	(0.053)			
log (GDP)	0.263**	0.298**	0.286**	0.855**	1.021**	0.936**
	(0.094)	(0.100)	(0.134)	(0.084)	(0.098)	(0.151)
log (Per Capita GDP)	-0.223	-0.442**	-0.202	-0.376*	-0.657**	-0.305
	(0.174)	(0.181)	(0.241)	(0.203)	(0.239)	(0.305)
log (distance)	-0.480**	-0.438**	-0.446**	-0.883**	-0.961**	-0.889**
	(0.095)	(0.100)	(0.099)	(0.099)	(0.116)	(0.102)
linguistic tie	0.221	0.009	0.203	0.856**	0.957**	0.682**
	(0.245)	(0.258)	(0.236)	(0.277)	(0.325)	(0.266)
lagged growth	-0.314	-0.203	-0.358	1.183	2.056**	1.320
	(0.738)	(0.779)	(1.113)	(0.835)	(0.993)	(1.425)
corporate tax rate	-0.005	-0.010	-0.010	-0.021*	-0.026*	-0.031#
	(0.010)	(0.010)	(0.016)	(0.011)	(0.014)	(0.021)
corruption	-0.220*	-0.196#	-0.105	-0.239*	-0.161	-0.094
	(0.124)	(0.131)	(0.173)	(0.145)	(0.172)	(0.220)
administrative regulations	-0.122	-0.144	-0.194	-0.190	-0.277#	-0.246
	(0.138)	(0.146)	(0.227)	(0.161)	(0.191)	(0.297)
capital controls	0.053	0.016	0.052	-0.008	-0.072	-0.003
	(0.037)	(0.039)	(0.055)	(0.043)	(0.051)	(0.071)
interest rate control	0.159	0.062	0.111	-0.155	-0.242	-0.250
	(0.142)	(0.149)	(0.219)	(0.160)	(0.190)	(0.280)
OECD	-0.008	0.217	0.171	-0.808**	-0.662*	-0.725#
	(0.264)	(0.277)	(0.363)	(0.289)	(0.339)	(0.445)
No. of Obs.	252	253	252	259	266	259
R2	0.75	0.30	0.77	0.68	0.23	0.70
Breusch and Pagan test p-value			0.00			0
Hausman specification test p-value			1.00			0.29

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- India: 1) 1980-90, 98: The World Bank.  
2) 1980 in Rs.Crores: *World Investment Directory 1992*.  
3) 1990 in Rs.Crores: Statistical Abstract India 1997.  
4) 1991-1997: <http://strategis.ic.gc.ca/SSG/da90893e.html> based on data provided by the Reserve Bank of India.
- Russia: 1) *World Investment Report 1998: Trends and Determinants* (data from UNCTAD, FDI/TNC database).  
2) <http://russia.shaps.hawaii.edu/economic/russia-dfi.html> based on data from Russian State Statistical Committee.  
3) *Statistical Handbook 1996*, States of Former USSR.  
4) *Global Development Finance 1999*



**Table 3. Source Country Distribution of Foreign Direct Investment in China**  
 ( Flow data in millions of U.S. Dollars)

Country	DFI1990	DFI 1991	DFI 1992	DFI 1993	DFI 1994	DFI 1995	DFI 1996	DFI 1997
Total	3487.11	4366.34	11007.51	27514.95	33766.50	37520.53	41725.52	45257.04
Hong Kong	1880.00	2405.25	7507.07	17274.75	19665.44	20060.37	20677.32	20632.00
Japan	503.38	532.50	709.83	1324.10	2075.29	3108.46	3679.35	4326.47
USA	455.99	323.20	511.05	2063.12	2490.80	3083.01	3443.33	3239.15
Germany	64.25	161.12	88.57	56.25	258.99	386.35	518.31	992.63
Macao	33.42	81.62	202.00	586.50	509.37	439.82	580.39	394.55
Singapore	50.43	58.21	122.31	490.04	1179.61	1851.22	2243.56	2606.41
UK	13.33	35.39	38.33	220.51	688.84	914.14	1300.73	1857.56
Italy	4.10	28.21	20.69	99.89	206.16	263.31	166.94	215.04
Thailand	6.72	19.62	83.03	233.18	234.87	288.24	323.31	194.00
Australia	24.87	14.91	35.03	109.96	188.26	232.99	193.92	313.74
Switzerland	1.48	12.31	29.14	41.02	70.54	63.53	187.61	215.67
Canada	8.04	10.76	58.24	136.88	216.05	257.02	337.93	344.12
France	21.06	9.88	44.93	141.41	192.04	287.02	423.75	474.65
Bermuda	---	8.00	0.29	18.53	50.74	109.14	86.12	104.89
Netherlands	15.98	6.67	28.41	84.00	111.05	114.11	125.11	413.80
Norway	2.23	6.05	5.06	1.34	2.31	1.53	26.79	6.46

Philippines	1.67	5.85	16.28	122.50	140.40	105.78	55.51	155.63
Panama	6.76	3.56	8.19	14.84	18.30	15.66	15.47	7.547
Ireland	---	2.50	1.00	1.50	---	0.99	10.03	0.3
Indonesia	1.00	2.18	20.17	65.75	115.70	111.63	93.54	79.98
Malaysia	0.64	1.96	24.67	91.42	200.99	259.00	459.95	381.83

Source: China Ministry of Foreign Economic Relations and Trade (various issues). *Almanac of China's Foreign Economic Relations and Trade 97/98* (for 1997).

**Table 4. FDI Flow into China**  
**Chinese vs. Source Country Statistics**

Country	DFI 1990	DFI 1991	DFI 1992	DFI 1993	DFI 1994	DFI 1995	DFI 1996	DFI 1997	Units
USA (OECD report)	30	40	74	556	1232	261	941	1217 <sup>P</sup>	Million US\$
USA (Chinese report)	455.99	323.20	511.05	2063.12	2490.80	3083.01	3443.33	3239.15	Million US\$
Japan (OECD report)	349	579	1070	1691	2565	3834	2599 / 282800 m yen	.	Million US\$
Japan (Chinese report)	503.38	532.50	709.83	1324.10	2075.29	3108.46	3679.35	4326.47	Million US\$
Germany (OECD report)	.	115	233	112	483	630	1145	1230 <sup>P</sup>	Million DM
Germany (OECD in US\$)	.	75.86	144	64.88	304.11	437.39	763.33	723.53	Million US\$
Germany (Chinese report)	64.25	161.12	88.57	56.25	258.99	386.35	518.31	992.63	Million US\$
UK (OECD report)	.	17	20	21	8	51	211	.	Million
UK (OECD in US\$)	.	31.80	30.24	31.11	12.5	83.7	351.67	.	Million US\$
UK (Chinese report)	13.33	35.39	38.33	220.51	688.84	914.14	1300.73	1857.56	Million US\$
France (OECD report)	-11	463	296	505	607	743	1280	1313 <sup>P</sup>	Million Francs

France (OECD in US\$)	-2.14	89.38	53.75	85.66	113.54	141.43	250.98	226.38	Million US\$
France (Chinese report)	21.06	9.88	44.93	141.41	192.04	287.02	423.75	474.65	Million US\$
Australia (OECD report)	.	.	.	16	50	33	.	.	Million Aus\$
Australia (OECD in US\$)	.	.	.	10.83	38.84	24.59	.	.	Million US\$
Australia (Chinese report)	24.87	14.91	35.03	109.96	188.26	232.99			Million US\$
Italy (OECD report)	.	.	24	4	33	51	136	197p	Billion Lires
Italy (OECD in US\$)	.	.	19.48	2.55	20.46	31.31	88.14	115.69	Million US\$
Italy (Chinese report)	4.10	28.21	20.69	99.89	206.16	263.31	166.94	215.04	Million US\$
Netherlands (OECD report)	.	12	-56	-30	332	169	500	.	Million Guilders
Netherlands (OECD in US\$)	.	6.32	-31.11	-15.79	184.44	105.63	294.12	.	Million US\$
Netherlands (Chinese report)	15.98	6.67	28.41	84.00	111.05	114.11	125.11	413.80	Million US\$
Switzerland (OECD report)	.	.	.	32	168	342	368	247 <sup>p</sup>	Million SF
Switzerland (OECD in US\$)	.	.	.	21.33	120	285	306.67	164.67	Million US\$

Switzerland (Chinese report)	1.48	12.31	29.14	41.02	70.54	63.53	187.61	215.67	Million US\$
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Sources:

1. OECD statistic: *International Direct Investment Statistics Yearbook 1998* (except Australia).
2. Chinese statistic: see sources for Table 2.

Notes:

1. p denotes provisional statistic.
2. Yearly average exchange rates are used for yen/US\$ conversion for 1996.

## Appendix A: Taxes to be Paid by Foreign Firms in China (Beijing Area)

Source: Beijing Government Web Site

<http://www.chinavista.com/beijing/invest/tax.html>

### Taxes Required to be Paid by Foreign-funded Enterprises

[Value Added Tax \(VAT\)](#) [Consumption Tax](#) [Business Tax](#) [Income Tax](#) [Land Appreciation Tax](#) [Tax on Building Property](#) [Stamp Tax](#) [License Fare for Vehicles and Vessels](#) [Individual Income Tax](#) [Customs Duty](#)

#### Value Added Tax (VAT)

There are 3 tiers of rates for VAT: For sales or import of goods and providing service of processing and repair, the tax rate is 17%.

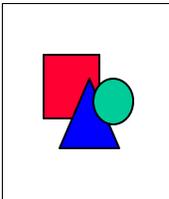
For sales or import of grain, edible oil, coal gas, natural gas, coal products for civil use, books, newspapers, magazines, etc., the tax rate is 13%.

For export goods, except for those that the State Council has special provisions, the tax rate is 0.

For enterprises and individuals engaged in production or providing taxable labor service with an annual sales volume under RMB 1 million, those engaged in wholesale and retailing with an annual sales volume under RMB 1.8 million, and those designated by the tax authority as small VAT payers, the tax rate is 6%.

#### Consumption Tax

Consumption tax has in all 11 tax items and 25 tax rates (tax volumes), from the lowest 3% to the highest 5%. The tax rate should be decided by prices in the production process while for yellow rice wine, beer, petrol and diesel oil, the tax volume is decided by its quantity. The taxable export consumer goods, except those subject to special State provisions, should be exempt from consumption tax.



#### Business Tax

There are 9 tax business rates, ranging from 3% (communications and transportation industry) to 20% (recreation industry). The temporary tax rate for recreation industry in Beijing is 10%.

#### Income Tax

In the administrative area of Beijing, the tax rate of foreign-funded enterprises of a production nature with an operation term over 10 years is reduced to 24%. They shall be exempt from this tax in the first two profitable years and allowed a 50% reduction in the following three years. Foreign-funded enterprises engaged in farming, forestry and husbandry may apply to the State Tax Bureau for a 15% to 30% reduction in income tax for 10 years after the expiration of the two-year income tax exemption and the three-year reduction period.

Foreign-funded production enterprises located in Beijing Economic and Technological Development Zone shall be levied at a reduced rate of 15%, and shall be exempt from this tax for two years starting from its first profitable year and allowed a reduction of 50% of this tax (7.5%) in the next three years.

Hi-tech enterprises set up in Beijing Hi-tech Industry Experimental Zone shall be exempt from this tax for three years from the date it gets the business license and

allowed a reduction of 50% of this tax (7.5%) in the next three years.

After application off the enterprise and approval from the tax authority, the elected technologically advanced enterprises may enjoy extension for another three years of 50% income tax reduction after the expiration of its exemption and reduction period of income tax. But if the reduced rate is lower than 10%, the income tax should be levied at the rate of 10%. After the expiration of the exemption and reduction period of income tax, export-oriented enterprises whose annual export volume amounts to 70% or higher of the annual output value, may enjoy 50% income tax reduction for that year.

Foreign-funded production enterprise which operate technology intensive projects, with a foreign investment over US\$30 million which need a long period to retrieve, and which are engaged in projects of energy, communications and construction of harbor, may enjoy a reduced income tax rate of 15%, with the approval of the State Tax Bureau.

Foreign investors in a foreign- funded enterprise, who reinvest the net profits directly in other enterprises in China for an operation term of no less than five years, shall obtain a refund of 40% of the income tax paid on the amount of reinvestment. Foreign investors who reinvest their directly owned net profits in the technologically advanced enterprises or export-oriented enterprises for an operation term no less than five years, may obtain a refund of all the income tax paid on the amount of reinvestment.

New technology enterprises, technologically advanced enterprises and export-oriented enterprises are exempt from local income tax. Foreign-funded production enterprises with an operation term over 10 years shall enjoy exemption from local income tax in the first five profitable years and a 50% reduction in the following five years.

### Land Appreciation Tax

Land Appreciation Tax has four levels of progressive tax rate.

1. For the part of increased value that does not surpass 50% of the deduction of fixed items, the tax rate is 30%.
2. For the part of increased value that surpasses 50% but no more than 100% of the deduction of fixed items, the tax rate is 40%
3. For the part of increased value that surpasses 100% but no more than 200% of the deduction of fixed items, the tax rate is 50%.
4. For the part of increased value that surpasses 200% of the deduction of fixed items, the tax rate is 60%.

The surplus amount of the Land Appreciation Tax payer's income from real estate transfer subtracting the fixed amount of deduction is the volume of increased value.

Fixed items for deduction:

\* The amount of money paid for the right to use the land; the development cost of the land; the cost and fees for new house building and the accessory equipment, or the assessed value for the old houses and buildings; the relevant taxes on real estate transfer as required by the Ministry of Finance.

In the calculation of Land Appreciation Tax, for expenses related to real estate development, such as sales expenses, financial expenses, management expense

situations, the deduction of real estate development expenses should be 10% of the total real estate cost.

### Tax on Building Property

The owner or renter (agent and user in case it is unidentifiable) is the tax payer. The building property of foreign-funded enterprises and of foreign personnel should be levied quarterly at an annual tax rate of 1.2%. And they may enjoy a 30% reduction of assessed tax.

### Stamp Tax

The taxable instruments:

Contracts or agreements on buying and selling, processing, building projects, leasing, goods transport, storage, loans, property insurance and technology contracts and vouchers of contract .

Instruments of property transfer, business account books, rights, certificates and licenses; other instruments that the Ministry of Finance deems necessary to be taxed.

### License Fare of Vehicles and Vessel

Users of automobiles and vessels as tax payers. Tax rate: the rate for trucks and ships is decided by their tonnage while that for passenger buses and cars by their types and number of seats.

- Trucks RMB 48 yuan per ton per year
- Buses and cars RMB 120-163 yuan per year (according to the number of seats)
- Motor bicycles RMB 20-48 yuan per year
- None-motor vehicles RMB 4-30 yuan per year

### Individual Income Tax

For individuals residing in China for less than one year, individual income tax shall be levied only on the income gained within China.

For individuals residing in China over one year but less than five years, individual income tax shall be levied on the income gained within or outside China.

For individuals residing in China over five years, individual total income from outside China from the sixth year.

Individual income tax shall be levied on the following categories of income:

Wages and salaries; compensation of personal services, royalties; interest, dividends and bonus; income from property leasing; income from property transfer; other kinds of income specified as taxable by the Ministry of Finance.

Foreign personnel working and performing personal services within China, whose continuous or accumulated residence in China does not exceed 90 days in one Gregorian calendar year (183 days for those from countries with which China has taxation agreement), shall be exempt from individual income tax, for income from salaries and wages obtained from employers outside China.

Income from wages and salaries is taxed at 8 progressive rates, ranging from 5% to 45%. One's monthly income minus RMB 4,000 yuan is his taxable amount of income.

Income from compensation for personal services, royalties, interest, dividends, bonus, lease of property, transfer of property, and other kinds of income shall be taxed at a proportional rate of 20%.

## Customs Duty

Import: Starting from April 1, 1996, the import of equipment and raw materials purchased by newly established foreign-funded enterprises within the stipulated total investment is subject to import tariff and import link tax. For foreign-funded enterprises founded before March 31, 1996, import of goods within the stipulated total investment and approved additional investment is exempt from import duty during the grace period (before Dec. 31, 1997, for projects with total investment above US\$30 million; before Dec. 31, 1996, for projects with total investment less than US\$30 million). Tax should be levied accordingly for their import beyond total investment. If the import can not be finished within the grace period, the State Council may extend the grace period upon the request of Moftec.

Export: Export products produced by the foreign-funded enterprise itself, except those prohibited from exportation by the State and those subject to other State regulations, shall be exempt from export tariff.

Bonded commodities: The necessary imports for foreign-funded firms to produce exports, such as raw materials, fuel, parts and components, accessories or packaging materials are regarded by the custom house as bonded commodities.

## Appendix B: Policies and Regulations on Foreign Firms in China (Beijing Area)

Source: Beijing government's web site

<http://www.chinavista.com/beijing/invest/policy.html>



# Policy and Regulations on Foreign-funded Enterprises

- [Policy and Regulations of Administration for Industry and Commerce](#)
- [Policy and Regulations on Labor Management](#)
- [Policy and Regulations of Foreign Exchange Control on Foreign-funded Enterprises](#)
- [Policy and Regulations on Real Estate Investment](#)
- [Policy and Stipulations Regarding the Inspection of Import & Export Goods](#)
- [Recognition and Definition of Technology Intensive and Knowledge Intensive Foreign-funded Enterprises](#)
- [Regulations on Reinvestment of Foreign-funded Enterprises](#)

## Policy and Regulations of Administration for Industry and Commerce

### Registration

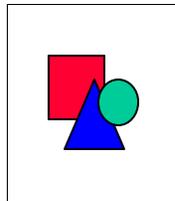
Within 30 days after the examination and approval organs issue approval document and certificate, investors should register at administrative offices for industry and commerce, which will issue business license after examination and ratification.

### Regulations on investment input

According to the Regulations on Investment Input of Different Parties of Joint Ventures, all parties should turn in the stipulated capital within six months from the issuance of business license, if the contract provides that investment be turned in one move; if the contract allows installments, the first installment should not be lower than 15% of the agreed amount of investment of each party and must be turned in within three months from the issuance of business license. If any party does not observe the regulations, the joint venture will be regarded as automatically dispersed and the approval certificate will expire automatically. The joint venture should cancel the registration at the administrative office for industry and commerce and return the business license. The Administration for Industry and Commerce will make the announcement of revoking business licenses of those who do not cancel registration or return the business license. The parties who do not make investment within the contracted period of time will be punished by the registration administrative offices.

### Annual inspection:

The registration administrative offices conduct an annual inspection on foreign-funded enterprises. The inspection examines the investment paid by different parties, whether the joint venture is doing normal business within the registered



scope of business, whether there is any investment withdrawal, transfer of property, or evasion of debts, whether it has opened business, change or cancel registration as stipulated by regulations. Foreign-funded enterprises should submit annual inspection reports and statements of assets and liabilities in time.

#### Supervision and administration:

The registration administrative offices take the responsibilities of supervising and administering the implementation of the contract and articles of foreign-funded enterprises. To those who do not or refuse to set up account books inside China, the registration administrative offices have the right to suspend their business or revoke their business licenses. The offices also make sure that foreign-funded enterprises open business, change or cancel registration as stipulated by regulations, do business within the registered scope of business and in accordance with the contracts and articles, go through annual inspection, and observe relevant laws and policies of the State.

All parties in a foreign-funded enterprise should state clearly in the contract and articles of association the time limit of the investment and turn in the registered capital before that time limit. Unless otherwise specified by the State, the following regulations on the time requirement of investment are applied to the investors of a foreign-funded enterprise. (Please refer to the table in page 68.)

## Policy and Regulations on Labor Management

### Contract of labor

Foreign-funded enterprises must comply with the Labor Law of the People's Republic of China and Regulations on the Implementation of Labor Contract System of Beijing. The legal representative must sign labor contracts with employees for a certain period of time on the day of the employment.

### The hiring, firing and resigning of employees

Employing: Foreign-funded enterprises can determine their institutional and personnel systems on their own and are free to decide the time, scale, conditions, and patterns of their employing activity. But child labor is prohibited. Women workers should not be assigned to do work specified by the State as unsuitable for women. If foreign-funded enterprises want to employ people from outside Beijing, they must individually make application on the employment relationship to local governments, or the administrative department of the municipality will collect the cases and apply to Beijing Municipal Bureau of Labor. People from Taiwan, Hong Kong and Macao, who want to work in Beijing must apply for the Employment License of People from Taiwan, Hong Kong and Macao. The Municipal Bureau of Labor is the administrative department of the employment of people from Taiwan, Hong Kong and Macao.

Dismissing: Foreign-funded enterprises are can dismiss those who remain unqualified after trial employment and professional training, who have broken the regulations of the enterprises } and those who are convicted.

Resigning: Employees can resign during the trial employment period, or at any time when the enterprise has violated the labor contract and encroached the lawful rights of the employees.

### Labor protection

Work time, holidays, and leave: The work time should not exceed eight hours per day. The average work time per week should not exceed 40 hours. Foreign-funded enterprises are required to arrange holiday leaves for employees in legal holidays such as the New Year, Spring Festival, the International Labor Day, and the National Day.

Labor safety and hygiene: Foreign-funded enterprises must strictly observe the regulations and standards of labor safety and hygiene in China. The production equipment and installations must be supplemented with safety and hygiene facilities. For new projects, expansion projects and renovation projects, the safety and hygiene facilities must be designed, constructed, and put into use simultaneously with the principal parts of the projects.

Employment of foreigners in China refers to the behavior of those who have not obtained residence but are engaged in social labor activities in China and get payment for their services. According to the Regulations on Employment of Foreigners in China, a license system is used to administer the employment of foreigners who come to work in China.

The employers are required to apply for Employment Licenses for the foreigners they want to employ and are not allowed to employ foreigners without the Employment License of Foreigners in People's Republic of China. The labor executive department of the municipal government is responsible for the administration of foreigners' employment in China. Foreign employees who work in foreign-funded enterprises should pay tax in accordance with relevant laws. If the salary, wage, and other legal income of the foreign employees are in foreign currencies, the employee, after paying the tax, can either remit the money or take it out of China; if the income is in RMB, the employee, after paying the tax, can purchase foreign currencies at designated banks with the effective certificate issued by foreign exchange control department, and then remit the money or take it out of China.

The employment of residents of Taiwan, Hong Kong and Macao should comply with the Regulations on Employment of Residents of Taiwan, Hong Kong and Macao.

### Labor Insurance, Welfare, and Salary System

Salary standard for foreign employees: Salaries for foreign employees shall be settled and paid according to the labor contract signed by both the enterprises and the employees. Salaries for the employees from Hong Kong, Macao and Taiwan shall be settled in light of the regulations for foreign employees.

The salary standard for Chinese employees is decided by the enterprise itself, but should not be lower than RMB 1.4 yuan per hour and RMB 240 yuan per month.

Standards for extraction of medical expenses, various welfare and pensions for Chinese employees: The foreign-funded enterprises should extract the total salaries and wages of Chinese employees from its cost and take the extraction as the base.

(see the table below)

Price subsidiaries standards: According to the rules of the Ministry of Finance, foreign-funded enterprises should hand in the various price allowances (RMB 30 yuan per month for each Chinese employee in the enterprise) to the local financial authorities that the State pays to the employees, in accordance with the standards

verified by local financial and labor departments of the provinces, autonomous regions and municipalities directly under the central government.

Exemption policies: Starting from the month of their establishment, the State-approved export-oriented and technologically advanced foreign funded enterprises are exempt from this 30-yuan price allowances. Cost and expenses of the enterprises shall be correspondingly reduced. The enterprises are exempt from all the price allowances for Chinese employees who hold rural residence cards.

## Policy and Regulations of Foreign Exchange Control on Foreign-funded Enterprises

### Issuance of Foreign Exchange Control Certificate of Foreign-funded Enterprises

Within 30 days from the issuance of business license, the foreign-funded enterprise should apply for the Foreign Exchange Control Certificate from the local administration on foreign exchange control and meanwhile submit the documents issued by the administration of industry and commerce. The enterprise can hold the certificate to open its foreign currency account in the designated banks. With the approval of administration of foreign exchange control, the foreign-funded enterprises can also open foreign currency accounts at financial organs within or out of the Chinese territory.

### Opening account in China

Opening a foreign currency account: Foreign-funded enterprises may choose any bank that has the right to do foreign currency operations to open a foreign currency account. In applying for the opening of account, the following documents are to be delivered:

5. Business license ratified and issued by the administration of industry and commerce
6. Approval certificate for establishment of the enterprise
7. Foreign Exchange Control Certificate of Foreign-funded Enterprises issued by the Administration of Foreign Exchange Control.

Opening a RMB account: Foreign-funded enterprises may choose any bank that has the right to do RMB operations to open a RMB account. For the application, the following documents are to be delivered:

1. Business license ratified and issued by the administration of industry and commerce
2. Approval certificate for establishment of the enterprise

### Payment and remittance of foreign exchange

With relevant certificates and documents, current payment of foreign exchange within the business scope of the foreign-funded enterprise can be directly remitted through the bank of deposit.

Foreign-funded enterprises can go through the repayment of foreign capital and interest with the bank of deposit by the Examined Paper of Foreign Loan issued by the Administration of Foreign Exchange Control. Profits that foreign investors obtained, and salary income of foreign employees and employees from Hong Kong, Macao and Taiwan can be remitted through the bank of deposit.

The remittance of foreign exchange under the items of the enterprise's capital, such

as the capital transfer of foreign-funded enterprises, recovery of investment, and the remittance of outlay of the enterprise's branches outside China, must be approved by the Administration of Foreign Exchange Control.

#### **Profits in RMB obtained by foreign investors**

Approved by the Administration of Foreign Exchange Control, the foreign investor of the foreign-funded enterprise can invest its profits in RMB in Chinese enterprises that can create foreign exchange or increase foreign exchange income. Besides the preferential treatment of partial refund of the paid income tax, the investor can also get the same treatment as the foreign exchange abroad, foreign-funded enterprises should go through foreign loan registration with the Administration of Foreign Exchange Control. Overseas loans that need the Chinese party's guarantee should be considered in light of the State plan of employing foreign investments and be reported to relevant departments for approval.

**Foreign currency exchange** Examined and approved by the Administration of Foreign Exchange Control, foreign-funded enterprises can sell their revenue in foreign currencies, foreign investment, etc. on the swap market. Also on the swap market, they can also buy foreign currencies needed for activities within their business scope, foreign loan repayment, and for remittance of the foreign investor's profits, etc.

#### **Annual check on foreign currency**

Foreign-funded enterprises should entrust accountant firms appointed by the Administration of Foreign Exchange Control to conduct annual check on their use of foreign exchange and present an annual report on the results of the inspection before April 30 each year. The enterprises should go to the Administration of Foreign Exchange Control with the annual report and their Foreign Exchange Control Certificates of Foreign-funded Enterprises to renew the ratification of the certificates before May 31 each year.

#### **Preferential policies to foreign investment**

Foreign-funded enterprises may open foreign currency account in the local designated banks with the Foreign Exchange Control Certificate of Foreign-funded Enterprises.

Foreign-funded enterprises may adjust their foreign currency surplus or shortage on the swap market.

Authorized by competent departments, foreign-funded enterprises may export products bought with RMB from domestic producers in order to achieve comprehensive compensation of foreign currency. Foreign investors may reinvest their RMB profits in other enterprises within China which can generate new and additional foreign currency earnings, meanwhile they can enjoy the same preferential treatment as that of investment in foreign currencies.

### **Policy and Regulations on Real Estate Investment**

Foreign investors may, in the form of joint venture, obtain the right to the use of state-owned land in Beijing with compensation by means of auction, bid or agreement. The allotted time for land-use right is from a minimum of 40 years to a maximum of 70 years, depending on the purpose of use.

Foreign investors are encouraged to develop and reconstruct the old residential

districts in the city proper of Beijing. They may engage in the development and construction of high-grade residence, industrial buildings, and commercial, tourist and recreational facilities and may also conduct operations and other economic activities with the developed real estate.

Foreign investors can sell or rent the real estate they have developed to enterprises, organizations and individuals both inside and outside China. Foreign investors can sell or rent their buildings and the right to the use of land to banks or other financial institutions in and outside China.

## Policy and Stipulations Regarding the Inspection of Import & Export Goods

**Mandatory inspection:** The scope of mandatory inspection:

inspection of all the goods enlisted to be inspected by the commercial inspection organization for import and export; quarantine tests for export food; quarantine tests for export animal products; appraisal for the function and usage of packages and containers for dangerous goods to be exported; appraisal for the transportation conditions of cargo holds and containers for decompose-prone food to be exported; tests on imports and exports which are regulated by other laws and stipulations.

**Inspection exemption:** Some goods are exempt from inspection providing that they meet the requirement of the State Commodity Inspection Bureau and are so approved of. Inspection exemption can also be granted to samples, presents and gifts, exhibits not for sale, and other goods with non-trade nature.

**Quality licensing:** For those import and export goods involving safety and sanitation, import license for safety and export license for quality are given to their manufacturers. No import or export of such goods is permitted without the verification and license of the commodity inspection organizations. At present, export licenses for quality are issued for nine categories of goods and the import licenses for safety are issued for 47 categories of goods.

**Hygienic enrollment and registration:** All plants and storehouses that produce, process and store export-oriented food in China must pass the verification test of commodity inspection organs and be given hygienic enrollment or registration for their plants and storehouses before they are entitled to produce, process, and store food for export. **Import inspection for foreign-funded enterprises:** Those import goods to be used by foreign-funded enterprises are subject to inspection to be conducted by these enterprises themselves. Except for imports subject to mandatory inspection and imports involving hygienic and safety issues, other imports are subject to inspection to be conducted by these enterprises. The equipment and raw materials, which are paid for by foreign-funded enterprises, who demand appraisal of the value of their imported equipment and raw materials, should be reported and inspected by the commodity inspection organization; the equipment and raw materials, which are purchased from overseas through entrustment by overseas partners, should be reported and inspected by the commodity inspection organization. Verification and appraisal certificates serve as the valid documents in the examination of the capital invested by the joint venture or cooperative enterprises.

**Priority policy:** Foreign-funded enterprises which produce export-oriented

products enjoy priority when applying for such documents as inspection appraisal, quality license, hygiene registration and referential certificate for original place of production.

## Recognition and Definition of Technology Intensive and Knowledge Intensive Foreign-funded Enterprises

To apply for the recognition and definition as technology intensive or knowledge intensive foreign funded enterprises, the enterprises must fill out the application form for recognition and definition of these two kinds enterprises, then submit their application to Beijing State Taxation Bureau, who will examine the application together with Beijing Science and Technology Commission. The latter will issue approval documents and recognition certificates to qualified enterprises.

When the application has been approved by administration of taxation, the recognized technology intensive and knowledge intensive enterprises can begin to enjoy preferential taxation.

Technology and knowledge intensive enterprises must be engaged in research, development, production, or marketing of one or more of the following technologies and products:

1. electronic information technology and its related products (including information processing softwares);
2. laser technology and its related products;
3. the technology of integration of laser, engine and electronics and related products;
4. life sciences, biology engineering technology, and related products;
5. new materials technology and related products;
6. new energy technology, new energy saving technology and related products;
7. environmental science, labor protection technology and related products;
8. (new building materials, parts, construction technology and related equipment;
9. refined chemical technology and related products;
10. new medicine and biological medical engineering;
11. nuclear application technology and related products;
12. geo-science, space technology, marine technology and related technology;
13. (other new technologies and products that can bring high economic profits and are suitable to be developed in Beijing.

## Regulations on Reinvestment of Foreign-funded Enterprises

According to the Corporation Law of People's Republic of China, foreign-funded enterprises can, in their own name, invest in limited liability companies with the capital and assets of the enterprises. To be registered as the stockholders or sponsors, the foreign-funded enterprises must accord with the following requirements:

1. having turned in all the investment promised in the contract;
2. having completed the examined and ratified project;

3. having begun to pay income tax

If the foreign-funded enterprise is the stockholder or sponsor of the limited liability company, its shares in the company must comply with the following requirements:

(1) For industries where the State encourages overseas investment, there is no limit as to the percentage of shares owned by the foreign-funded enterprise (unless specified as otherwise by the State).

(2) For industries where the State limits overseas investment, the shares owned by the foreign-funded enterprise can not exceed 25% of the total registered capital.