Taiwanese investment in selected cities in the People's Republic of China

Su-Wei Hu

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TAIWANESE INVESTMENT IN SELECTED CITIES IN
THE PEOPLE'S REPUBLIC OF CHINA

By
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B.A., Chinese Cultural University
1985, R. O. C.

Presented in partial fulfillment of the requirements
for the degree of
Master of Business Administration
University of Montana
1991

Approved by:

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Chairman, Board of Examiners

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Dean, Graduate School

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Date

Aug. 21, 1991
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CHAPTER I.
INTRODUCTION

Taiwan was originally one of the provinces of the Republic of China (ROC). After the Civil War between the ROC and the Chinese Communists in 1949, the ROC government moved to Taiwan. China was separated into two countries -- the Republic of China and the People's Republic of China (PRC). After 1949 the two countries had no trading relationship nor other forms of contact, because it violated ROC's Martial Law. Since 1987, trading and investment activities between Taiwan and China have rapidly increased, and Taiwanese investments are increasing at a faster rate than those of other countries.

Taiwan now ranks as the world's twelfth largest trading nation. In 1989, the estimated value of Taiwan's foreign trade was US$120 billion, and its per capita Gross National Product (GNP) was about US$8,000,1 25th in the world.2 In 1990, Taiwan's foreign-exchange reserves were nearly US$75 billion.3

As a small island, Taiwan is limited in most of the natural resources needed to produce manufactured goods. Its industries depend on import for raw materials and natural resources. China is the largest raw material and herbal medicine exporter for Taiwan's industries.

Indirect trade through Hong Kong or other third party countries is the only means of trade between Taiwan and China. In 1988, Hong Kong ranked as Taiwan's third export and fourth import trading partner. (see Table 1) Indirect bilateral trade between
Taiwan and China in 1988 reached US$3.4 billion, 42.5 times more than in 1979. It represented almost half of the total trade between Taiwan and Hong Kong that year.

Table 1

<table>
<thead>
<tr>
<th>TAIWAN'S FIVE LEADING TRADING PARTNERS (1988)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Unit: US$ million)</td>
</tr>
<tr>
<td>Exports to</td>
</tr>
<tr>
<td>U.S.A.</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>Hong Kong</td>
</tr>
<tr>
<td>West Germany</td>
</tr>
<tr>
<td>United Kingdom</td>
</tr>
</tbody>
</table>

Source: Republic of China Yearbook, (Taipei, Taiwan, Kwang Hwa Co., 1989); 716.

In the 1980’s, the internal economic environment of Taiwan expanded tremendously and rapid export expansion gave rise to a change in the entire society. The savings rate has exceeded that of investment in the domestic market since 1981 (e.g. in 1987, the saving rate was 39.3 percent and the investment rate was 19.6 percent). The fact that there was an abundance of capital and a shortage of investment areas not only caused Taiwan’s housing, land and stock prices to skyrocket, but also resulted in continued appreciation of the New Taiwan dollar (NT$). In 1985, US$1 converted to almost NT$40; in August, 1991 the exchange rate was NT$26.82 to US$1. (see Table 2) A combination of the rapidly expanding economy, and the wide availability of higher-paying jobs (in 1989, the unemployment rate in Taiwan was 1.37 percent), reduced the number of Taiwanese willing to work in manual labor jobs. This caused a tighter labor
market, increasing wage rates, and rising production costs in Taiwan.

Table 2

EXCHANGE RATES, NEW TAIWAN DOLLAR CONVERTED TO U.S. DOLLAR
(Unit: Per US$)

<table>
<thead>
<tr>
<th>Mo/Dv/Yr</th>
<th>Buying Rates</th>
<th>Selling Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/81</td>
<td>37.95</td>
<td>38.05</td>
</tr>
<tr>
<td>12/31/82</td>
<td>39.86</td>
<td>39.96</td>
</tr>
<tr>
<td>12/31/83</td>
<td>40.22</td>
<td>40.32</td>
</tr>
<tr>
<td>12/31/84</td>
<td>39.42</td>
<td>39.52</td>
</tr>
<tr>
<td>12/31/85</td>
<td>39.80</td>
<td>39.90</td>
</tr>
<tr>
<td>12/31/86</td>
<td>35.45</td>
<td>35.55</td>
</tr>
<tr>
<td>12/31/87</td>
<td>28.50</td>
<td>28.60</td>
</tr>
<tr>
<td>12/31/88</td>
<td>28.12</td>
<td>28.22</td>
</tr>
<tr>
<td>12/31/89</td>
<td>26.12</td>
<td>26.22</td>
</tr>
<tr>
<td>12/31/90</td>
<td>27.10</td>
<td>27.20</td>
</tr>
<tr>
<td>08/02/91</td>
<td>26.82</td>
<td>26.92</td>
</tr>
</tbody>
</table>


Rapid industry expansion also caused Taiwan to become an expensive place for industry. The internal industrial structure has transformed from labor-intensive to capital-intensive and technology-intensive. Taiwanese entrepreneurs, especially in labor-intensive enterprises, have started to look outside Taiwan to establish their businesses. (see Table 3)

Taiwanese investment in China can be traced back to 1982. At that time, there were only a few Taiwanese investors setting up enterprises in China. Due to the change
in the economic structure and investment environment in Taiwan, businesses have been actively investing in China since 1986. In 1988, the year after the Taiwanese government lifted its ban on Taiwanese citizens visiting China, there were more than 200 Taiwanese investment projects in China. Before 1988, there were 430 Taiwanese projects totalling US$600 million in China.7

Table 3

TAIWAN'S OVERSEAS INVESTMENT

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Value Cases (US$m)</td>
<td>No. of Value Cases (US$m)</td>
<td>No. of Value Cases (US$m)</td>
<td>No. of Value Cases (US$m)</td>
</tr>
<tr>
<td>Thailand</td>
<td>3</td>
<td>5.8</td>
<td>102</td>
<td>300</td>
</tr>
<tr>
<td>Malaysia</td>
<td>none</td>
<td>none</td>
<td>37</td>
<td>90</td>
</tr>
<tr>
<td>Indonesia</td>
<td>n.a.</td>
<td>1.8</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Philippines</td>
<td>1</td>
<td>0.07</td>
<td>18</td>
<td>9</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1</td>
<td>0.26</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>China</td>
<td>n.a.</td>
<td>n.a.</td>
<td>100</td>
<td>n.a.</td>
</tr>
<tr>
<td>U.S.</td>
<td>16</td>
<td>46.00</td>
<td>21</td>
<td>70</td>
</tr>
<tr>
<td>Europe</td>
<td>1</td>
<td>0.2</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>Rest of World</td>
<td>20</td>
<td>2.8</td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: R.O.C., Industrial Development and Investment Center and Chung Hwa Institute for Economic Research.

Presently, the Taiwanese government only allows its people to invest in China through companies in third party countries. There were still 1,117 Taiwanese investors who obtained approval from Mainland China in 1990, for a total investment of US$984 million. This ranked Taiwan as the second largest investor in China, next to Hong Kong. The Taiwanese concentrate their investments in the Special Economic Zones (SEZs), in
which the PRC government grants special privileges to attract foreign capital (i.e., banking services, taxes preferential, land, and housing ownership and using rights). Also popular are the opened coastal cities, which the PRC government wants to use as development models to develop inner parts of China.®

The purpose of this paper is to discuss the investment environment and the current investment activities of Taiwanese investors in three SEZs -- Shenzhen, Shantou, and Xiamen -- and in two opened coastal cities of China -- Shanghai and Dalian. This study will discuss current investment activities and the industries that are more suitable for Taiwanese investors. The paper will then continue with discussion of the obstacles (i.e., the quality of labor forces, currency problems, the legal system, and other internal factors) that affect foreign investors.

Throughout the paper, the terms Mainland China, China and PRC will be used interchangeably. Taiwan or ROC will be used for the island also known as Formosa.
 CHAPTER II.

PERSPECTIVES ON REPUBLIC OF CHINA

AND

PEOPLE'S REPUBLIC OF CHINA ECONOMIC RELATIONS

In May 1981, China revoked the rule of Tariff Privilege which Taiwanese could obtain special tariff treatment exporting goods to China from Taiwan. This caused a reduction of Taiwanese indirect exports to China. China started to establish Special Economic Zones (SEZs) to attract foreign investment, but the relationship between Taiwan and China was still retained.

Non-Interference in One-Way Indirect Trade, 1985-1987

Since 1984, the trend has been toward large foreign investments into China. Foreign investment was encouraged not only in SEZs, but also in 14 coastal cities and three deltas, the areas which account for most of the industrial and commercial business in the national economy. In 1986, China promulgated Provisional Regulations on Foreign Ventures, which allowed foreign investors to wholly own their enterprises in these open-door areas. The Provisions for the Encouragement of Foreign Investment were also issued. The central government went a step further; it not only relinquished much of its control over trading business to local governments or individual enterprises themselves, but also relaxed its control over foreign currency. These measures opened the door much wider to foreign investors.
Table 4

<table>
<thead>
<tr>
<th>Year</th>
<th>Value (US$1,000)</th>
<th>HK's Re-exports to China</th>
<th>Growth rate of Taiwan's total export value (%)</th>
<th>Growth rate of PRC's total import value (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>51</td>
<td>--</td>
<td>35.54</td>
<td>51.0</td>
</tr>
<tr>
<td>1979</td>
<td>21,291</td>
<td>41,747.05</td>
<td>26.93</td>
<td>43.9</td>
</tr>
<tr>
<td>1980</td>
<td>242,244</td>
<td>1,137.80</td>
<td>23.00</td>
<td>24.7</td>
</tr>
<tr>
<td>1981</td>
<td>390,186</td>
<td>61.07</td>
<td>14.10</td>
<td>-0.3</td>
</tr>
<tr>
<td>1982</td>
<td>208,159</td>
<td>-46.65</td>
<td>-1.80</td>
<td>-10.3</td>
</tr>
<tr>
<td>1983</td>
<td>168,643</td>
<td>-18.98</td>
<td>13.10</td>
<td>6.0</td>
</tr>
<tr>
<td>1984</td>
<td>425,618</td>
<td>152.38</td>
<td>21.20</td>
<td>36.8</td>
</tr>
<tr>
<td>1985</td>
<td>987,977</td>
<td>132.13</td>
<td>0.90</td>
<td>35.4</td>
</tr>
<tr>
<td>1986</td>
<td>811,024</td>
<td>-17.91</td>
<td>29.70</td>
<td>-3.6</td>
</tr>
<tr>
<td>1987</td>
<td>1,226,839</td>
<td>51.27</td>
<td>34.50</td>
<td>1.0</td>
</tr>
<tr>
<td>1988</td>
<td>2,242,200</td>
<td>82.76</td>
<td>13.00</td>
<td>27.9</td>
</tr>
<tr>
<td>1989</td>
<td>2,896,487</td>
<td>29.18</td>
<td>9.30</td>
<td>7.0</td>
</tr>
</tbody>
</table>


During this time, the Taiwanese government still maintained its position that bilateral trade between China and Taiwan was illegal. It was not until July, 1985, that the Taiwanese government, under pressure from both international trends and domestic public opinion, announced that it would stand by the principle of "non-interference" and "non-encouragement" in dealing with exports of Taiwanese goods to Mainland China through third party countries. The main products that Taiwan shipped to Mainland China at that time were raw chemical fibers, textiles, building materials, machinery and electrical appliances.
Table 5

GROWTH OF DIRECT FOREIGN INVESTMENT IN CHINA (1979 -- 1988)

(by number of contracts)

<table>
<thead>
<tr>
<th>Year</th>
<th>Contracts signed</th>
<th>Cumulative total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>83</td>
<td>83</td>
</tr>
<tr>
<td>1981</td>
<td>320</td>
<td>403</td>
</tr>
<tr>
<td>1982</td>
<td>519</td>
<td>922</td>
</tr>
<tr>
<td>1983</td>
<td>470</td>
<td>1,392</td>
</tr>
<tr>
<td>1984</td>
<td>1,856</td>
<td>3,248</td>
</tr>
<tr>
<td>1985</td>
<td>3,073</td>
<td>6,321</td>
</tr>
<tr>
<td>1986</td>
<td>1,498</td>
<td>7,819</td>
</tr>
<tr>
<td>1987</td>
<td>2,233</td>
<td>10,052</td>
</tr>
<tr>
<td>1988</td>
<td>5,890</td>
<td>15,942</td>
</tr>
</tbody>
</table>

(by capital amount, US$ billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount pledged Yearly</th>
<th>Cumulative</th>
<th>Amount utilized Yearly</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-1982</td>
<td>N.A.</td>
<td>6.01</td>
<td>N.A.</td>
<td>1.17</td>
</tr>
<tr>
<td>1983</td>
<td>1.73</td>
<td>7.74</td>
<td>0.64</td>
<td>1.80</td>
</tr>
<tr>
<td>1984</td>
<td>2.65</td>
<td>10.39</td>
<td>1.26</td>
<td>3.06</td>
</tr>
<tr>
<td>1985</td>
<td>5.93</td>
<td>16.32</td>
<td>1.66</td>
<td>4.72</td>
</tr>
<tr>
<td>1986</td>
<td>2.83</td>
<td>19.15</td>
<td>1.87</td>
<td>6.59</td>
</tr>
<tr>
<td>1987</td>
<td>3.71</td>
<td>22.86</td>
<td>2.31</td>
<td>8.90</td>
</tr>
<tr>
<td>1988</td>
<td>5.20</td>
<td>28.06</td>
<td>2.40</td>
<td>11.30</td>
</tr>
</tbody>
</table>

Source: R.O.C., Ministry of Foreign Economic Relations and Trade.

In return, Mainland China supplied Taiwan with herbal medicines, minerals, and special local products -- animal by-products and raw materials for the chemical industry. Indirect trade surged and in 1985 the total amount exceeded US$1.1 billion.¹⁰

In the mid-1980's, another important dimension of Taiwan-Mainland economic relations emerged: some Taiwanese investors, who were sanguine about the market potential and irreversibility of the Mainland's ongoing economic reform, started searching
for direct investment opportunities on China’s southeast coast.11

1987 to Mid-1989

Although the total amount of Taiwanese investment in Southeast Asia surpassed that in China, the value and the number of Taiwanese investments in China increased year by year. (see Table 3) Investors were lured by lower wage rates (the average monthly wage rate was US$60 in China, compared to US$600 in Taiwan), rental of land or factories, a huge pool of labor, ample raw materials and convenience in using the same language, all of which could reduce the trading cost between Taiwan and China.12

China was now eager to obtain high-tech knowledge, management and marketing skills and as much foreign capital as possible. Taiwanese investors were welcomed in China not only for political reasons, such as a desire for reunification, but also for the reasons stated above.

With the new Provisions for the Encouragement of Foreign Investment, Taiwanese investors accelerated their investment in the southeast coast of China in 1986. In 1987, the Taiwanese government announced that restrictions on indirect imports of twenty-seven agricultural and industrial raw materials from the PRC (China) were terminated. Taiwan residents were also permitted to visit their relatives in the PRC starting in November, 1987. In August, 1988, the Taiwanese government legalized the indirect import of another fifty categories of PRC agricultural and industrial raw materials (e.g. coal, steel, raw cotton, and others).

In April, 1988, China passed the Law of Foreign Cooperative Enterprise to encourage foreign investors to invest in China by means of technical co-operation, joint
ventures, and wholly foreign-owned enterprises. In July of 1988, China announced the National Regulations On Encouraging Taiwan Compatriots’ Investment. This legislation allowed Taiwanese citizens to invest in the same types of enterprises and to enjoy the same tax breaks as other foreign investors. Taiwanese investors were also given special privileges not available to other foreign investors, such as the right to buy and sell real estate, enterprise stocks and bonds.\textsuperscript{13}

As a result of these incentives, indirect trade and Taiwanese investment in China reached its highest levels to date. The total amount of indirect bilateral trade in 1988 increased to US$2.72 billion, compared to US$1.56 billion in 1987. In 1988, Taiwanese investment in the PRC amounted to US$600 million, while the total accumulated amount of Taiwanese investment during the years 1979-1987 amounted to only US$100 million.\textsuperscript{14} During 1979-1987, the goods that China imported from Taiwan were mostly cloth, electronics, chemical fiber, machinery, transportation equipment and raw materials for chemical industries. In return, China exported an abundant supply of coal, petroleum, cotton, minerals (uranium, tungsten, tin, antimony, and mercury), traditional Chinese medicinal herbs and animal and plant products.\textsuperscript{15} Most of Taiwan’s investments were still focused on labor-intensive industries and infrastructure businesses, including textiles, toys, sporting shoes and umbrellas in the SEZs and southeast coastal areas.

Post-Tiananmen

After the popular uprising which culminated in Tiananmen Square on June 4, 1989, China took actions designed to control foreign investment and solve its internal economic problems (e.g., shortage of foreign currency and serious domestic inflation).
Investors from Japan, the U.S., Korea, European countries and Taiwan pared down or completely stopped their investments. Numerous foreign countries stopped their technologic cooperation with China, and suspended their loans, and foreign countries suggested to their citizens that they cease investment contracts with China.\textsuperscript{16}

Eventually, China started re-adjusting its direction. It hosted conferences in the SEZs and east coast cities to explain in detail the Tiananmen incident. It declared again its adherence to the open-door policy and privileges for foreign investors. In order to attract more investors, China lengthened its land-use rights to 70 years in several of its larger cities (e.g. Xiamen, Guangzhou, Tianjin, Hainan). It also created Taiwanese Investment Zones (TIZs) in Fujian, Guangdong, Hainan, and other provinces.\textsuperscript{17}

Although trading and investment activities obviously declined after the Tiananmen incident, the total trade across the straits still grew by 28 percent in 1989, reaching US$3.5 billion.\textsuperscript{18} New investment in that year amounted to US$440 million.

By order of the Taiwanese government, direct investment in China is still illegal for Taiwanese investors. Hence, Taiwanese investment must still be done indirectly through companies in a third country. In 1990, the indirect trade between the two sides reached US$4 billion and approved Taiwan enterprises there numbered 1,117.\textsuperscript{19} This is a 105 percent increase over 1989. Total investment reached US$984 million, 225 percent as much as that in 1989.

Of all the SEZs and east coast cities, Fujian Province is the major investment target, receiving almost three-fourths of the total investments from the Taiwanese.\textsuperscript{20} During this time, the goods Taiwan indirectly exported to China were chiefly industrial
materials and parts and components, followed by electronical parts and components, plastic raw materials and machinery and equipment. Herbal medicines remained Taiwan’s leading indirect import from China, followed by food products, tobacco, and fuel. In recent years, the structure of Taiwanese investment in China’s SEZs and coast cities has changed. First, it has been shifting from labor-intensive industry to high-tech-intensive industry and capital-intensive industry. Second, investment activities are now extending in such a way that the cooperative fields of the two sides are expanding to include industrial investment as well as agricultural cooperation. Third, investors are prolonging their involvement from short-term to long-term investment (i.e. contracts extending from 15 years to 30 years). Fourth, investment diversity is increasing, expanding from investment in a single industry to widespread investment in related industries. Finally, the number of wholly foreign-owned enterprises is increasing.
CHAPTER III.
THE INVESTMENT ENVIRONMENT OF CHINA'S SPECIAL ECONOMIC ZONES AND MAJOR COASTAL CITIES AND CURRENT INVESTING ACTIVITIES

In order to attract foreign investment to achieve its modernization strategy, China established, four Special Economic Zones (SEZs) in August, 1980: Shenzhen, Zhuhai, and Shantou, which are all in Guangdong Province; and Xiamen, in Fujian Province. In 1988, a fifth SEZ was established on Hainan Island. In 1984, it opened fourteen coastal cities (Dalian, Shanghai, Tianjin, Nantong, Qianghuangdao, Yantai, Qingdao, Lianyungang, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai) which were more economically developed, had obtained higher technology and had more convenient transportation than other areas in China. China also granted foreign investors special privileges in the open cities and SEZs.23

In 1985, three deltas along the east coast were opened to investment: the Yangtze Delta near Shanghai, the Zhujiang Delta near Guangdong, and the Zhanjiang Delta near Xiamen. Also opened were Shandong and Liaodong peninsulas.24

Together, all those cities and areas contain approximately 49 percent of the total labor involved in light industries, 51 percent of the fixed assets and 55 percent of the total production value in China.25 As such, they have become the lifelines of the internal and external markets of China.

13
The central government in Beijing has given local governments the authority to approve foreign investment, within certain limits. Shanghai can approve projects of up to renminbi (Rmb) 200 million (US$38 million). (US$1 is equal to Rmb 5.32.) Beijing and Tianjin cities can decide on projects of up to Rmb 150 million (US$28 million). The coastal provinces, such as Guangdong, Fujian, Liaoning, and other cities such as Dalian, Guangzhou, and Shenyang can rule on projects valued at up to Rmb 50 million (US$10 million). Other provinces, autonomous regions and coastal cities can usually make decisions on projects up to Rmb 25 million (US$4.7 million). The SEZs have been given authority to approve heavy industrial projects under Rmb 50 million (US$10 million) and light industrial projects under Rmb 30 million (US$5.6 million).

The SEZs: Shenzhen, Shantou, and Xiamen

Because Hainan is only in the early stages of development and there is minimal investing activity there and in Zhuhai, these two SEZs will not be included in the analysis in this paper.

Initially, significant obstacles to investment remained. The political situation and legal standards of SEZs were unstable, the quality of the workforce was not as good as had been expected, the freedom to hire and fire labor was limited, and market opportunities were limited. China’s infrastructure (transportation, energy, communication, water supplies and other basic economic necessities) and the legal system were still largely undeveloped at the time, and investors were waiting to analyze developments these areas. Nevertheless, in 1988, Taiwanese investors moved into China’s coastal areas and the SEZs grew. Although Hong Kong still has the largest number of projects and most
money invested in China, Taiwan is the country that boasts the most rapidly increasing rate of investment.29

In the past three years, foreign investment and production output have increased in the SEZs and other open areas. The SEZs have served as gateways of economic exchange and cooperation between China and foreign countries. Infrastructure development in the SEZs has been rapid, providing the necessary environment to attract investors, which has helped China prosper. At the same time, economic strategies have taken shape, involving the absorption of foreign funds and an emphasis on industrial exports.30

The following is a description and analysis of each of the SEZs and the opened coastal cities which have received the bulk of Taiwanese investments or have more potential for Taiwanese investors.

**Shenzhen SEZ**

In 1980, Shenzhen was still a sleepy village with an area of no more than 3 square kilometers and an industrial base of 20 small factories. Today, the city has expanded to occupy at least 61 square kilometers of land. Shenzhen was the pioneer area for rapid development in China during the decade from 1980-1990.31 One of the major factors contributing to its rapid development is its geographic location. It is close to Hong Kong and the living style, language, and customs are similar in both places. As a result, much Hong Kong capital was attracted to this area. Shenzhen is also the largest import and export city in the south of China, with a total trade volume that was the third highest among China's coastal cities, behind Shanghai and Tianjin.
Before 1979, 80 percent of the population of Shenzhen was engaged in agriculture. By 1988, it was only 30 percent. Nevertheless, the value of agricultural production has increased by 150 percent from 1980 to 1990. The agricultural production structure has also changed from focusing on grains to aquatic products, fruit, vegetables, pigs and chickens.32

Industrial output has seen similar growth. Since 1985, the average annual increase in industrial output has been 40-50 percent in Shenzhen, while the average annual growth of the entire country of China has been only 17.5 percent. The main industries in Shenzhen include electronics, textiles, apparel, food processing, drinks, precision instruments, machinery, chemicals, building materials and petrochemicals.33

Shenzhen was established earlier than other SEZs, so its infrastructure (railroad, highway, airport, harbor, telecommunication, energy, land, and water supply systems), labor resources, legal system and investment environments are all superior to those in other places. Investment in Shenzhen has been encouraged by preferential tax treatment and other incentives especially developed by the central government for joint-ventures. Wide managerial latitude is allowed, including decisions regarding labor. Shenzhen offers bonuses to motivate workers and endorses the labor-contract system under which workers are paid in accordance with the job they are doing, not simply by their rank. Shenzhen's enterprises are less subject to detailed state plans, have less bureaucratic supervising, and have more opportunities for direct access to funding.

Simplification of the economic bureaucracy has been undertaken. In order to avoid systematic complications, Shenzhen reduced the bureaucracy between enterprises
and the top local government agency. There is now only one layer of bureaucracy instead of two.

Freedom in land use reforms has been initiated. In addition to outright foreign ownership of land, the government allows foreign investors to build their own plants or factories on land leased, rented, or otherwise provided by the state. Investors have the freedom to sell and mortgage their land-using right to banks or others. From January to November, 1990, there were 662 new foreign investment projects that received approval. The total investment amount in 1990 increased by 30 percent compared with the same period of 1989 and reached US$630 million.

The mayor of Shenzhen predicts that by the end of this century, it will be securely established as an industrially oriented SEZ. It will have a diversified economy, generating trade in areas such as science and technology, finance, tourism, agriculture, animal husbandry and fishing. Although Shenzhen has been the most dynamic and successful SEZ, in the opinion of the Taiwanese, it is not as attractive as the Xiamen SEZ. Nevertheless, as much as 16.16 percent of the Taiwanese investment funds that China obtained actually flowed into Shenzhen SEZ. By April 1991, 537 Taiwanese investors had come to invest in Shenzhen and 90 percent of those gained profits.

 Taiwanese investors in Shenzhen typically have three characteristics in common. First, over 70 percent of Taiwanese investments are wholly-owned enterprises. Second, they are focused on small and medium-sized businesses such as electronics, machinery, textiles, plastics, hardware, toys, shoes, umbrellas and furniture. Third, by way of turnkey operation, almost all of the Taiwanese investors shifted their skills, management
talent, advanced equipment and sometimes entire factories/plants to Shenzhen. Shenzhen's products made by enterprises with Taiwanese investment capital are higher in quality and offer greater variety of styles than PRC's products.

Ironically, if the Taiwanese and other foreign investors remain in Shenzhen, they may experience some problems that may obstruct their industrial development. Although Shenzhen's investment environment is better than other areas in China, this environment is still not highly developed and modernized. It lacks specialists, capital and high-tech and managerial skills. Nearly 50 percent of the jobs are part-time and a large number of workers are actually from other provinces. Labor resources are not easy to control. Labor costs have doubled since 1987, although they are still one-third the price of labor in Hong Kong.

Other segments of the economy besides manufacturing are available to Taiwanese investors. Houses and land leasing rights can be owned and sold by private persons in Shenzhen. Shenzhen has a land area twice that of Hong Kong, and construction costs are lower. Real estate (houses, factories and land) is a new opportunity for investors. Foreign ownership in these areas was approved in early 1991. By 1991, housing and land prices had gone up three to four times compared to the previous three years.

As China is planning to develop its oil refining sector, petrochemical and petrochemical downstream industries have gained potential for Taiwanese investors. Taiwan has the capability to export advanced equipment and technology in these areas.

With plenty of tourist areas near Hong Kong, tourism, hotel and restaurant
businesses are all good industries for investors. Taiwanese enterprises can use their management methods and managerial skills to offer better services and improve the poor management in state-owned hotels and restaurants.

Generally speaking, foreign bank systems are more flexible regarding foreign currency transmittance and can offer more attractive customer services than PRC-owned banks. Since the system of Chinese banks is limited and more restricted, foreign banks are more popular in Shenzhen. Although some of them have the capital and expertise, Taiwanese investors are limited by ROC government's restrictions in their activity in Taiwan's banking sector. With the more open regulations available in Shenzhen, the banking business is potentially lucrative for Taiwanese investors.

The furniture industry is another new business in Shenzhen. The living standard in Shenzhen is rising and creating demand for furniture in local markets. Furniture requests in the international market are also increasing. There is a convenient supply of wood materials both from inner provinces and imported from abroad. Thanks to the reputation of the quality and innovative design of their products, Taiwanese furniture enterprises can bring their advanced skills to develop the Shenzhen furniture industry.

Shantou SEZ

Before 1949, Shantou was a trading center in Guangdong province, like Guangzhou. Ten years ago, what is now Shantou SEZ was an area of rolling dunes and low-lying land over-grown with weeds. In 1981, Shantou had an area of only 1.6 square kilometers within Longhu area. After 1984, it was expanded to include the whole 22.6 square kilometers of Longhu and 30 square kilometers of the Guangao area.
As Shantou is located in the subtropical zone, its climate and land conditions are suitable for the cultivation of large quantities of vegetables, fruits, flowers, fishery and aquatic products. In 1980s-1990s, Shantou has become well-known for its high-quality agriculture products and has many highly-trained agricultural technologists. It has also become an experimental agriculture station for the surrounding areas. In its new agricultural area, Shantou has built up special ponds to raise shrimp and eels. Production lines include fruit canning, instant-freezing of lobsters and vegetable processing (e.g. broccoli and asparagus). Other processing operations involve fresh-preservation of fruit, meat, bread and snack foods and refining of oyster sauce. By using imported fine breeds and advanced technology, Shantou has set up various orchards and pig, duck, fish and pigeon farms to enlarge its agricultural exports and speed up the modernization of its agriculture.39

Taiwan was once the largest producer of shrimp and other marine products in the world. Novice farmers rushed into the industry and ran into problems. Poor cultivation practices, overpopulation of shrimp or fish in ponds where diseases easily spread, and the difficulty in acquiring land in Taiwan caused production costs to rise rapidly. A number of Taiwanese aquacultural investors went overseas to find profitable development sites. Shantou has geographic advantages, highly knowledgeable agricultural specialists and cheaper production costs (labor, land and ponds). Since 1987, together with other developed zones, Shantou has made China the largest shrimp producer in the world (see Table 6). Thus, one of the most attractive fields for Taiwan is aquaculture, where Taiwanese producers can exchange their knowledge and experience with the local
specialists. In the late 1980's, Taiwanese investors started to invest in Shantou. By March 1989, there were 13 Taiwanese-owned enterprises there.

Table 6

ASIA'S SHRIMP FARMERS
(Output of cultured crustaceans, in '000 tones)

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>'80</th>
<th>'81</th>
<th>'82</th>
<th>'83</th>
<th>'84</th>
<th>'85</th>
<th>'86</th>
<th>'87</th>
<th>'88</th>
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<tr>
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<td>3.0</td>
<td>3.4</td>
<td>3.8</td>
<td>8.2</td>
<td>11.3</td>
<td>19.5</td>
<td>22.1</td>
<td>25.0</td>
</tr>
<tr>
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<td>5.0</td>
<td>9.6</td>
<td>22.0</td>
<td>42.7</td>
<td>85.4</td>
<td>156.0</td>
<td>200.0</td>
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<tr>
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<td>11.2</td>
<td>11.2</td>
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<td>17.0</td>
<td>17.0</td>
<td>17.0</td>
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</tr>
<tr>
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<td>31.1</td>
<td>28.0</td>
<td>32.4</td>
<td>38.9</td>
<td>41.1</td>
<td>42.6</td>
<td>50.0</td>
</tr>
<tr>
<td>Japan</td>
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<td>1.7</td>
<td>2.0</td>
<td>2.0</td>
<td>2.1</td>
<td>2.2</td>
<td>2.5</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
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<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
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<td>n.a.</td>
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<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
<td>0.4</td>
<td>0.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>1.4</td>
<td>1.7</td>
<td>1.8</td>
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<td>30.3</td>
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<td>n.a.</td>
<td>n.a.</td>
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<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Taiwan</td>
<td>3.9</td>
<td>6.1</td>
<td>9.6</td>
<td>11.0</td>
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<td>65.0</td>
<td>75.0</td>
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<tr>
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<td>10.4</td>
<td>12.7</td>
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<td>18.5</td>
<td>19.1</td>
<td>22.6</td>
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<tr>
<td>Vietnam</td>
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<td>4.0</td>
<td>7.0</td>
<td>7.0</td>
<td>13.0</td>
<td>18.0</td>
<td>23.8</td>
<td>28.6</td>
<td>30.0</td>
</tr>
</tbody>
</table>

Source: R.O.C., Food and Agriculture Organization

There are other good fields in which to invest in Longhu. They include textiles, electronics, fine chemicals, aquatic products, fruit and vegetable and flower planting, recreation centers, banking services and warehousing. In Guangao, the better industries to invest in are tourism, petrochemistry, light textiles, fisheries, aquatic products, transportation and banking services.40

Shantou is the second most attractive SEZ to Taiwanese investors, next to Xiamen.41 In order to attract more Taiwanese investors, Shantou established some special regulations for them.42 Taiwanese investors need not pay user-fees for
plants/factories, land and houses for the first five years. Machines, plants, factories and houses can use rapid cumulative depreciation. Taiwanese industries can be managed by their relatives in China. If a Taiwanese investment exceeds US$1 million, two of the investor's relatives in China are allowed change their status from rural residents to urban citizens. This means they can obtain the benefits of urban citizens, such as not being required to work as farmers, they can be assigned to a better job, and they can move and live in urban areas. If a Taiwanese owns over 25 percent of the stock share in Shantou's joint venture and technical co-operation industries, two of their relatives may also enjoy the same privileges as described above. Similar to other SEZs, Taiwanese investors can also invest in land development in Shantou.

**Xiamen SEZ**

Xiamen is an urban SEZ located right on the shore of Fujian Province, just across the Taiwan Strait from Taiwan. Xiamen SEZ was established in 1980, including 2.2 square kilometers of Huli Industrial Zone. By 1984, the local government had expanded the land area of Xiamen SEZ to encompass the entirety of Xiamen island, which is 130 square kilometers.

Since 1984, Xiamen has tried to improve its infrastructure through US$540 million of government investment, including transportation, public utilities and communication systems. This amount was 54 times the total state investment that Xiamen received during the period from 1949 through 1979. These efforts have resulted in an expanded and reliable infrastructure. During the whole year of 1987, there was not a single interruption of electrical power supply to Huli. Railroad and highway systems have been
expanded and upgraded to handle the doubled volume of traffic since 1980.\(^4^4\)

 Unlike other SEZs, which were built on bare marsh and farm land, Xiamen had an established industrial base. Xiamen had a large number of factories, a commercial port and, compared with much of the rest of China, a better-educated workforce (The Xiamen University is located here).

 Among all foreign investments, only 18 projects came from Taiwan. During this time, the development goal of Xiamen was focused on export processing industries and tourism. Overseas Chinese investors were the first group of tourists that Xiamen wanted to attract.\(^4^5\) Since 1989, the total amount of foreign investment absorbed by Xiamen (US$18.285 million) has surpassed Shenzhen and ranked Xiamen first among the coastal areas of China.\(^4^6\)

 In 1988, many of the limitations on travel between Taiwan and China were relaxed, and the Taiwanese government began to allow its citizens to visit their relatives in China. Taiwanese investors started to operate in Xiamen through trade and investment. Almost one-third of the Taiwanese capital invested in China flowed into this area. From then on, development and investment in Xiamen started to boom. By the end of 1988, 113 Taiwanese investors, almost all of whom had invested in labor-intensive industries, had moved into this zone.\(^4^7\)

 By the end of November 1989, there were 225 Taiwanese investors who invested their money in Xiamen. Although they were relative latecomers, Taiwanese entrepreneurs outstripped in 1989, in total investment, the veteran investors from Hong Kong, overseas Chinese and other foreign investors. Of total foreign investment in Xiamen in 1989,
almost 70 percent came from Taiwan. Since then, the foreign investment amount in Xiamen has surpassed that in Shenzhen, giving Xiamen the highest Taiwanese investment among all SEZs. Almost 50 percent of the total Taiwanese investment in China flowed into Fujian Province, with Xiamen sharing 33 percent of this figure.

The cost of labor in Xiamen was the lowest among the SEZs before 1988. Although it had almost doubled by 1991, it was still very low, compared with that outside China. Turnover for the highest paid workers and total overhead costs were both low. Taiwanese investments in Xiamen are largely in manufacturing and production; wholly-owned enterprises were geared towards production for export. The investments have focused on small and medium-sized businesses. Almost 40 percent of Taiwanese investments have accomplished the cycle of investment, production, and remuneration within only one year. Most of these investments have been channeled into light and labor-intensive industries such as production of shoes, eyeglasses, plastics, and electronics and chemical engineering projects. These businesses imported from abroad 80 percent of the raw materials used in production. Over 80 percent of its production was exported to Taiwan’s international market. Xiamen’s ultimate success will depend on its ability to develop as a source of both investment and production materials to the Taiwanese. This is not unrealistic, as in the past three years, over 90 percent of Taiwanese investors gained profits in Xiamen.

Taiwanese initially invested in Xiamen on a trial basis. Their investments were always placed in low-cost, labor-intensive industry. Today, Taiwanese investors have changed their attitude and turned to long-term, stable investment, group investment and
entire-area development. In response, the local government established a new Taiwanese Investment Zone (TIZ) and granted special privileges for Taiwanese investors in order to encourage them. This TIZ includes the old Xiamen SEZ and is expanded to cover the Xingling and Haichang areas.

The sudden boom in Xiamen's economy has resulted in some problems:

-- Lack of infrastructure. An increase in number of plants/factories has caused a power shortage problem. The increase in business also brought about an increase of vehicles involved in transportation, thus giving rise to frequent traffic jams in Xiamen.

-- Shortage of business space. Hotel and office accommodations have become inadequate as more businessmen come to this area. The ever-increasing investment from Taiwan led to a shortage of supply of plants/factories. Some Taiwanese investors had no recourse but to rent schools or military camps as their provisional plants/factories.

-- Speculative activities. As Taiwanese investment increased in Xiamen, the prices of land-use rights and houses spiraled. Many Taiwanese went into the real estate business.

-- Low skill level in the workforce. The economic boom in Xiamen led to a great demand for high-tech specialists and high-level managers. Despite their relatively good education, the average skill level of workers and managers was still quite low. The cost of training the Chinese and providing expatriate management for foreign joint ventures was correspondingly high.
As Taiwan and Xiamen share one dialect (Minnanhua), food culture and common heritage (over half of Taiwanese's ancestors were from Fujian), there is some kinship and special feeling between them. Hence, tourism is a good field to develop. In addition, real estate prices in Xiamen had nearly doubled from 1988 to 1990. Real estate trading business is another potentially profitable field for Taiwanese investors.

Taiwan's plastics and petrochemical tycoon, Yung-ching Wang, has announced that his company, Formosa Plastics, will invest in a naphtha-cracking plant in Xiamen in the mid-1990's. A large number of related mid- and downstream petrochemical processors which are suffering from a shortage of raw materials will follow Wang to China to join the 700 Taiwan petrochemical processors who are already there. This will be another boost for Xiamen's economy. Petrochemicals and their mid- and downstream petrochemical processing industries are all potential profit-yielding fields for Taiwanese investors in Xiamen.

In view of Taiwan's new technology and skills in breeding, raising, and packing aquatic products, the Xiamen government has developed another investment area -- Dongshan Island, a county of Xiamen, for Taiwanese aquaculture investment. By March 1991, there were 16 Taiwanese businesses invested in aquatic products raising and processing. The total investment was US$9.3 million.

China's Coastal Cities.

In 1984, Beijing opened its fourteen coastal cities to complement its SEZ development plans. According to their characteristics, these fourteen cities can be divided into four categories: synthetic open, trading, base and harbor transporting.
As of 1991, synthetic open style includes Shanghai, Tiangjin, and Guangzhou. The requirements to be in this category include having been an economic center, having obtained higher technology and management skills, having more developed international trade, and possessing convenient transportation and developed industries.

In 1991, the trading category included three cities: Dalian, Qingdao, and Ningbo. The special features of these cities are that they have attracted more foreign investors than other cities and they might develop to be the potential middlemen between China and outside countries.

Base category in 1991 included Fuzhou, Wenzhou, Nantong, Yantai, Zhanjiang, and Beihai. These cities have easy access to raw materials and natural resources.

Harbor transporting category had only two cities to date: Qianghuangdao, and Lianyungang.

Only Shanghai and Dalian will be discussed in this report.

**Shanghai**

Shanghai, the so-called oriental Paris, is the largest city and sea port in China. It is a gate to the Yangtze River areas, and it serves as a window to the outside world. Since the beginning of economic reform, it has also become an economic, commercial (i.e., import and export products gathering spot), information, industrial, and financial center in China. The old city of Shanghai, including Hongqiao, Minghang, and Zhaohejing industrial areas, is on the western side of the Huangpu River.

In order to accelerate development in Shanghai, the government offered Taiwanese and other foreign investors some special benefits that differ little from those already
enjoyed by the SEZs (i.e., sizeable tax concessions, the grant of land leases, and banking services' setting). Other enticements include a 15 percent low profit tax rate for joint ventures and other foreign enterprises. If enterprises are committed for 10 years or more, they are duty-free for the first two profitable years. In the third profitable year, they are granted a 50 percent reduction in tax. They can import duty-free raw materials and equipment. There is a five-year tax holiday for foreign businesses involved in building infrastructural facilities (airports, ports, railroads, subways, and power systems), followed by a 50 percent reduction in tax for the next five years.

Foreign banks and other financial services are allowed to operate on a trial basis. Only foreign currency transactions are permitted. Foreign banks are not allowed to handle renminbi business. Red tape has been reduced to a minimum (the approval process for foreign operations has been shortened from originally having to obtain 133 separate chops (approvals) to 20), with traders exempt from having to obtain visas.

The Pudong sector of Shanghai has the right to retain its revenues for further development. It also established a free-trade zone (FTZ). Imports moving into this FTZ are tax-free if they are intended for re-export. Wide consultation with scientists and people from all sectors has resulted in full use of the city’s geographical, industrial, and scientific advantages to develop economic links with other countries. Foreign investors may own shares in the local stock market. They also have the right to lease large tracts of land for 50-70 years for development. As the statistics show, foreign joint ventures have done better in Shanghai than elsewhere in China. Almost 98 percent have gained profits from investments in Shanghai, while the failure rate of investment in other places.
is 60 percent. However, some chronic problems (e.g. shortage of cash and raw materials, and poor transportation) still present obstacles to development.

Shanghai, Ningbo, Hainan, and other opened cities share almost 60 percent of all the Taiwanese investment in China. To Taiwanese investors, Shanghai is not as attractive as other opened areas in Fujian and Guangdong Provinces. Shanghai has not enough infrastructure to meet the rapidly increasing demand. In 1987, the price of raw materials skyrocketed and production costs rose. After the Tiananmen incident, the central government even restricted shipping and selling of raw materials within China. This brought about a raw materials shortage for the industries in Shanghai. The only way to solve the problem was to import more expensive raw materials from abroad by using scarce, costly foreign currency.

Although Shanghai has a special tax incentive for investors to invest in local infrastructure, foreign investors will probably be reluctant to make major investment in this infrastructure. It takes too long for this kind of investment to recover the capital and to yield a profit.

In 1989, the city's profit tax on industrial enterprises was 33 percent of earnings, compared to a national average tax of 19 percent (and just 17 percent in Guangdong Province). Each year Shanghai contributes 60-70 percent of its income to the state. In 1989, it was allowed to keep 33 percent of the revenue, up from 25 percent previously. Shanghai's annual contribution to the state is computed to be as much as one-sixth of the country's total revenue. The real revenue from investment that investors might keep in Shanghai is not as profitable as in other opened areas.
In 1990, Taiwanese investment in Shanghai was computed at over US$100 million, and the total investment amount had surpassed US$300 million. It is evident that Taiwanese investors are most interested in Pudong. In March 1990, the local government set up Taiwan Business and Industries Zones for the more than 7500 Taiwanese investors in Shanghai. The Taiwanese focused their investments primarily on textiles, food processing, and tourism. They also invested in hotels, recreation centers, department stores and golf course development.

**Dalian**

In 1984, when China was still in the initial stage of opening its door to trade, Dalian was only a wasteland of 3 square kilometers dotted with fishing villages. It is located in the southern part of Liaodong Peninsula in Liaoning Province. Today it functions as a key link in import and export of the three northeastern provinces and Inner Mongolia. An international, commercial and industrial harbor, it has regular shipping business with over sixty countries. It has a modern industrial base, and is home to a number of foreign joint ventures.59

To create the best possible atmosphere for cooperation with potential partners from overseas, Dalian concentrated its efforts on setting up modern infrastructure facilities. Since 1985, the local government has invested Rmb 430 million (US$80.83 million) in its basic infrastructure. Its overall aim was to develop advanced and export-oriented technology industries, with a special emphasis on high-tech projects and capital-intensive industries that have an objective to export 60 percent of their output. By 1990, it had expanded to a new 20 square kilometers’ Economic and Technological Developed Zone.
The major industries in Dalian are electronics, machinery, chemical products, textiles, food processing, light manufacturing, and ship-building.

From January to June, 1990, the total export value from Dalian was US$2.68 billion, a 23.3 percent increase from 1989. The average annual volume of foreign shipments handled in Dalian Harbor was 50 million tons, comprising 68 percent of the total foreign shipments in China.

Entrepreneurs who started their businesses in Dalian before the end of 1990 were offered a 10-30 percent discount on land rents. In order to attract high-tech knowledge, the municipal government set up several areas for foreign investors to use. The investors are free to transfer or sell their use and lease rights. The land use and rental periods are for 50 years.

Dalian has an excellent geographic location for both land and water transport. Investors might come not only for the immediate economic benefits, but with an eye to its future development. Given these incentives, shipping enterprises and firms that handle the harbor loading and unloading services and transit marine cargos might be good investments in Dalian.

The scenery is attractive and the climate is pleasant in Dalian. The northeastern provinces are the original home of the Ching Dynasty. The historic sites attract Taiwanese tourists. Tourism might be a profitable field to invest in. The three northeastern provinces, together with Inner Mongolia, make up a vast area with rich manpower, ample natural resources, strong industrial bases and a considerable technical force. In cooperation with the U.S., China has set up a Dalian industrial and technical
management training center. It is close to the iron, steel, coal operations (Anshun and Shenyang) and aluminium (Fushun) mines. These natural resources are all very important in Taiwan's heavy industry development. As Dalian has convenient access to ample resources that Taiwan is short of, it is better for Taiwanese investors to use local minerals to develop heavy industries in Dalian than to invest in other coastal cities.

Taiwanese investors can invest in the emerging mill or steel refinery areas, or in raw materials export. By way of turn-key operations, Taiwanese industries in Dalian can reduce costs and control the quality of their products. In the last two years, Taiwanese investors in Dalian have focused on value added industries like building materials, food processing, metallurgy, chemicals, electronics, and machinery.
Basic Infrastructure System:

A shortage of infrastructure is a chronic problem in China. Some opened coastal cities, such as Nantong, Wenzhou, and Beihai rely on highways as the major form of transportation. Some areas have just one railroad. Lack of transportation systems (railroads, highways, harbors and airports) causes a raw materials shortage for the industries in the opened coastal areas. Transporting raw materials from inner China to the coastal areas is difficult, and the cost is higher than importing from outside countries.

China has promised Taiwanese enterprises adequate energy supplies, but there is still a 15 percent to 20 percent energy shortage, and energy interruptions of two to three days a week are not uncommon. Production, delivery, and distribution schedule delays due to inefficient energy supply and transportation are very common in China.

Out-of-date telecommunication systems cause delays in receiving information from and about the outside world. This causes investors to lose opportunities and to make incorrect business decisions. This will indirectly influence the reputation (high efficiency and good quality) and profits of Taiwanese enterprises in China. This, in turn, causes Taiwanese industries to only accept long-term or regular orders for their products, giving up the short-term or rushed orders.

Since the Tiananmen incident, the World Bank has adopted a tighter policy for loans to China. The tighter credit from outside of China, combined with the shortage of
funds from within China, has caused serious shortages of capital for infrastructure. These problems have caused Taiwanese investors to avoid investment in inner China and to focus on Guangdong and Fujian Provinces. Total Taiwanese investment in these areas represented one-tenth of the total amount of foreign investment as of 1989.\textsuperscript{64}

**Raw Materials Supply:**

China’s inefficient transportation system makes it difficult to transport building and industrial materials. It is illegal to trade raw materials between provinces due to the 1988 austerity policy. This problem has caused some raw materials producers or producing provinces to arbitrarily raise the price of raw materials. The quantity and quality of raw materials are hard for management to control. This causes delays in production and delays delivery dates. Although China faces a foreign currency shortage, investors must still spend their foreign currency to import more expensive raw materials from other countries. The short supply of raw materials increases the investment risk for Taiwanese investors, and causes economic inflation in China.

**Government Administration:**

In order to increase the development in opened coastal areas, China granted more privileges and authority to local governments. This has led to some enterprises having to pay unreasonable taxes or fees, under threat of losing approval of the local government officials.

China has simplified the permission and approval process for Taiwanese investors, but the bureaucracy and overlapping organizations in the Chinese government continue to cause the paperwork process to be a time-consuming process filled with delays.
Spending 6 months to 1 year waiting for the approval from over a hundred government officials is not uncommon when setting up a business in China. This wastes investors' money and time. The officials often try to shirk their responsibility to avoid troubles, which increases the paper shuffling by investors even after production has begun.

Chinese like to use "guanxi" (the Chinese word for connections or contacts) when they deal in business. There are some implicit agreements or so-called "understandings" between businessmen and officials. The businessmen give under-the-table money, and offer social parties and gifts to the public officials who handle their cases. If the Taiwanese investors do not have any close relationships or know any important officials in the government, the permission and approval process will be extremely difficult for those who are not schooled in this type of business dealing. If they do have "guanxi" in the government organization, they do not even need the normal application process, and are able to get the permission license privately.

If raw materials are imported for processing, but the completed products are only exported, the Taiwanese enterprises can apply for an import tax reimbursement on them. This is a special preference for Taiwanese enterprises, but the application process is complicated and applicants can not apply for the entire import tax reimbursement at one time. The order of tax reimbursement does not give Taiwanese investors any preference. It only increases their problems because the amount of time that it takes due to the bureaucratic red tape may not be worth the amount of money that is received as a tax reimbursement.

Legal System:
Besides central government control, every local government can enact its own regulations. There are 35 provinces and more than 10 municipalities in China, leading to many different types of regulations in the country. Ironically, from a profit standpoint, sometimes the regulations which are enacted by the local government will conflict with those issued by the central government. For example: the central government forbids Taiwanese investors to invest in hotels, restaurants, and department stores. In order to attract Taiwanese investors, a number of opened coastal areas allow investment in these fields. There is not a standard rule for investors to follow.

Although there are a number of supposedly preferential treatments for Taiwanese investors, the effectiveness of the measures depend on the language of the law. It is not clear what the terms are. For example, the Regulation on Encouraging Foreign Investment announced that foreign investors can refuse to pay unreasonable fees. However, there is no definition of what is an unreasonable fee, and no legal rules stating what constitutes violations. In view of this inept legal system, the person who charges the unreasonable fees to the investors will never be punished. There is not an arbitration system or neutral organization to handle the cases for the Taiwanese investors who have suffered from unfair treatment.

Since China is without legal concepts and business ethics, the contracts signed by both China and the investors might be arbitrarily modified. The investors may have thought items in the contract they signed were satisfactory and fair. However, the items in the contract might be totally different from the original contract. Usually both parties sign the last page, enabling one to have the other pages changed. The best way for the
investors to avoid being cheated by China is for both parties to chop (stamp), sign, or impress the thumb on the binding between each page of the contract. To prevent page editing, both parties must keep track on the top of each edited column.

Political Situation:

China's economic policies always follow its political policies. In view of China's internal political problems, with top-level bureaucrats fighting among themselves for power, its political policies are not stable. This instability causes erratic economic policies, which sometimes tighten and sometimes relax. Between tightening and relaxing, it makes it difficult for investors to have principles to follow.

Before the Tiananmen incident, Taiwanese could get multiple-entry visas from China. After Tiananmen, China was scared of bad influences (i.e., invasion of democratic ideas) from Taiwan and suddenly changed its policy to a single entry visa for Taiwanese.

In 1988 and 1989, China changed its international trading policy three times. It focused on export trade, then changed to both domestic and export trade. After the Tiananmen incident, it switched to restricted import and controlled export policy further confusing potential investors.

Operating Costs:

There are two kinds of operational costs in China. The first is the visible cost. This includes labor wages, bonuses, overhead (taxes, raw materials, telecommunication, delivery, water, power, rental, managerial, and transportation expenses), as discussed above. The other is the invisible cost. This includes several kinds of fees that the investors would not know about before they moved into China. These include social,
problem solving, investment consultant, research, and training fees. Both costs are a heavy burden for Taiwanese investors. The invisible cost cannot be controlled or researched before investments flow into China.

It is difficult for the investors to predict the future profits of enterprises. Since 1985, the land, housing, and product prices in China have been getting higher, causing a serious inflation problem. In the first six months of 1988, the retail price index rose by 13 percent, and the cost of living for workers in the major cities grew by 14.4 percent. The living and production operation costs in China in 1991 were two to three times higher than in 1988.

Although wages have increased, many people still complain that the rate at which incomes rise cannot keep up with the rate of inflation. China now has the highest inflation rate in Asia. (see Table 7)

Another problem in China that increases the investors' operation costs is the serious depreciation of its renminbi. For example, in late 1988, one U.S. dollar converted to approximately 3.5 Rmb. In May of 1991, Rmb 5.32 converted to one U.S. dollar. The renminbi depreciation problem causes Taiwanese enterprises, which import raw materials for processing, to spend more renminbi to buy the needed raw materials.
Table 7

INFLATION RATES IN SELECTED ASIAN COUNTRIES (1981-1990)
Unit: Percent

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rep. of China</td>
<td>6.9</td>
<td>0.2</td>
<td>1.3</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>(Taiwan)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>11.5</td>
<td>4.9</td>
<td>7.5</td>
<td>10.0</td>
<td>7.5</td>
</tr>
<tr>
<td>India</td>
<td>10.9</td>
<td>10.9</td>
<td>9.4</td>
<td>8.5</td>
<td>10.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>11.2</td>
<td>7.6</td>
<td>8.0</td>
<td>6.5</td>
<td>7.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>6.4</td>
<td>1.5</td>
<td>2.5</td>
<td>4.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Philippines</td>
<td>11.1</td>
<td>19.6</td>
<td>8.7</td>
<td>10.5</td>
<td>11.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.5</td>
<td>0.6</td>
<td>1.5</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>South Korea</td>
<td>10.5</td>
<td>2.7</td>
<td>7.1</td>
<td>6.5</td>
<td>7.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>7.2</td>
<td>1.9</td>
<td>3.8</td>
<td>6.0</td>
<td>6.5</td>
</tr>
<tr>
<td>People’s Rep.</td>
<td>1.9</td>
<td>6.2</td>
<td>18.5</td>
<td>21.0</td>
<td>12.0</td>
</tr>
<tr>
<td>of China</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Average figure of Asian Countries 7.2 6.1 10.5 11.6 9.1


Labor Quality:

Although China has ample labor resources, there are problems with the quality of its labor force. The investors cannot hire or fire workers without permission of local government. The workers have no fear of bad performance in their jobs. Chatting, skipping work, or leaving the office early are common problems in China.

Although the investors pay higher wages to their workers, compared with the wages of those who work for Chinese enterprises, the Chinese workers cannot receive all their wages from foreign enterprises. The actual payment the workers receive is almost the same as if they worked for domestic enterprises. For example, every month the
enterprise pays Rmb 600 to its workers. The actual amount the worker can receive might only be Rmb 150. Without any incentive, the workers will not be very productive.

Bad labor quality can influence the production quality. World Bank statistics show that China is one of the lowest working efficiency countries in the world. (see Table 8) Combining the wage and working efficiency problems in China, the overall operations cost may actually be cheaper in Taiwan.

Table 8

<table>
<thead>
<tr>
<th>Country</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>100</td>
</tr>
<tr>
<td>Japan</td>
<td>75</td>
</tr>
<tr>
<td>Singapore</td>
<td>60</td>
</tr>
<tr>
<td>Taiwan</td>
<td>33</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>32</td>
</tr>
<tr>
<td>South Korea</td>
<td>22</td>
</tr>
<tr>
<td>China (Representative -- Shenzhen)</td>
<td>18</td>
</tr>
</tbody>
</table>


Foreign Currency and Monetary System:

In view of the shortage of foreign currency, China has severely controlled this resource. In order to prevent foreign currency outflow, China requires that foreign investors use a convertible foreign currency to reimburse loans to Chinese banks, to pay for the cost of imported raw materials, to pay salaries of their foreign workers, and to pay for profit distribution to foreign stockholders. These restrictions cause investors to have a large supply of foreign currency, but the foreign currency demand exceeds the supply.
Many investors can only get the foreign currency they need on the black market. This has caused the price of foreign currency to skyrocket over its official stated value, which then invisibly increases the operation cost for the foreign investors.\footnote{1}

It is also difficult for investors to repatriate profits out of China. They can only reinvest their profits back into China's market. The investing enterprises vastly prefer to use cash when conducting business in China because checking accounts and capital movement are difficult using Chinese banks. The amount of funds that Taiwanese investors need may be two to three times more than they need to invest in Taiwan.

There are three kinds of currency circulated in China: Renminbi is used only in the domestic market; Foreign Exchange Certificates (FEC) can be kept by the foreigner and used in hotels, government owned department stores, or foreign enterprises; and foreign currency can be used in international transactions. They all have their own exchange rate in the official market. The official exchange rates for FEC and foreign currency are usually two to three times less than the rate in the black market. There are too many types of currencies to be controlled by the government, causing confusion for the foreign investors.

Some investors run currency speculation businesses. They buy FEC or foreign currency first, and then exchange it in the black market to obtain two to three times as much renminbi. The people who own FEC or foreign currency can obtain more cash by exchanging the currency. This gives the enterprises more funds to run their businesses. Although the investors can obtain more by exchanging FEC or foreign currency on the black market, it is riskier for them. Using this source of funds, a number of Taiwanese
investors have been swindled by speculating in the black market.

Banking Problems:

Chinese National Banks do not accept letters of credit (L/C) from Taiwanese banks, and vice versa. This is because any kind of amendment to the credit and banking regulations would entail an enormous amount of negotiation between China and Taiwan. The only option for both parties is to allow banks from a third country to process L/C forms for Taiwan and China. This further complicates the banking process and increases the payment time.

In order for Taiwanese enterprises to import raw materials from outside China, they need permission from the Chinese government. After the investors obtain permission, they can request that the Bank of China issue its letters of credit. Due to China's shortage of foreign currency, the approval for import permission and the application for L/C can be difficult. These factors cause production schedules and shipping delays. The delays hurt the reputation of Taiwanese enterprises in the international market.

Since there is a shortage of funds in China, loan service for Taiwanese investors is more difficult than other services in Chinese banks. According to Taiwan law, direct investment in China is still illegal for Taiwanese investors. It is impossible for Taiwanese enterprises who set up businesses in China to obtain support (loans) from Taiwan's banks. The Taiwanese investors must have their own capital or get loans from third country banks when considering the financing of their enterprises.

Future Problems:
Hong Kong is the bridge for Taiwanese trading and investment in China. In 1997, Hong Kong will be returned to China. The political situation in China is not yet stable, so it is hard for Taiwanese investors to predict China’s future strategy in managing Hong Kong. The chronic political problems between Taiwan and China will not be solved in a short period of time. Perhaps Taiwanese investors who have a branch office or agent in Hong Kong would be better off to try to find another third party country in which to locate.
CHAPTER V.

SUMMARY AND CONCLUSIONS

After the Tiananmen incident, the American Business Environment Risk Information Service surveyed each country’s investing environment and income difference among citizens, the political and social environment, and availability of foreign exchange. The company rated China as one of the riskiest areas for investment for the next five years. The lowest risk areas obtained an index of one (e.g., Taiwan, Japan, Singapore, and West Germany), while China received an index of three.\textsuperscript{72}

The factors influencing Taiwanese investment in China are political stability, labor resource, the stability of economic strategy, market potential, and the social atmosphere.\textsuperscript{73} (see Table 9) Political stability is the most important factor for Taiwanese investors to evaluate before investing capital in China.

Table 9

COMPARATIVE INVESTMENT FACTORS INFLUENCING TAIWANESE INVESTMENT (From a Survey of Taiwanese Investors)

(Unit: percent)

<table>
<thead>
<tr>
<th></th>
<th>July, 1989</th>
<th>May 1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political Stability</td>
<td>91.7</td>
<td>66.8</td>
</tr>
<tr>
<td>Labor Problem</td>
<td>58.8</td>
<td>56.8</td>
</tr>
<tr>
<td>Stabilities of Economic Strategy</td>
<td>52.5</td>
<td>42.3</td>
</tr>
<tr>
<td>Market Potential</td>
<td>44.9</td>
<td>58.1</td>
</tr>
<tr>
<td>Social atmosphere</td>
<td>22.6</td>
<td>45.2</td>
</tr>
</tbody>
</table>

Source: Global Views Monthly, July 14, 1989;162

Due to the unstable political environment, investment in China is riskier than in
other countries. The two Chinese economies would greatly benefit from a normal economic relationship. China offers Taiwan a familiar investment environment with the same language, customs, and living styles. It also offers a potentially huge market with ample labor resources, a large supply of untapped natural resources, and a relatively solid heavy industry and technological base. It lacks capital and management knowledge. In contrast, Taiwan, with the highest foreign exchange reserves in the world, has a resourceful workforce, advanced marketing and management skills, and a very competitive consumer industry. As the two economies evolve to naturally complement each other, conditions will become more and more favorable for Taiwanese investment in China. Although past records indicate that the success rate of Taiwanese investment in China was only 50 percent, Taiwanese investors are still the fastest-growing group among all foreign investors in China.

After the Tiananmen incident, economic policy has become more conservative in China, but its open-door policy has never changed. Since 1990, the political situation has become more stable, and foreign investment has started to return. In the first four months of 1991, there were more than 3,100 foreign projects approved, an increase of 90 percent over the previous year. The total value of investment contracts hit US$3.26 billion, which was 164 percent higher than 1990. Actual foreign investment value reached US$857 million, a 16 percent increase. The wholly foreign-owned enterprises increased 106 percent. These figures show that the confidence of foreign investors in China is recovering.

Taiwanese investors have shown confidence in China similar to that of other
foreign investors. Past investment emphasized short-term investments in labor-intensive industries, in small areas, or on a single industry, and in cooperation with China. Today the trend is toward long-term investments in high-tech-intensive and capital-intensive industries, whole-area development, and vertical integration of related industries.

Taiwanese investors have broadened from concentrating enterprises in Guangdong and Fujian Provinces to all areas rich in natural resources. They have also changed the means of investment from indirect through a third country to over 50 percent direct investment in China, even though official Taiwanese government policy is that direct investment remains illegal. The ROC government overlooks these transactions.

There are different regulations and privileges in the SEZs and opened coastal cities. In each place, there are different natural resources, raw materials, environments, and/or customs. These were discussed in chapter III. From the author's viewpoint, although China is a risky place to invest, it is still has great potential as an investment site for Taiwanese investors. In view of political reunification and mutual economic supplementary issues, Taiwanese are treated better than other foreigners in China. China has made efforts to improve the investing environment. It not only improved its infrastructure, but also announced and amended several regulations for Taiwanese investors. The influence of China's internal political instability will not have as drastic effect on Taiwanese investors as on those from other countries.

Investors should monitor the changes of the political and economic strategies before investing in China. Investors should not only research the area and businesses to invest in, but also study the obstacles that were discussed in chapter IV. Taiwanese
investors should diversify their investments in order to prevent China from controlling Taiwan's economy. The unstable political situation, the changing economic policies, and unhealthy legal system are still problems inside of China. Given these concerns, Taiwanese investors should not depend on China too much. An appropriate balance between short- and long-term investments should be sought, with caution (but not timidity) governing investment activities.
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