China

With a dramatic rise in foreign investment in 1992 and 1993, the Chinese economy grew over 13%. 1994 saw growth slowed to 11%, a result of stringent government policy, including tighter control over lending for fixed-asset investments due to the over-heated economy brought about by sharp growth. Although the tightening policy has decelerated price increases for raw materials and growth in fixed-asset investments, it has not yet succeeded in curving overall inflation.

With prices continually accelerating—especially for agricultural products—and wages rising at a fast pace, inflational pressures are still strongly felt. On the other hand, the trade balance, which recorded a large deficit of $12.2 billion in 1993 due to increasing imports as a result of economic growth, was brought back to near even in 1994 due to efforts to reduce imports (mainly luxury consumer products such as automobiles), a de-facto devaluation of Rmb, and export promotion measures.

For 1995, the main focus in the Chinese economy should be anti-inflation measures and bail-outs of state enterprises. As the government is likely to continue with stringent measures, economic growth in 1995 should slow to around 9.5% from the double-digits of 1994. Although tight monetary policies, including raising interest rates and squeezing the money supply, is effective in curving inflation, it may compound the difficulties that management of state enterprises, which are currently experiencing a severe shortage of funds, may face.

Managerial improvement in state enterprises has long been called for, but the situation has steadily been growing worse. As state enterprises provide for employees, the retired, and their families, the government cannot simply let inefficient ones go bankrupt, creating additional unemployment, with the current insufficient social security system. This dilemma has been blocking additional measures. Still, to establish a socialist market economy, state enterprise reform is the most urgent agenda point. What is required to steer the economy in 1995 is to carry out both the state enterprise reform and curving inflation simultaneously.

Introduction of foreign investment

Although foreign capital inflow has in general been growing since the introduction of reform and open-door policies, there have been three distinctive booms. The first came during 1984-85; the second in 1988. These booms coincided with a period of high growth and step-ups in liberalization, and the growing interests among companies in both Japan and NIEs in overseas investments (driven by deteriorating export competitiveness due to currency appreciation, 1985 for the yen, and around 1988 for Taiwan, South Korea and other NIEs).

However, following the Tiananmen Square incident in June 1989 foreign investment declined as many companies expressed caution about which direction China was headed. But as they regained confidence with the continuation of reform and liberalization, vigorous foreign investments returned. Triggered by Deng Xiaoping's early 1992 comments made during his trip to Southern China (emphasizing increased economic development through accelerating reform and open-door policies), foreign direct investments in China surged, mainly by overseas Chinese companies, representing the third boom.

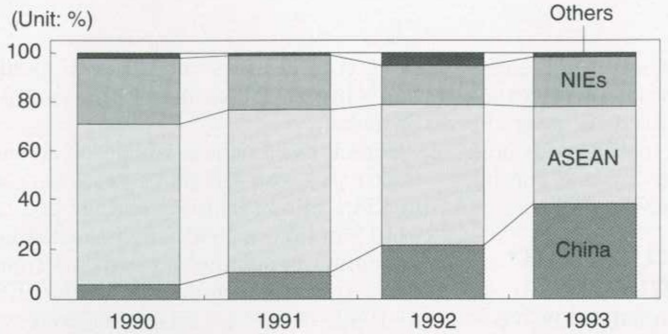
Although China has introduced foreign investment mainly along coastal areas, since 1992 those investments have expanded inland. Led by foreign investment, the economy in coastal areas traditionally has shown remarkable growth, unexpectedly leaving the inland economy behind. Thus, there was a growing need for a new strategy to prompt regional development, the most notable being a plan for simultaneous development in a T-shape zone covering coastal areas and the area along the Yangtze River basin crossing at Shanghai.

Direct investment in China (on a contract base) rose 4.8 times year-on-year to $58.1 billion in 1992, and jumped to $110.9 billion in 1993, almost matching the entire cumulative investments from the start of the open-door policy in 1979 to 1992. However, reflecting concern about the overheated economy, since the start of 1994 foreign investment in real estate, including construction in developing zones, has been discouraged by governmental tightening policies. Investments appear to have slowed in the first-half of 1994, falling 25.3% year-on-year to $44 billion.

One characteristic of investment in China is the dominance which Hong Kong and Macau play, reflecting both geological and historical relations. Since 1992 investments from Hong Kong and Macau have shown a sharp rise, with their share of total foreign investment growing from 62.6% in 1991 to 71.5% in 1992. Although their share fell to 66.6% in 1993, they still remain dominant, followed only by the U.S. at 6.1%, and Japan at 2.7%. As for Taiwan, although its "Three No's" policy officially prohibits any direct contact with the mainland, the policy has lost real meaning and vigorous investments from Taiwan via third countries are estimated to account for about 10% of the total investments in China.

A by-industry characteristic is the heavy weight of secondary industries, accounting for more than 50%, followed by the real estate industry and public works. In recent years, investment fields have been expanding and the government is also moving toward deregulation over foreign investments in tertiary industries, announcing a decision to accelerate development in tertiary industries in July 1992. However, many regulations still remain, and it is likely to take some time before investments in this area begin in earnest.

Chart: Japanese Manufacturers Direct Investment in Asia by Region



Source: Ministry of Finance

Japanese investment trends

According to the Ministry of Finance, Japan's investments in China rose by a record 2.3 times and 5.4 times respectively in both fiscal 1986 and 1987. They plunged 20.4% in fiscal 1990 following the Tiananmen Square incident, but quickly recovered in fiscal 1991 and resumed double-digit growth in fiscal 1992 and 1993. Fiscal 1993 Japanese corporate investments in China jumped 58.1% to $1.691 billion, and China replaced Indonesia to assume the top position for the first time in both value and volume among Asian recipients.

The growth in China was much stronger than the 23.8% for Asian NIEs, and 25.0% in ASEAN in the same period. As a result, the difference becomes even sharper if compared to changes from fiscal 1983: investment in China jumped 573 times, compared to two times for Asian NIEs, and four times for ASEAN during the 10 years to fiscal 1993.

As Japanese wage levels have become extremely high against the international standard due to the appreciation of the yen since September 1985, Japanese companies have been pushed to expand into Asia, seeking cheaper labor. Currently Japanese labor-intensive industries appear to be shifting their production base to China, following NIEs and ASEAN. However, Asia accounted for only 18.4%, and China for 4.7%, of Japan's total direct investment abroad in fiscal 1993, which seems still low compared to 42.4% for North America and 22% for Europe.

Viewing Japanese investment in China by industry, manufacturers dominate Japanese corporate investments in China, accounting for 81.4% in fiscal 1993. This figure is quite high compared to 30.1% of the international total, 27.1% for North America, 25.7% for Europe, and 30.4% for NIEs, although ASEAN also comes in relatively high at 61.5%.

Within Asia, direct investments by Japanese manufacturers were broken down into NIEs at 20.1%, ASEAN at 40.3%, and China at 37.6% in fiscal 1993. Although ASEAN still holds the top share, recent growth in China is noticeable (see chart), providing evidence of the trend that Japanese manufacturers have shifted their production base from Asian NIEs in the mid-1980s to ASEAN from the late 1980s to early 1990s, and then recently to China.

Among manufacturers, proportions of electric machinery and textile are high in value terms for fiscal 1993, accounting for 24.1% and 16.8% respectively. Also, by number, textile overwhelms with a share of over 40%. As for location, coastal areas, where the investing environment has been well organized, naturally absorbs most of these investments.

Among coastal cities, Dalian is particularly favored by Japanese investors, compared to Southern China where investments from Hong Kong and Taiwan concentrate. The reason for this inclination includes the enthusiasm of the local government of Dalian to invite Japanese companies, the geographical nearness to Japan, and perhaps some kind of nostalgic attachment to the city among Japanese investors.

Future outlook

China is confronting the distortions that accompany rapid moves toward a market economy and growth policies, and has been compelled to cope with new social problems caused by unequal regional distribution, growing disparities between rich and poor, poverty in farming villages, bureaucratic corruption, and rising inflation. To ensure future economic growth China must obtain international acceptance by urgently taking appropriate measures to deal with these problems. On the other hand, by continuing to implement market opening policies China can strengthen ties with the international society while promoting economic expansion.

The open-door policy expanded Chinese international trade, making China the 11th largest trader in the world. For Japan, China is the second largest importer only after the U.S., and the sixth largest exporter. Japanese trade with China quadrupled from $10 billion in 1983 to $39 billion in 1993, ranking second after the U.S. In line with economic development in China, and strengthening economic ties between Japan and China, direct investment by Japanese companies is likely to shift from those seeking abundant and cheap labor (export and production bases) to those focusing on the local market (production and marketing bases), the same pattern as for NIEs and ASEAN.

Given the tremendous land and population in China, however, entries only by individual companies seems insufficient in securing a continuing presence, competing against companies from the U.S. and other advanced countries. It appears necessary that future entries should be ones incorporating supporting industries that provide parts and materials for local production and marketing subsidiaries targeting the Chinese market. Although this may not be allowed for all the foreign industries, considering the Chinese industrial policy which would prefer to develop and protect local industries, this type of entry incorporating supporting industries should be noted as a future form of investment in China. JJTI

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