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**China's Accession to WTO and its Impacts on Foreign Direct
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China's Accession to WTO and its Impacts on Foreign Direct Investment

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内容提要: 本文试图对我国加入世界贸易组织对我国吸收外国直接投资的影响做一个总体评价。文章首先总结了我国入世的主要承诺。然后,将履行承诺对外国直接投资的影响概括为四点,并用数据加以论证:(1) 入世将使我国经济更加融入世界经济,并加深中国与其他亚洲国家的专业化和地区分工;(2) 入世带来的国内市场开放将使跨国公司加紧在华建立其生产及研发基地,这将在我国产生现代工业的集聚效应;(3) 入世引起的新一轮开放和投资高潮可能使我国经济和社会发展的东西差距进一步扩大,政府应采取积极的应对措施;(4) 贸易和投资的进一步自由化将加速我国建立社会主义市场经济的改革,特别是国有企业的改革。

Summary: China's progress during the economic reform era that began in 1978 has been one of the great economic success stories of the post-war era. The accession of China to the World Trade Organization (WTO) marks an important milestone along the reform path China has been following for more than twenty years, namely the opening up to foreign trade and investment. Foreign direct investment (FDI) played a major role for the growth and social development in China since 1990. China has become the world's seventh largest economy and the largest recipient of FDI (2002). In this paper, I will make some comments about the impacts of China's accession to WTO on FDI in China from a general perspective. First, I shall present some of the commitments undertaken by China in the WTO agreement. I will then identify four points that to my opinion will influence FDI in China quite considerably. At last, I will present some data that support my arguments.

Zusammenfassung: Der Beitritt Chinas zur Welthandelsorganisation (World Trade Organization/WTO), verbunden mit der Öffnung des Landes für den Außenhandel, war ein sehr bedeutender Schritt innerhalb der wirtschaftlichen Reformprozesse seit 1978. Die dadurch erhaltenen ausländischen Direktinvestitionen spielen seit den 90er Jahren eine große Rolle für das Wirtschaftswachstum und die sozialen Entwicklungen, so dass sich im Jahr 2002 China zum Land mit den höchsten Direktinvestitionszuflüssen und sich bereits zur siebtgrößten Volkswirtschaft entwickelt hat. In diesem Diskussionspapier stellt der Autor die Auswirkungen des WTO-Beitritts Chinas auf die Direktinvestitionen dar, die auf Basis der vorgestellten WTO-Vereinbarungen im Wesentlichen aufgrund von vier dargestellten Faktoren erklärt werden.

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1. Among some important commitments undertaken by China's WTO agreement

There are two key aspects contained in the WTO agreement:

- Market liberalization and improved access for FDI
- Reduction of tariffs and phase out of quotas

In the area of market liberalization and improved access for FDI:

- China will provide non-discriminatory treatment to all WTO members. All foreign individuals and enterprises will be accorded treatment no less favorable than that accorded to enterprises in China (national treatment).
- China will eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China in comparison to those produced for export.
- Price controls will not be used for purposes of affording protection to domestic industries or services providers.
- The WTO Agreement will be implemented by China in an effective and uniform manner by revising its existing domestic laws and enacting new legislation fully in compliance with the WTO Agreement.
- Within three years of accession, all enterprises will have the right to import and export all goods and trade them throughout the customs territory with limited exceptions.
- China will implement the TRIPS (Trade-related Aspects of Intellectual Property Rights) Agreement in full from the date of accession.
- China has made a broad range of commitments to open up its services to foreign investment gradually after its entry into the WTO, which was previously severely restricted to foreign participation - such as banking, insurance, telecoms, tourism, retails etc.

Table 1: Ratio of foreign direct Investment inflows to China's GDP and gross capital formation

	Total foreign direct investment inflows (US\$ billion)	China's GDP (US\$ billion)	Ratio of total foreign direct investment inflows to China's GDP (%)	China's domestic GCF ¹ (US\$ billion)	Ratio of total foreign direct investment inflows to China's domestic GCF ¹ (%)
1983	0.916	300.375	0.31	101.483	0.90
1985	1.661	305.254	0.54	115.300	1.44
1990	3.487	387.723	0.90	134.705	2.59
1995	37.521	700.278	5.36	285.928	13.12
1996	41.725	816.490	5.11	323.148	12.91
1997	45.257	898.244	5.04	343.285	13.18
1998	45.463	958.990	4.74	356.964	12.74
1999	40.319	989.621	4.07	368.446	10.94

1. GCF refers to gross domestic capital formation.

Source: OECD: *China in the World Economy. The domestic policy challenges*. Paris: OECD 2002

With respect to tariff reduction and phase out of quotas:

- China has bound all tariffs for imported goods. After implementing all the commitments made, China's average tariff level for agricultural goods will decrease from an average of 18.9 per cent to an average of 15 per cent. The range is from 0 to 65% per cent, with the higher rate applied to cereals. For industrial goods, the average tariff will go down from an average of 14.8 per cent to 8.9 per cent with a range from 0 to 47 per cent, with the highest rates applied to photographic film and automobiles and related products. Some tariffs were eliminated upon accession, with most other reductions to be completed by the end of 2004, and in no circumstance later than 2010.
- China also made commitments to phase out quotas, licenses, tendering requirements, and other quantitative restrictions that restrict trade in industrial goods – some upon accession, many others within the two following years, and the rest within five years. For example, all quotas on civil aircraft, medical equipment, and IT products were eliminated upon accession. For automobiles and key parts, quotas will rise by 15 per cent annually until all licenses and quotas are eliminated by 1 January 2005.

All of those commitments will improve the investment environment in China tremendously, as soon as they have been implemented.

Table 2: Timetable of the tariff reduction upon the WTO Entry

Sector	2001	Reduction	Difference
Agriculture (average)	18,9	15 (1.1.2005)	3,9
Industrial products (average)	14,8	8,9 (1.1.2005)	5,9
IT-Products	13,3	0 (1.1.2005)	13,3
Automobiles	80-100	25 (1.7.2006)	55-75
Textile und apparel	25,4	11,7 (1.1.2005)	13,7
Steel	10,6	8,1 (1.1.2004)	2,5

Source: OECD, s. above

2. Impacts of these commitments on the FDI inflows into China

The implementation of the commitments will influence or have influenced the FDI in 4 points as follow:

- The growth of FDI as a result of the improved investment environment will integrate the Chinese economy into the world economy more closely and accelerate the regional division of labor and industrial specialization among the Asian countries.
- The market liberalization will encourage the engagement of multinational companies in China to set up their whole supply chains. This will accelerate the

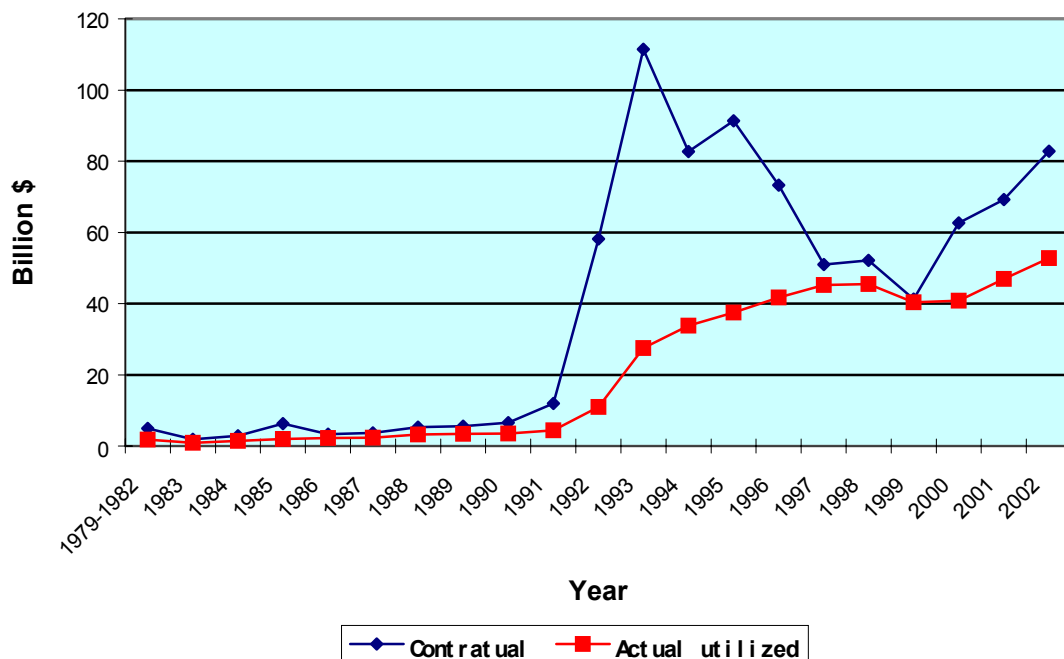
clustering of modern industrial production in China thereby benefiting the consumers.

- The Chinese government will impose some policy measures to direct the FDI inflows into the central and western regions of the country. If this were not the case, the remaining severe regional discrepancies will even become more aggravated.
- The sharpened competition by foreign-funded enterprises will press the inefficient state-owned enterprises (SOEs) to enhance performance thereby accelerating the reform effects of the Chinese economy to a more market-driven economy as well as the reform of SOEs.

3. Empirical data on FDI

Some Data as illustrated below underscore these opinions.

Figure 1: Foreign Direct Investment in China (1979-2002)



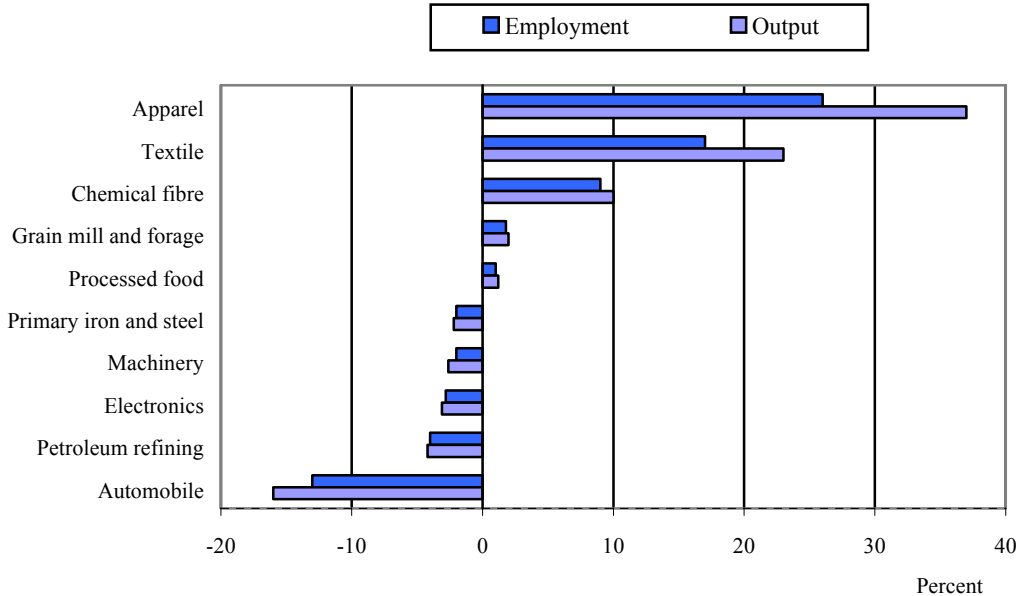
Source: China Statistic Yearbooks and MOFTEC

The FDI inflows have continued to grow rapidly in the first two months of this year. The contractual FDI has gone up by 59.11% compared to the some period last year and the actual utilized one by 53.61%. By the end of February 2003, cumulative FDI in China reached a sum of USD 842.283 billion (contractual) and USD 455.509 billion (actual utilized), respectively.

There is a positive correlation between the increase of the FDI inflows since 2001 and the WTO accession of China on December 10, 2001.

Efforts for improvement in the investment environment have been made since entry into the WTO. By the end of 2002, for instance, 2300 laws and regulations that are not in compliance with WTO rules have been amended and 830 abolished. Especially important for the improvement of FDI access is the amendment of the Law for Equity Joint Ventures, the Law for contractual Joint Ventures and the Law for the enterprises with lonely foreign capitals. The clauses that restrict and discriminate foreign-funded enterprises (e.g., local content requirement, export quotas, technology transfer requirement and foreign currency balance requirement, etc.) have been phased out. This policy change made it possible for foreign firms to compete with their Chinese counterparts on an equal footing and provided more incentives for the engagement of foreign companies in China.

Figure 2: Impact of WTO entry on the most affected sectors

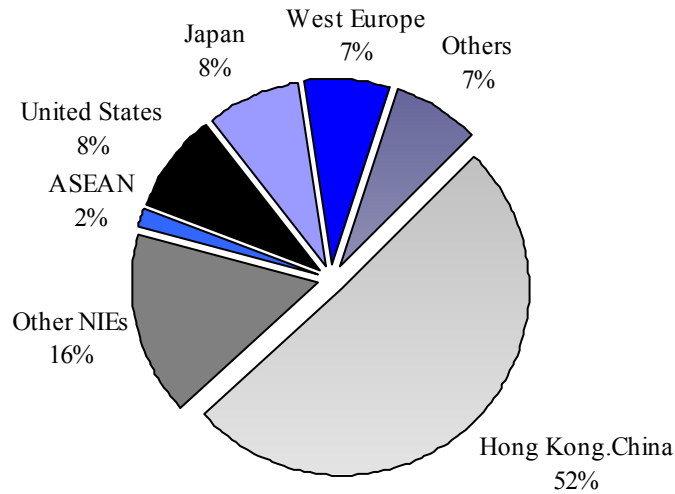


Source: OECD: *China in the World Economy. The domestic policy challenges.* Paris: OECD 2002

Prior to WTO accession, the Chinese domestic economy was protected to a considerable degree. Not only were the whole infrastructure sector and most of the service sectors – such as banks, insurances, transport, telecommunications and distribution – closed to foreign investors, but some industrial branches like electricity, petroleum/gas extraction, mineral extraction, steel and other metallurgical industries basic chemicals were also protected from foreign competitors. Even in the automobile industry, in which foreign participation is permitted and welcome, some restrictions on the entry of foreign automobile producers have been imposed in order to protect the domestic producers. For instance, foreign companies were not allowed to set up the second joint venture with the production of the same sort of cars. Their shares in an equity joint venture had to be limited to 49 per cent. Upon WTO accession, those limitations were abolished. The international operating companies such as GM and the Volkswagen Group have already seized upon this chance to enhance their investments in China in order to maintain market shares as a reaction to fierier competition within the Chinese market. If we reviewed the function of FDI since the 1990s, it is possible

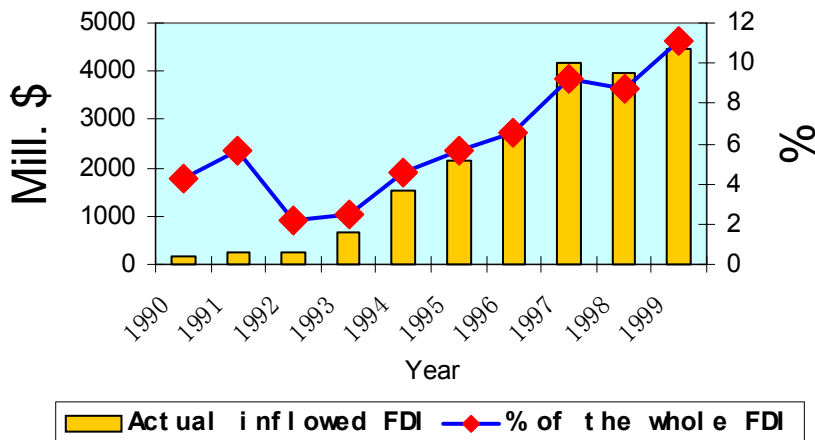
to come to the conclusion that the FDI has made a great contribution to China's export industries, initially in the labor-intensive industries and then, particularly in the recent years, shifting towards capital- and technology-intensive export sectors. But now market liberalization according to the WTO rules will open new opportunities for the penetration of FDI into the domestic market in China. Access to the service sector will especially open up such opportunities for foreign investors in China.

Figure 3: The main investors in China (1983-1999)



Source: Various issues of the State Statistical Bureau, *Zhongguo Duiwai Jingji Tongji Nianjian (China foreign Economic 5)*
Zhongguo Jingji Tongji Nianjian (China Statistica Yearbook), *Zhongguo Tongji Chubanshe, Beijing*

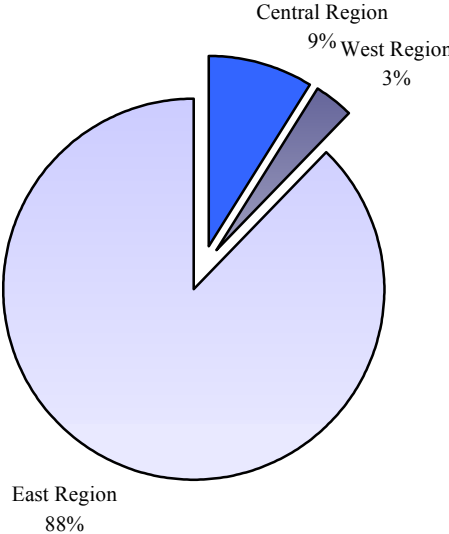
Figure 4: Development of FDI from EU (1990-1999)



Source: MOFTEC

As one can see, the performance in attracting FDI to China has been uneven. The bulk of FDI has come from Hong Kong and Taiwan, while China has been less successful in attracting FDI from OECD countries. But this situation began changing at the eve of China's WTO accession and thereafter (s. figure 4). FDI inflows from OECD countries, the hosts to most MNCs, have been growing more rapidly than those from the Asian countries and other regions with a large ethnic Chinese population. The proportion of FDI from OECD countries has increased. Four hundred of the 500 international operating MNCs have become active in China, investing not only in production and distribution, but also setting up new R&D centers in China to develop products that adapt better to the Chinese market.

Figure 5: Regional distribution of accumulated FDI stocks in China (1983-1999)



Data for 1983-1991 are calculated from the State Statistical Bureau (1992). Zhongguo Duiwi Jingji Tongji Daquan for 1992-1999 are calculated from various issues of the State Statistical Bureau. Zhongguo Tongji Nianjian (China Statistical Yearbook), Zhongguo Tongji Chubanshe, Beijing.

Figure 5 shows that FDI has been largely concentrated in coastal provinces, mainly because most of special economic zones (SEZ) granting preferences to foreign investment have been established in these regions. The Chinese government has already pronounced and implemented a policy change in favor of its western regions to narrow regional disparities. As mentioned above, China must implement uniform and transparent administration of its trade regime upon the WTO entry. The special treatment granted to the SEZ and other coastal cities should be eliminated. Some preferential policies, which are not inconsistent with the WTO rules, have nevertheless been adopted to attract more FDI to the western region. Furthermore, the government spent a considerable sum of money to improve infrastructure in the hinterland, encouraging foreign investors to join in. Even so, the Chinese government is facing the great challenge of developing the western regions more rapidly to prevent the existing gap between the coastal region and the rest of the country from growing even larger.

Table 3: Per capita GDP and real GDP growth by province

	per capita GDP RMB/capita		Rank in the year		Change of rank	Growth rate of GDP	
	1980	1999	1980	1999	1980-99	1980-90	1990-00
Eastern							
Beijing	1 582	19 803	2	2	0	8.8	10.9
Tianjin	1 392	15 932	3	3	0	7.3	11.5
Hebei	427	6 913	12	11	-1	9.2	12.8
Liaoning	768	9 958	4	8	4	8.4	9.4
Shanghai	2 738	30 805	1	1	6	7.4	12.2
Zhejiang	468	11 981	9	4	-5	11.1	15.0
jiangsu	544	10 699	6	7	1	11.6	14.0
Fujian	343	10 969	20	6	-11	11.4	15.4
Shandong	405	8 648	14	9	-5	10.1	19.6
Guangdong	473	11 739	8	5	-3	12.8	14.6
Guangxi	281	4264	26	25	-1	7.2	12.6
Hainan	278	6 227	27	15	-12	11.7	12.5
Central							
Shanxi	437	5 117	10	18	8	8.7	9.4
Inner Mongolia	345	5 400	19	16	-3	10.6	9.8
ilin	384	6 302	17	14	-3	9.5	10.4
Heilongjiang	685	7 660	5	10	5	6.9	8.4
Anhui	285	4 710	25	21	-4	9.9	12.2
iangxi	342	4 673	21	23	2	8.8	11.7
Henan	317	4 899	23	19	-4	9.6	11.5
Hubei	428	6 511	11	13	2	9.2	11.9
Hunan	365	5 227	18	17	-1	7.8	10.5
Western							
Chongqing	-	4 852		20	-		
Sichuan	315	4 356	24	26	2	8.1	10.0
Guizhou	219	2 463	30	29	-1	9.5	8.7
Yunnan	367	4 444	28	25	-3	11.8	9.3
Tibet	259		29		-	6.4	9.2
Shaanxi	335	4 107	22	27	5	10.0	9.1
Gansu	388	3 595	16	28	12	8.8	9.4
Qinghai	475	4 707	7	22	15	7.1	8.2
Ningxia	409	4 777	13	24	11	9.7	8.5
Xinjiang	405	6 653	15	12	-3	11.1	9.7

Source: China Statistical Yearbook, 2000

The establishment of new foreign firms and the intensification of competition as a result of China's accession to the WTO will accelerate economic reform in China, especially the reform of SOEs. Recently, the Chinese central government has imposed regulations that allow foreign firms to merge with and acquire SOEs. Some time earlier, another regulation adopted by the government set forth conditions for the entry of qualified foreign institutional investors into the Chinese stock market (QFII-System). Because of the heritage of Soviet-style planned economics and the special path of the Chinese economic reform, the Chinese economy remains highly fragmented and segmented in spite of its 20-year economic reform. Administrable monopolies and regional protectionism are rampant. These have impaired the efficiency of the Chinese economy. Many industrial branches are lacking on a sufficient scale and therefore lose money (s. table 4). Another severe problem inherent within the Chinese economy is the bad credits and inefficiency of the finance sector. The reform of finance sector and the labor market is far behind the reform and liberalization of

commodity market. Access on the part of foreign investors to service sectors such as banks and insurance companies as well as some other previously heavily-protected sectors (electricity, telecommunication, transport, etc.) will put pressure on the SOEs which dominate in these sectors to enhance their efficiency. The four large state banks of China that keep the bulk of domestic savings have already accelerated steps to reduce their non-performing loans in order to make them more competitive against their foreign rivals. Merger and acquisition by foreign firms will improve the ownership structure of the SOEs and step up the economies of scale. In 2002, after the reduction of the tariff for imported cars by almost 30 per cent, the restructuring and merger of the automotive branch was accelerated. The China First Motor Work in Changchun merged with the Tianjin Automobile plant, and the Shanghai Automobile Group merged with the Qirui Car Factory in Liuzhou. Two global players, Toyota and General Motors, were actually behind these mergers.

Table 4: Evolution of concentration in Chinese industry between 1990 and 1996

Sectors	Level of concentration		
	{Market share of the 8 leading companies in the sector }		
	1990	1996	change
Chemical fibers	44.6	35.0	-9.6
Construction materials	2.6	2.7	0.0
Steel	31.0	29.7	-1.3
Non-ferrous metals	23.4	15.0	-8.4
Publishing and media	5.5	5.6	0.1
Chemicals	15.6	10.1	-5.6
Drinks	5.4	9.4	4.0
Paper	10.8	5.4	-5.4
Textiles	1.4	3.0	1.6
Basic machines	4.0	6.8	2.8
Woodworking	8.1	7.6	-0.5
Production of plastics	6.1	3.7	-2.4
Office equipment	10.5	11.8	1.3
Pharmaceuticals	9.7	11.8	2.1
Transport equipment	21.0	22.3	1.3
Metals	3.7	5.5	1.8
Rubber	12.7	18.5	5.8
Food	2.3	11.3	9.0
Furniture	5.4	6.1	0.7
Tobacco	26.0	37.1	11.1
Electric machines	9.3	10.0	0.7
Electronics and telecommunications	14.6	16.9	2.3
Cultural and sporting goods	8.8	11.7	2.9
Clothing	5.0	4.5	-0.5
Leather	4.2	4.1	-0.1
Average	11.7	12.2	0.6

Source: Zhongguo gongye fazhan baogao: 1997 (Report on industrial development in China)

Thus, we can conclude that China's accession into the WTO has given way to a great impetus for a new wave of FDI inflows into China. FDI will continue to play a major role in the economic development of China.

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