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Foreign Investment in China: Impact of New Regulations 25X1

Summary

Since 1979 more than 5,000 joint ventures, cooperative enterprises, and businesses wholly owned by foreign firms have been established in China. By the end of 1985, we estimate that total paid-in foreign investment in these enterprises reached $5.4 billion. We believe that through the Seventh Five-Year Plan (1986-90) Beijing will continue to seek higher levels of foreign investment, although changes in Chinese regulations may work against small investors. In addition, the drop in oil prices will probably delay further investment in China's oil industry. 25X1

How Much Foreign and US Investment Now?

Foreign investment in China has been growing rapidly over the past five years. According to China's Ministry of Foreign Economic Relations and Trade (MFERT), between 1979 and 1985 Chinese authorities granted approval for nearly 2,300 joint ventures and over 3,700 cooperative enterprises. In addition, there were 30 offshore oil

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Information available as of 28 March 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, China Division, OEA, 25X1 25X1

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exploration and exploitation projects[1] as well as 120 wholly owned foreign enterprises. According to MFERT, by September 1985 paid-in foreign investment totalled $5.4 billion. [redacted] 25X1

According to US industry sources, total US investment in China as of last December was about $1 billion, $600 million of that in oil exploration. US firms also are involved in some 100 joint equity ventures with investments of about $150 million. The balance of US investment is probably in cooperative enterprises. [redacted] 25X1

Driving Forces Behind Foreign Investment in China

Hong Kong is responsible for roughly two-thirds of all foreign investment in China and as much as 80 percent of all joint equity venture projects. Hong Kong businessmen find China, especially neighboring Guangdong Province, an attractive place to invest partly because of family ties and other personal linkages. In addition, China has designed some of its investment incentives--such as establishing the Shenzhen special economic zone adjacent to the Hong Kong border--specifically to attract Hong Kong investment. Potential investors, faced with a 3.4-percent unemployment rate that makes enterprise expansion difficult within Hong Kong itself, find China's labor costs--one-third lower than Hong Kong's--especially attractive. [redacted] 25X1

China has also improved its investment environment by developing its legal infrastructure. In 1983, Beijing began to enact scores of laws to attract or protect the foreign investor. In September of that year, China issued regulations to clarify its 1979 law governing joint ventures. The new rules offered longer tax holidays, increased opportunities to sell the output of the venture in the domestic Chinese market, and gave more decisionmaking autonomy to the venture. In early 1984, China exempted joint ventures from import duties and abolished selected taxes on ventures that import advanced machinery and technology. In April 1984, the National People's Congress formally ratified the leadership's decision to open 14 additional port cities and Hainan Island to foreign investment, giving entrepreneurs many of the advantages available in the Special Economic Zones. However, the central government has since withdrawn plans to invest heavily in infrastructure in these areas. [redacted] 25X1

In May 1984, Beijing extended the maximum limit of the term of joint ventures from 30 to 50 years, giving the foreign investor more time to recoup its investment and make a profit. In December of that year, China also joined the Paris Convention for the protection of industrial property rights thereby easing concerns of investors about pirating protected technologies. [redacted] 25X1

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[1] We count only 25 offshore contracts total. MFERT may also count areas where bids have closed but no firm contracts have been signed. [redacted] 25X1

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Last year, Beijing revamped its tariff regulations, lowering duties on raw materials and high-technology items and gave special tax reductions and exemptions to joint ventures and projects in Special Economic Zones. The State Council also eased regulations for high-technology joint ventures giving them more discretion over the level of their reserves and greater access to domestic markets. 25X1

Investment in the Seventh Five-Year Plan

China will continue to try to attract foreign investment throughout the Seventh Five-Year Plan but with a few modifications. Priority will be given to the development of natural resources, transport, upgrading existing enterprises, and tourism. Because of foreign exchange difficulties, however, China has revoked some of the autonomy allowed local planners. Beijing also is instituting regulations to prevent foreign exchange loss in certain types of investment. For example, wholly foreign-owned ventures will be required to export part or all of their product; officials stress that this rule is not intended to limit foreign investment but to stem foreign exchange loss. 25X1

Beijing is also implementing internal regulations designed to limit the share of borrowed funds that can be used to finance small investments. The rule permits no debt for any investment less than $3 million; Beijing believes low levels of equity have been a major cause of bankruptcies. The limitations could undermine plans of small investors who lacked sufficient financial resources to cover the cost of their venture but hoped to profit from China's growth in the late 1980s. 25X1

Of special interest to the United States over the past few years, investment in oil exploration probably will slow as long as oil prices remain low. This will adversely affect the total share of future US investment in China inasmuch as oil represents two-thirds of all US investment in China and has been the one area where US firms have been dominant. This, too, is more likely to affect small, independent firms that have insufficient financial resources to survive until oil prices rise again. 25X1

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Typescript "Foreign Investment in China: Import of New Regulations [redacted] 25X1

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