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THE POLITICS OF FOREIGN DIRECT INVESTMENT IN SHANGHAI

By

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ABSTRACT

THE POLITICS OF FOREIGN DIRECT INVESTMENT IN SHANGHAI

By

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Foreign direct investment (FDI) has influenced the Chinese economy tremendously since economic reform was initiated in the late 1970s. FDI, however, has been embedded in national and local politics. This thesis, a case study of the politics of FDI in Shanghai -- a provincial municipality in Eastern China -- explores how public policy influenced inflows of FDI by changing the local political environment in the 1980s and '90s. Historical literature, government documents and census data are used in this study. Central and local government have led FDI inflow in Shanghai. National policies have offered Shanghai developmental priorities with favorable treatments since late 1980s. Shanghai municipality took this political opportunity to reverse its previous backward status and promote its economy in the nation by soliciting and guiding FDI flow. The development of FDI in Shanghai was hence initiated by the center and reinforced by local polices.

To My Family

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LIST OF ABBREVIATIONS

ETDZ: ECONOMIC TECHNICAL DEVELOPMENT ZONE

FDI: FOREIGN DIRECT INVESTMENT

GDP: GROSS DOMESTIC PRODUCT

OCEA: OPEN COASTAL ECONOMIC AREA

OCC: OPEN COASTAL CITY

SEZ: SPECIAL ECONOMIC ZONE

SOE: STATE-OWNED ENTERPRISE

TNC: TRANSNATIONAL CORPORATION

INTRODUCTION

Since economic reform was initiated in the late 1970s, foreign direct investment (FDI) has influenced the Chinese economy in ways that no one anticipated. High economic growth rates are usually associated with vast amounts of foreign direct investment in Chinese cities. And foreign investment is widely considered a blessing to break with local economic stagnation and a miraculous catalyst to speed up urban economic growth. Hence, FDI is overwhelmingly desired in regional economic development strategies. Competing for the available yet limited FDI has become a major concern in urban economic development. However, on the supply side, FDI is limited, and foreign investors carefully weigh economic, political and social factors at national and local levels. Obviously, a favorable investment environment may induce a substantial inflow of FDI. This thesis, a case study of the politics of FDI in Shanghai, a provincial municipality in Eastern China, explores how public policy influenced inflows of FDI by changing the local political environment in the 1980s and '90s. This study concurs with the assumptions of urban political economy that urban development and municipal behavior are outcomes of extra-local political, economic and social processes (Castells, 1977; Hill, 1977). An urban economy cannot be isolated from the larger political and economic systems of which it forms a part.

At the outset of urban reform, the central government adopted preferential policies only for four Special Economic Zones (SEZs). In 1984, these preferential treatments were expanded to Coastal Cities. Shanghai was one of them. Starting from 1990, more favorable conditions have been granted to Shanghai to allow the city to resume its pivotal and locomotive role in national economy. These changes in national policies toward regions had tremendous consequences for Shanghai's economy. FDI in Shanghai is first situated in this political context of China's economic reform. In the 1990s, local policy initiatives have become important in soliciting and managing FDI. Beyond public policy, the politics of national and local leadership has made FDI development in Shanghai differ from that in Southern Chinese cities, especially Shenzhen. As one journalist points out, "Mr. Deng [Xiaoping] often seemed most enthusiastic about southern Chinese cities like Shenzhen, where the economy boomed because of private enterprises and joint ventures with foreign companies, ...Mr. Jiang [Zemin], in contrast, has always seemed most enchanted by the economic model of Shanghai, the city where he served as mayor and Communist Party leader, where the Government plays a major role in guiding the economy and large, modern companies build their glass-and-steel offices." (Kristof, 1997) Thus, from the very beginning, FDI has been embedded in national and local politics.

This paper consists of five sections. Chapter 1 presents an overview of Chinese economic reform and FDI. The open-door policy is discussed because of its importance in facilitating FDI's growth. Chapter 2 centers on the impact of central government policies on trends in FDI. Chapter 3 surveys major local initiatives adapted to central planning to solicit FDI into Shanghai. In Chapter 4, the politics of FDI inflow in Shanghai during the reform are investigated. Chapter 5 discusses the implications of FDI for Shanghai's local political economy. Conclusions are drawn in Section VI.

Chapter 1

INFLOW OF FDI IN CHINA: AN OVERVIEW

FDI is one consequence of China's economic reform and open-door policy. Between 1949 and 1980, there had been little FDI in China for ideological reasons. China had been satisfied with its closed self-reliance economy, termed a "socialist command planned economy". Before the reform, this economic system seemed to be realizing officially defined advantages of socialism[1], though it was wastefully inefficient in today's perspective. The Chinese economic system was pushed to the edge of debacle by the turbulence of the ten-year (1966-1976) Cultural Revolution. At the passing of Mao Zedong in 1976, various political forces inside the Chinese Communist Party had an opportunity to redistribute power and adjust national policies. Deng Xiaoping became the leader of China and began to reformulate the liberal vision of national development that he had in 1950s in order to avoid further economic disaster and reinvigorate China's economy. However, Deng's developmental strategies focused on rectifying mistakes in previous economic not political systems. Hence, economic reform and the open-door policy were formulated in the late 1970s. Without this national economic policy change, foreign investors could not have entered China.

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[1]Though the Chinese Communist Party tried to adopt the Stalinist economic system, some disagreed. For instance, Liu Shaoqi, who was once President of the country, advocated leasing arable land to peasants, but his ideas were opposed by hardliners, and he was soon forced out of the Party.

China's Economic Reform and the Open-door Policy

One major reform task was to tackle inefficiencies in Chinese agriculture under the Commune system. Farm workers had little incentive to work hard under the work-point system because they were not rewarded for their labors. To enhance agricultural productivity and stabilize agricultural supply, the "household responsibility system" was promoted by the Fourth Plenum of the Eleventh Central Committee of the Communist Party in September 1979. In this system, each farm household is leased a certain amount of land for a given number of years and is granted control over the land. The household can choose what to grow and after delivering a given quantity of its production to satisfy the procurement requirement of the government how to allocate its remaining products for self consumption or sale. This reform led to a rapid increase in agricultural output and incomes of the farmers.

The agricultural reform, as Gregory Chow (1994) points out, was the first step in the economic reform. The subsequent steps included (1) allowing private markets and small private enterprises to flourish, (2) state-owned enterprise reform; (3) allowing price determination by market supply and demand, (4) the decontrol of the supply of consumer goods, (5) expanding foreign trade and encouraging foreign investment, and (6) banking reform. These steps were designed to help achieve the modernization goals set in late 1970s and '80s. Since the open-door policy is claimed to be one fundamental element of China's economic reform, and reform and opening up are always linked together in the Chinese mass media, a thorough investigation of this policy is presented in this section; other reform policies will be taken up in the discussion of specific political influences on FDI inflow in Shanghai.

The open-door policy was adopted in 1979. After the ten-year Cultural Revolution was over and the focus of socialist construction was transformed from class struggle to economic development, China found its economy far behind neighboring countries. The rise of the so-called "four little dragons", South Korean, Singapore, Taiwan, and Hong Kong, along with Japan, which in the 1950s or '60s were almost at the same economic level as China, posed a profound challenge to socialist China. The gap in living standards, GDP per capita, and national income per capita between China and these countries/regions had grown bigger and bigger. China's central government was determined to design new national economic development strategies based upon its own past lessons from failure and, more importantly, the successful economic experience of its neighbors. Government officials and scholars began to acknowledge that internationalized production and an open-door policy had been the inexorable trend in social development since World War II. (Gao, 1996)

The open-door policy intends to increase China's participation in the world economy and allow foreign economic entities to do business in China, and thus to facilitate high and stable growth of the national economy. The policy contains strategies such as,

1. Reducing the trade controls that prevailed for three decades between 1949 and 1979 and gradually abolishing state monopolies on foreign trade by permitting more active participation by the private sector in external economic activities;
2. Active interaction in international financial markets, utilizing foreign capital;
3. Encouraging foreign direct investment, primarily through equity joint ventures;

4. Adopting other trade practices, such as leasing, compensation trade, export processing, and assembling to rapidly expand external trade; and
5. Encouraging overseas equity investment by Chinese industrial companies and financial institutions in order to broaden the export base and marketing network for Chinese products. (Grub and Lin, 1991, p.18)

One short-term goal of the open-door policy is to enhance domestic production and access to the international market by acquiring foreign capital, advanced technology, and managerial skills. Establishing Special Economic Zones and designating Open Coastal Cities to solicit FDI, rather than foreign loans, was considered to be the best way to implement this goal.

In August 1980, the central government declared four cities, Shenzhen, Zhuhai, Shantou, and Xiamen, "Special Economic Zones". SEZ investment decisions are made largely outside the state plan. Privileges such as special tax concessions and less restrictive regulations on foreign exchange and land use were granted to attract foreign investment. Foreign-owned/managed firms received a two-year tax holiday, followed by another three years of low tax rate (7.5 percent). After the initial five years, foreign firms paid a 15 percent tax rate. Outside the SEZs, the tax rate was 33 percent for foreign firms and 55 percent for domestic, state-owned firms.

Hainan Island was soon granted more decision-making power equivalent to the SEZs. Moreover, foreign businesspersons and their resident dependents are issued multi-entry visas. Natives of Hong Kong, Macao and Taiwan, along with overseas Chinese, enjoy even simpler and more convenient entry and exit procedures. In 1988, the Island was declared an independent province. By elevating the status of Hainan Island, the central government wanted to create a zone that would provide an even better investment environment than was available in the SEZs.

In April 1984, fourteen more coastal cities, named Open Coastal Cities (OCCs), on the western Pacific rim were opened up by the central government. From north to south, they are Dalian, Qinghuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai. In comparison to the SEZs and Hainan Island (or Hainan Province), as Shangquan Gao (1996) points out, OCCs are either the most economically developed areas in the country or are regional political centers with rich experience in developing overseas economic links and trade. The open-door policy thus began to touch the core of the national economy, and entered an important transitional stage from limited experiment to nationwide opening up. These OCCs were explicitly designed to focus on technological innovations and export industries, a more defined target than simple foreign capital attraction, and were expected to lead to a national economic boom. They also have greater decision-making power in their dealings with foreign business. Many hi-tech parks and economic districts have been set up in the OCCs to allow FDI to take full advantage of local resources.

In February 1985, Changjiang (Yangtze) Delta, Zhujiang Delta and the triangle region of southern Fujian including Xianmen, Zhangzhou and Quanzhou were designated as “Open Coastal Economic Areas” (OCEAs). These areas include thirteen cities, forty-six counties and two district counties. In March 1988, the State Council decided to further expand the scope of these coastal areas, and designated several more territories to share this status. These include Liaodong Peninsula, Shandong Peninsula, Circular Bohai Region, and the counties governed by the OCCs. Hence the OCEAs include seven cities and sixteen counties in Liaoning Province, two cities and twelve counties in Hebei Province, five counties in Tianjin, three cities and twenty-seven counties in Shandong Province, seven cities and forty counties in Jiangsu Province, ten counties in Shanghai, five cities and thirty counties in Zhejiang Province, four cities and twenty-eight counties in Fujian Province, thirteen cities and thirty-nine counties in Guangdong Province, one city and five counties in Guangxi Autonomous Region (Gao, 1996, p.42).

Inflow of FDI in China

FDI flows into China have grown steadily since the beginning of the economic reform (Table 1), and China has become a major recipient of FDI. Between 1979 and 1983, China actually used an average of US$360 million FDI annually. The annual amount of utilized FDI reached US$37.5 billion in 1995. The annual growth rate of used FDI in China between 1979 and 1995 was 85 percent. In 1993 China received more FDI than any other country (World Bank, 1994, p. 16), and in 1994 China was exceeded only by the United States in gross value of FDI (Lardy, 1996).

Compared with growth rates in contracted FDI, actually utilized FDI had changed little except for sharp increases in 1992 and '93. Actually utilized FDI has recently become the predominant form of foreign capital in China, reaching a record

Table 1

Flow of FDI into China, 1979-1995

Year	Number of Contracts	Contracted Value (US$1,000,000)		Used Value (US$1,000,000)	
1979-83	1,392	7,742	(8,916)	1,802	(2,683)
1984	1,856	2,651	(2,875)	1,258	(1,419)
1985	3,073	5,932	(6,333)	1,661	(1,959)
1986	1,498	2,834	(3,330)	1,874	(2,244)
1987	2,233	3,709	(4,319)	2,314	(2,467)
1988	5,945	5,297	(6,191)	3,194	(3,739)
1989	5,779	5,600	(6,294)	3,392	(3,773)
1990	7,273	6,596	(6,987)	3,487	(3,755)
1991	12,978	11,977	(12,422)	4,366	(4,666)
1992	48,764	58,124	(58,736)	11,007	(11,292)
1993	83,437	111,436	(110,850)	27,515	(25,750)
1994	47,549	82,680		33,767	
1995	37,011	91,282		37,521	

Sources: China Statistical Yearbook 1996, State Statistical Bureau, p. 597; figures in parentheses are used by Lardy (1994), p.63 (since Lardy uses the World Bank's data rather the figures from China Statistical Yearbook, there are discrepancies between the two.).

high of 78 percent of total used foreign capital in 1995 (Figure 1). This suggests that the motives underlying China's open-door policy, which are to take advantage of western advanced technology and scientific managerial expertise to modernize Chinese industry, as well as to employ foreign investors' established access to global market to expand China's export capacity, have been effectively guiding foreign capital inflow. Other factors also contribute to this. Foreign investors find China has comparative advantages in certain kinds of production, and thus their locally produced products can be very competitive in the international market. They also are allured by China's vast market potential, and find it much more profitable to sell products made in their China's plants in Chinese market. This feature in China's foreign capital will carry on into the next century.

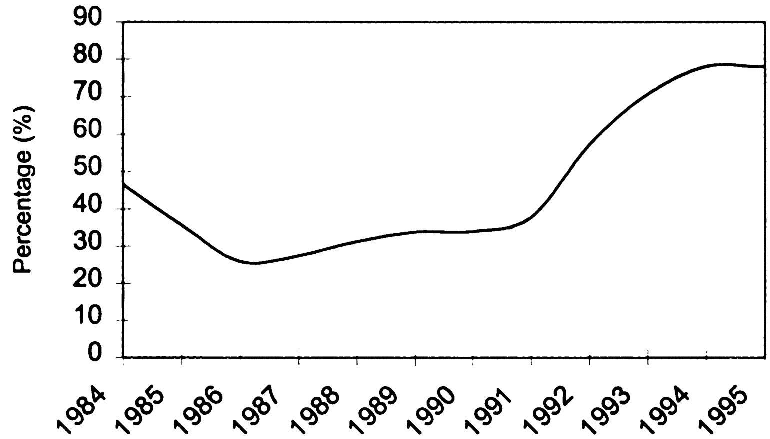

Figure 1

Share of Actually Utilized FDI in Total Foreign Capital Used by China, 1984-1995

Source: China Statistical Yearbook 1996, State Statistical Bureau, p. 597.

Chapter 2

FDI IN SHANGHAI: CENTER-LED GROWTH

As a result of national economic considerations, Shanghai was designated one of fourteen OCCs by the central government in 1984, and a variety of investment policies and incentives, targeted on restructuring industry and expanding production capacity, were offered to the city. Investments from wholly foreign-owned firms are allowed, and no limits on the duration of FDI projects, choices of investment locations/sectors, or hiring practices are imposed. Joint ventures are managed by their own boards of directors, and wholly foreign-owned ventures have complete autonomy over their internal operations. Shanghai also has the authority to approve FDI projects up to US$30 million, and this simplifies investment application and approval for foreign investors.

The investment incentives awarded to Shanghai by the central government in 1984 mainly involved tax incentives and preferential land use. Lower tax rates are given to technology, capital intensive, and other desired FDI projects. For example, income tax rate is 15 percent for technology projects with foreign capital of US$30 million or more and a long period of investment recovery, or for energy, transport and port construction projects for means of transport. Equipment and raw materials are tax-exempted (Grub and Lin, p. 48-9). Shanghai is also allowed to offer exemptions from the land-use fee during construction and start-up periods, and may extend reductions for FDI projects.

Hence, it is no wonder that Shanghai's FDI had increased in 1984 and '85, and this growth accorded with the FDI situation at the national level during the period (Figures 2 and 3). When the national growth rate of FDI experienced fluctuations, FDI in Shanghai also wavered. For nationally contracted FDI from 1984 through 1995, the lowest years of growth were 1986, 1989, and 1994. FDI in Shanghai correspondingly dropped in those years.

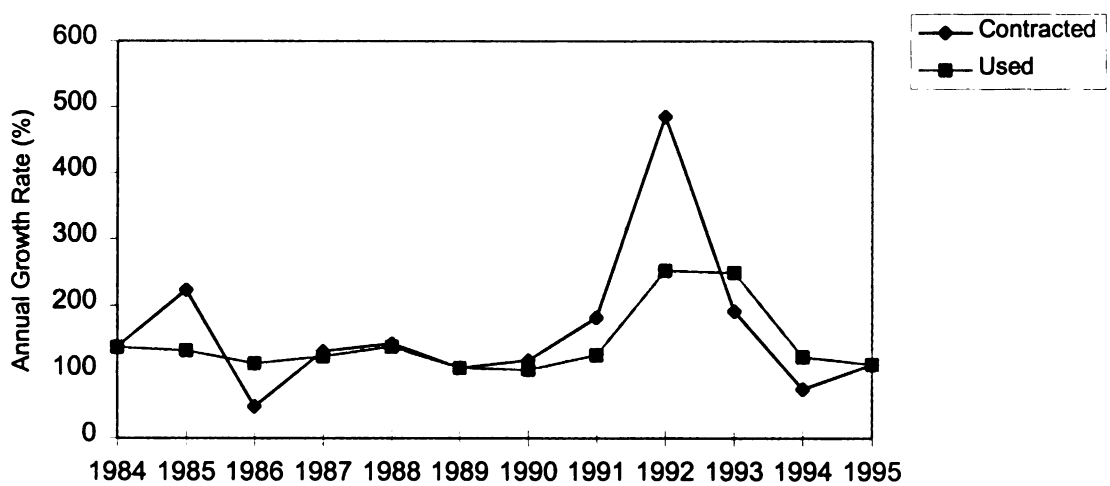

Figure 2

Annual Growth Rate of FDI in China, 1984-1995

Source: China Statistical Yearbook 1985, 1996, State Statistical Bureau.

Some scholars point out (Lardy, 1994, 1996) that these drops in the FDI growth rate were directly linked to China's internal political disturbances. At the end of 1986, students at the Chinese University of Science and Technology in Hefei, capital of Anhui Province began demonstrations. And this evolved into the Beijing

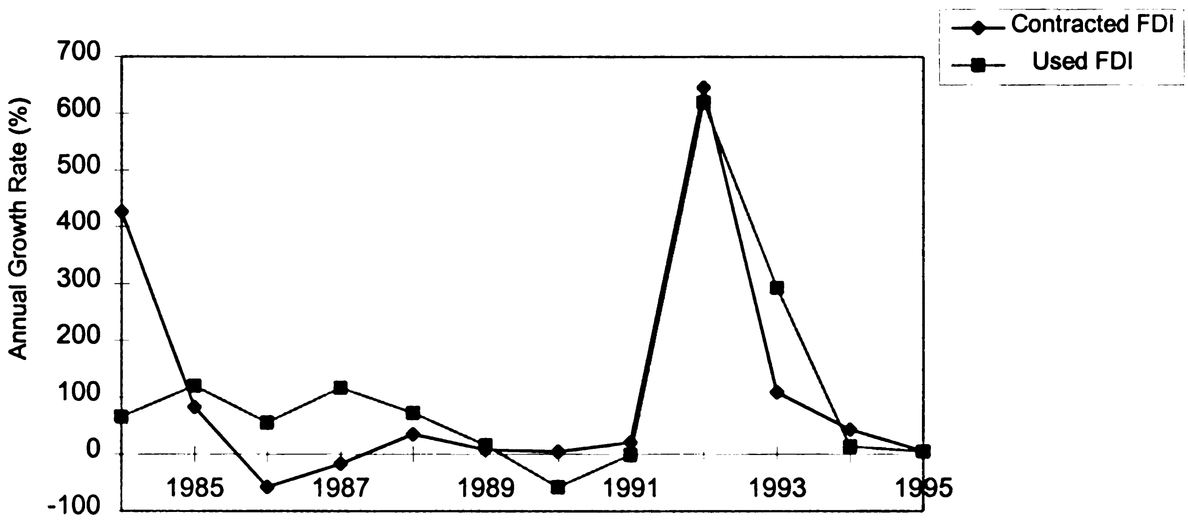

Figure 3

Annual Growth Rate of FDI in Shanghai, 1984-1995

Source: Tian (1996) p.169

students' demonstrations for greater democratization in Tiananmen Square in January 1987 (Dreyer, 1993, p. 161-2). After the demonstrations were put down, Hu Yaobang, was removed from the position of General Secretary of the Party, as a result of compromises between reformers and hardliners. He was succeeded by Zhao Ziyang, then Premier of the State Council. Then a campaign opposing bourgeoisie liberalization and upholding the Four Basic Principles[2] was launched.

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[2] The Four Basic Principles are (1) acceptance of the leadership of the communist party, (2) adherence to Marxism-Leninism-Mao Zedong thought, (3) the practice of democratic centralism, and (4) following the socialist road. They have become the central tasks of Chinese socialist construction.

But soon the policies were back on the liberal track, and reform was stressed by the Thirteenth Party Congress in April 1988. Later in the same year, Zhao Ziyang, backed by Deng Xiaoping, launched an ambitious retail-price reform with intent to move to a free market. This reform induced the worst inflation since 1949. In June 1989 the central government, using military forces, cracked down on the nationwide, pro-democracy anti-corruption student movement, which had been ignited by the death of Hu Yaobang. Zhao Ziyang was deprived of political power, and his position was taken over Jiang Zemin, a former Shanghai party chief. Since Hu Yaobang and Zhao Ziyang were the most important leaders supporting Deng Xiaoping's reform strategies, their ousting from China's political stage made the 1989 political disturbance seem more severe than the 1986 one. "In general, the policies China has pursued since the Tiananmen incident of 1989 have been in line with the composition of the standing committee: somewhat more conservative, but not without important countertrends." (Dreyer, 1993, p. 169) However, when comparing the percentages of FDI increase over the previous year, the figure of 1986 (47.8%) was far smaller than that of 1989 (105.7%).

In addition to the political disturbances hindering the FDI growth rate, the national fiscal austerity policy worsened the environment for foreign investors. It was introduced to curb the "overheated" economy after the second half of 1985. As a result, the authorities began screening new investments more tightly. The foreign exchange requirement turned out to be too restrictive for both investors and China. The tight fiscal control was relaxed later in the 1980s.

The slight decrease of FDI in 1989 also suggests that foreign investors were less upset about their business prospects in China than in1986. Though the crackdown on the student movement was annoying, China was still an attractive place for foreign investors , especially when the tradeoff for the crackdown was political stability and policy continuity. The confidence of foreign investors in China soon recovered and was further dramatized by the following political events. In the closing days of 1990 the open-door policy was reaffirmed in a party plenum. In early 1992, Deng Xiaoping made a heavily publicized visit to Wuhan, Shanghai, Shenzhen, and Zhuhai, praising achievements of the reform and open-door policy while harshly criticizing conservatives who opposed the peaceful transformation instigated by western capitalist countries instead of insisting on economic reform and opening up. His speeches had a tremendous political influence and symbolized a new reform era. The contracted value of FDI surged in 1992 overall.

Chinese legislation since 1990 has also enhanced the national investment environment, including Shanghai. Changes included promulgating an amended law on Sino-foreign joint ventures in and legalizing the transfer and retransfer of usage rights for state-owned land in Chinese cities and large-scale land development schemes by foreign investors. More importantly, a comprehensive legal system protecting intellectual property rights was established.

Chapter 3

FDI IN SHANGHAI AND THE EXPANDING LOCAL AUTONOMY

It is oversimplified to assume that FDI growth in Shanghai has solely been led by national policy. Various factors in Shanghai itself also contributed to the increase of FDI, especially in the 1990s. The establishment of industry including human capital stock and local policy initiatives are most important. The following discussion will focus on local policy initiatives.

Shanghai first requested privileges granted by the central government, then prepared a favorable local social, economic and political environment for FDI inflow to upgrade for technology, expand exports, and reestablish itself as the nation's industrial and financial center. Not until the city was designated one of the fourteen OCCs in 1984 could local initiatives be effective, however.

Local Political Bargaining with the Central Government

In 1983, Shanghai submitted "A Report on Shanghai's Economic Strategy" to the central government. The city promised to revitalize its role as the nation's center for international trade, finance, and commerce by opening up more widely and upgrading its industries, concentrating on hi-tech sectors, and asked the center to give the city more control over its own resources. This report was approved by the State Council in 1984. This deal allowed Shanghai municipality to retain more of its revenue. The new money enabled the city to start a series of local economic projects.

In 1986 the State Council approved Shanghai's request to expand foreign capital (SJN, 1987). Shanghai was able to solicit capital in international financial market for urban infrastructure construction, technology upgrading and innovation, increased exports, and developing tertiary industries like tourism. At the time, it was difficult to solve Shanghai's urban infrastructure problems by state fiscal allocation and/or FDI since the central government didn't have enough available funds, and infrastructure construction was not profitable for foreign investors. With foreign capital, the city gained time to restructure its low-efficiency high-waste economy, and lay down a foundation for revitalization. Moreover, the local government accumulated valuable experience in managing foreign capital since it had to assume all risks of international borrowing.

Local Policy Initiatives

The municipality then offered additional incentives to foreign investors. Its local Sixteen article provisions supplemented the national legislation and promised another set of preferential treatments for enterprises operating in Shanghai's three Economic Technical Development Zones (ETDZs): Minhang, Hongqiao, and Caohejing. These changes in the national FDI policy and local regulations removed most bureaucratic obstacles to small, export-oriented investments (Tian, 1996).

In 1989 Shanghai increased the number of wholly foreign-owned enterprises from 3 to 12, with gross investment value from \$4.06 to \$152 million (*SJN,* 1990, p. 99). Five were from Hong Kong, 4 from Japan, 2 from the United States, and 1 from Taiwan. Most were export-oriented or import substituted for local. In setting up these enterprises, foreign investors were preparing for larger-scale investments in the future.

As with the SEZs and other OCCs, Shanghai saw a dramatic increase of FDI in the 1990s. The central government's decision to develop the Pudong New Area and improvement in China's legislative environment markedly improved the investment environment in Shanghai.

Shanghai's efforts to expand its local authority were reinforced by the central government's decision to develop the Pudong District. This project brought Shanghai an additional 6.5 billion Chinese Yuan from the center to help build infrastructure in the eastern part of the city. It had also brought Shanghai the authority to implement several special policies it had long hoped for, such as the authority to issue stocks to overseas investors and to open tertiary sectors, including banking, retail-wholesale and service, to foreign investors.

FDI jumped more than fifteen times between 1991 and 1993, that is, from US$450 million to US$7,016 million (Table 2). In 1994, FDI in Shanghai grew by 43 percent in comparison to an overall decline of FDI in the country as a whole. FDI in Shanghai grew by five percent in 1995, which made the city China's second largest region for attracting FDI following Guandong.

However, the realization ratio (actual value/approval value) (Tian, 1996) of FDI in Shanghai has also declined since 1988 (Figure 4). Along with the negative impact of the political disturbance in 1989, the local government was forced to revoke the business licenses of 140 foreign enterprises since late 1994 as their capital funds failed to arrive long after registration (*CBJ*, 27 April 1995). After that

Table 2

Flow of FDI into Shanghai, 1980-1995

Year	Number of Contracts	Contracted Value (US$1,000,000)	Used Value (US$1,000,000)
1980-83	17	113.7	17
1984	41	389.1	28
1985	94	710.8	62
1986	62	297.4	98
1987	76	246.6	212
1988	219	333.3	364
1989	199	360.0	422
1990	201	375.0	177
1991	365	450.0	175
1992	2014	3357.0	1259
1993	3650	7016.0	2318
1994	3803	10025.8	3137
1995	2845	10540.0	3250
By 1995	13586	34271.1	11519

Source: Tian (1996) p.169.

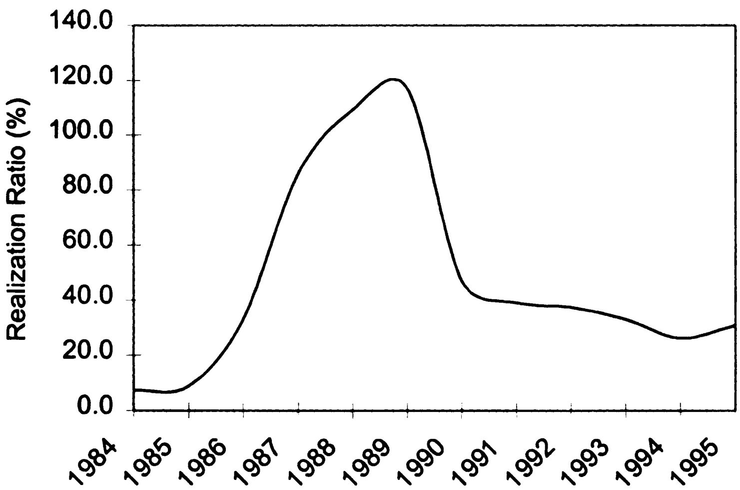


Figure 4

Realization Ratio of FDI in Shanghai, 1984-1995

Source: Tian (1996) p.169.

the Municipal Foreign Investment Management Committee and the Municipal Industrial and Commercial Administration intensified their supervision over the arrival of foreign capital for enterprise business operations (Tian, 1996). FDI has increasingly been concentrated in large projects in recent years (Figure 5).

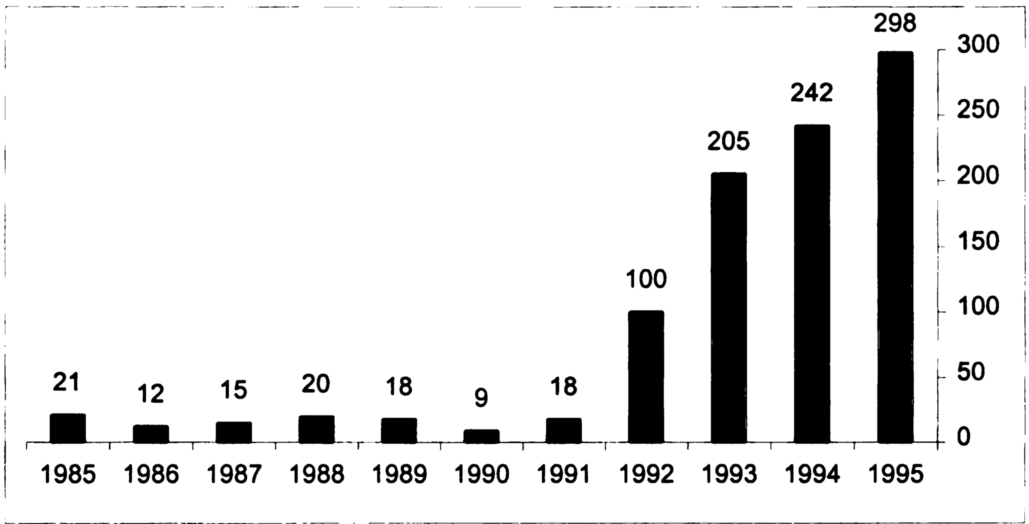


Figure 5

Numbers of Foreign Invested Enterprises with Total Investment of US$ 10 Million or More in Shanghai

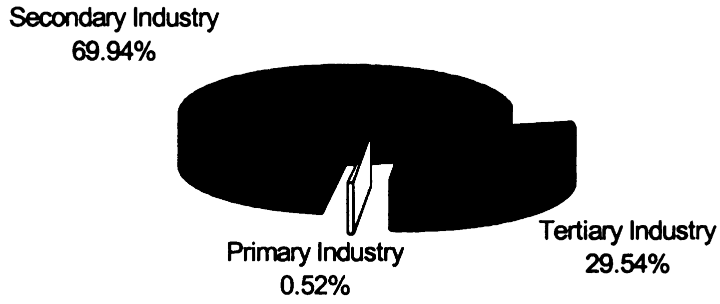
Source: *Shanghai Internet Trading & Consultancy Ltd.*, 1997.

Sectoral Distribution of FDI in Shanghai

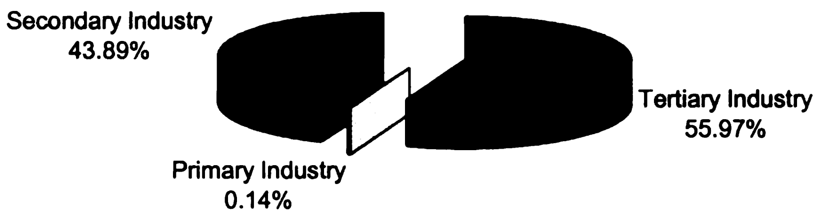
On October 11, 1986, the State Council promulgated *The Regulations of the State Council on Encouraging Foreign Investment,* or *The Twenty-Two Articles* in short, to develop selected manufacturing, like electronics and the chemical industry and expand technology transfer and exports. In addition, Shanghai also established

"Two Kinds Enterprise" honors for foreign enterprises: one is "Technology-Advanced Firm" (TAF) and the other is "Export Firm". Thus Chinese governments have changed policy from providing incentives for foreign investment in general to selecting industries for large investments, such as high-tech energy-related industries. FDI in priority industrial sectors has been particularly supported since 1990s when Shanghai selected six pillar industries of the Eighth Five-Year Plan (FYP) (1991-96). To promote these industries, the local government has chosen several large and medium-sized SOEs for cooperation with transnational enterprises.

In 1992 Shanghai, together with Beijing, Tianjin, Guanzhou, Dalian, Qingdao, and the SEZs, was granted rights to open more tertiary industries to foreign investors. These industries include finance, insurance, land rent, retail, wholesale, and telecommunications. These industries were initially monopolized by the SOEs because they were regarded as the arterial industries for whole economy of China, especially wholesale and retail, which are highly profitable. FDI had increased strikingly in the tertiary industry by the end of 1995 (Figure 6). This change in sectoral distribution indicates a dramatic FDI policy shift from a focus just on industrial production during 1986-91 to a focus on both industrial production and a more open service sector.



i) Sectoral Distribution of Projects Number



ii) Sectoral Distribution of Pledged Foreign Capital

Figure 6

Foreign Investment in Industrial Sectors in Shanghai (end of 1995)

Source: *Shanghai Internet Trading & Consultancy Ltd.*, 1997.

Chapter 4

POLITICALLY EMBEDDED FDI AND THE CHANGING RELATIONSHIP BETWEEN THE CENTRAL AND LOCAL GOVERNMENTS

It is evident that FDI has never been independent of national policies in China. As we discussed above, changes of FDI inflow into Shanghai has been consistent with changes of FDI inflow into China as a whole. When national policies retrench, FDI value, contracts and actually utilized, tends to decline significantly. Conversely, when national policies are relaxed, it goes up dramatically. Shanghai, despite its extraordinary importance in national economy and politics, has never been able to override these political restraints on FDI. Thus, the fluctuations of FDI over time are embedded in China's political regime. In other words, whether localities are effective in economic development or not, they alone do not produce regional FDI inflows, which are actually a function of preferential treatments by the central government. However, regional differences in FDI inflows are beyond the scope of this investigation because consistent time-series data on FDI inflows at city levels are not available. In order to understand the dominant role of China's central government in FDI inflows, the following discussion centers on theories of state and civil society in China.

Civil society is not a new concept; it was extensively discussed in works of nineteenth-century philosophers such as Hobbes, Paine, Locke and Hegel. What is new is applying the concept "civil society" to social nonconformity and opposition in Communist regimes. Civil society theory was initially applied to East Europe and the former Soviet Union, and its importance lies in pinpointing small civil societies as potential carriers of the transition from a totalitarian dictatorship to an authoritarian and further to a pluralist order (Brzezinski, 1990; Frentzel-Zagorska, 1990; Keane, 1988; Miller 1992; Tismaneanu, 1990). The development of civil societies in state socialist systems has fundamentally changed their political process.

However, when the theory of "civil society" constructed upon the collapse of Communism in East Europe is used to analyze China's case, it seems limited and superficial. First of all, it is controversial whether China has a "civil society", comparable with the one conceptualized in East Europe. One influential theory claiming an emerging civil society in China is the drama vision. This vision contends that the 1989 student demonstration showed the potential of civil society in China as nationwide massive autonomous groups organized for a civic politics. It concludes civil society is the product of a "revolutionary moment," when disparate social elements forge a solid front against an intransigent regime (Sullivan, 1990; Unger, 1991). A weakness of this theory is that it fails to distinguish mass social movements from the political expression of civil society. We have to acknowledge the fact that the 1989 student movement was originally initiated by students' intellectual consciousness, which is embedded in the core of Chinese traditional Confucianism, and in socialist patriotism, though it later mobilized diverse social forces and evolved into actual political dissatisfaction and protest. The movement had complex dynamics; without a more comprehensive analysis, it can't be treated as the beginning of a civil society era in China. Another theory is the intellectual's vision of civil society: urban-based intellectuals have protested against the state since the early 1980s (Bonnin and Chevrier, 1991; Goldman, 1991; McCormick, Su and Xiao, 1992; Nathan, 1990). The eruption of the 1989 student movement was an expression of this flourishing civil consciousness. The significance of this theory is to shed light on the institutional process of civil consciousness formation. But it leaves out social and economic factors in its theoretical framework.

The second problem in applying the "civil society" theory to China is the dichotomy between "the state versus civil society". This is well pointed out by X.L. Ding (1994). He argues that it is oversimplified to adopt this dichotomy in analyzing the developmental process of Chinese civil society. Instead, he employs "institutional amphibiousness" as an analytical tool. Dissenting and protesting organizations are seen to be in a parasitic relationship with party-structures, and the civil society emerges and grows through institutional manipulation and conversion within the political regime. For example, opposition-minded intellectuals were well-educated specialists working in education, research, publishing, consulting, legal service, and mass media institutions. They were situated inside the political system, acted as institution heads and researchers, and voiced their dissent through meetings, magazines, newspapers, books and television programs. They gradually formed a nonconforming and opposition stratum through official and semi-official institutions, as a part of the party-state machinery, as well as through non-official institutions. That China's civil society is contextualized in the party-state regime is also recognized by other studies (Chamberlain, 1993; Tong, 1994). Prior to the reform the party-state monopolized institutional resources. Local government became an extended instrument of the center rather than a local political actor. In the late 1970s the center began to balance society and state as well as economy and state to maintain its political legitimacy. However, under China's socialist system the balance between society and state is much harder to achieve than the balance between economy and state, since the former requires fundamental political reform which would shake long accepted socialist ideology. Therefore, since 1979 national policies have primarily been designed to facilitate economic growth and to improve domestic living standards.

The weak civil society, strong party-state leadership, and a different relation between state and civil society have made China's political transition gradual instead of the Big Bang experienced by the former Soviet Union, Poland, and other East European Communist countries. The most recent development in Chinese politics is the empowerment of local government.

During the economic reform and decentralization, challenges to the party-state regime by intellectuals and students have been suppressed. Desires of the nascent civil society are not limited to only wanting back political freedom and democracy from the party-state. Non-state business bodies have emerged at local level, gradually forming voluntary associations, and have become a basis of local empowerment. Local government has started to bargain and negotiate with the center to promote local interests nationally. After 1990, local states became an interface between the structure of the regime and the structure of civil society. The active role of the local state was conceptualized as *local state corporatism* by Oi (1992, 1996), *local market socialism* by Lin (1995), or *industrial firms* by Walder (1995). In order to compete more efficiently in external markets. Local political institutions must use their administrative power to mobilize local, and sometime national, resources to coordinate local economic entities, and thus to realize state-led growth strategies.

Therefore, central and local governments, as well as the changing relationship between them during the reform era, constitute the political framework of FDI inflows in China, including in Shanghai. Without recourse to the center, foreign investors initially had no guarantee for their business operation at the local level; local government in general had not the power or capability to handle complex international deals. With continuously growing civil society and the penetration of market mechanism in Chinese society, local states will be more and more important in the politics of FDI inflows. Voluntary, nongovernmental organizations such as trade unions, religious and cultural groups have little influence the economy in today's China through their strategic interactions with local government make it somehow represent their respective interests. Local developmental strategies will shift focus from direct involvement and intervention to creating a favorable environment for business. However, this by no means implies that the center will lose its influence on the local economy. The central government might change from commanding and controlling to guiding, coordinating and negotiating, but localities will still depend upon the center's support.

Chapter 5

IMPLICATIONS OF FDI FOR SHANGHAI'S POLITICAL ECONOMY

The contributions of FDI to economic development in Shanghai are obvious. The increasing inflow of FDI has promoted continuous export growth. The annual growth rate of foreign invested firms' exports grew from 60 percent in 1990 to 67 percent in 1991, to 109 percent in 1992, and dropped back to 55 percent in 1993; however, the absolute volume of exports in 1993, US$ 1,61 billion, was still remarkable, and constituted 21.8 percent of Shanghai's total exports (Tian, 1996, p. 98). Though it was difficult to get accurate imports figure for foreign invested firms for these years, rough estimates show foreign invested firms almost balanced their foreign exchange accounts. As the local government becomes more interested in hi-tech, capital intensive, large-scale, and/or export-oriented foreign funded projects, FDI will continuously enhance Shanghai's export capacity and facilitate technology transfer, and sustain fast economic growth.

However, when the inflow of FDI in cities involves foreign transnational corporations (TNCs), it usually brings about complex consequences for the urban economy and politics, especially in a city like Shanghai. What are the potential effects of TNCs on the city's political economy?

TNCs and Local Market Socialist Economy

China's economic growth is led by the state. The role of the local government, mainly city government, during the economic reform has also been noticed by academia (Parris, 1993; Solinger, 1996; Wong, 1987). The emerging local market socialist economy in Shanghai, sometimes termed *local state corporatism* or *local market socialism*, has a fundamental characteristic: local competition is minimized under the corporate-style political administration.

The emergence and bloom of TNCs in Shanghai has mixed effects on the local market socialist economy. According to John Dunning's OLI (organization, location, internalization) paradigm (1979; 1981; 1983), FDI adds the comparative advantage of internationalization by TNCs. Associated with this are the competitive advantages of ownership and location. He points out that the mushrooming in all types of transactions, notably of intermediate products, are best undertaken by hierarchies rather than markets since TNCs are much better-equipped to supply goods, services and distribution channels than their competitors. Thus, along with TNCs, growth of exports will continue in Shanghai.

Nonetheless, TNCs also have negative impacts on urban economies in host countries. Usually the urban economy in Third World countries is worsened by rapid urbanization, and such rapid urbanization is brought about by TNCs' economic stimuli. Empirical studies suggest that economic dependency of host countries brought by TNCs penetration is one primary cause of urban economic stagnation and poverty in developing countries (Chase-Dunn, 1984; London and Smith, 1988; Timberlake, 1985, 1987). However, sufficient data are not available to replicate these analyses for Shanghai. But it is clear that inequality, as Stephen Hymer (Hymer, 1979) argues, is built into the growth mechanism of the contemporary world capitalist system and the pyramid hierarchies of TNC structures. These influences will attempt to undermine local coordination over Shanghai's market socialist economy once internal and external markets are no longer differentiated.

Implications of TNCs for Shanghai's economy can be seen in Singapore's experience. The ongoing economic development strategies of Shanghai are very similar to those of Singapore: "its requirements for technology, capital, management skills and access to export markets ... have impelled Singapore towards high levels of trade and inward investment by MNEs [TNCs]" (Lecraw, 1985). TNCs and international trade have played crucial roles in the growth and structural change of Singapore's economy. To attract FDI, the government severely limited the rights of workers to strike and bargain for wage increases and the rights of its citizens to engage in political dissent. Local businessmen complained they were discriminated against by those government incentive programs. In addition, local formerly state-owned enterprises in Shanghai have lost their identities after joint venture with TNCs. TNCs are usually reluctant to use the trademarks and brand names owned by these enterprises even though they had been very famous in the country. Furthermore, R&D personnel are dismissed. Foreign trademarks and brand names are then substituted on products made by these joint ventures in China's domestic market. With these issues in mind, it is difficult to predict how the local market socialist economy in Shanghai will accommodate increasing inflow of FDI in the future.

Organizational Power of TNCs and Local Politics

When tension between TNCs and local market socialist economy is generated in economic sphere, it inevitably evolves into tension between the organizational power of TNCs and the political power of the municipality. Hymer (1979) claims modern TNCs are more powerful and sophisticated business organizations than domestic economic enterprises, and they not only destroy the possibility of national independence but also weaken local political control and inhibit economic development in the hinterland regions through international labor division and by manipulating government's tax capacity. No evidence has suggested this is the case for Shanghai by far. However, the growing organizational power of TNCs in local politics cannot be ignored or underestimated.

TNCs also have an indirect yet important impact on the local government of Shanghai. As stated above, growing civil society may internally weaken the local government power. TNCs play a facilitator role in this process. The boom of TNCs has helped economic prosperity in Shanghai, and in turn bolstered growth of the nascent civil society. As a result, the local government of Shanghai current strong control over its economy will become even more problematic in the future.

Chapter 6

CONCLUSIONS

Central and local governments have led FDI inflow in Shanghai. The center designated the city to be another model for utilizing FDI in the early 1990s, to serve socialist construction with Chinese characteristics after Shenzhen. National policies offered Shanghai developmental priorities with favorable treatment. Shanghai municipality took this political opportunity to reverse its backward status and promote its economy in the nation by soliciting and guiding FDI inflow. The development of FDI in Shanghai was hence initiated by the center and coordinated by local policies.

With preferential treatment from the central government, Shanghai will regain its primary status in China's economy. With continuous growth of FDI and TNCs in the city, Shanghai's GDP growth rate jumped from 7.1 percent in 1991 to 14.8 percent in 1992, and has been above 14 percent since then. Such urban growth led by the state is not a new invention in world urban development. The rise of Tokyo to national prominence in Japan was propelled by the developmental state (Hill and Fujita, 1995). Since theories based on observations of the collapse of East European Communism have proved not applicable for China, the comparative study of developmental strategies and political dynamics between China and other East Asian countries such as Japan and South Korea will be important and necessary despite of different political, social and economic systems. The theory of the developmental state, in addition to civil society theory, will likely further light on the politics of FDI in China.

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