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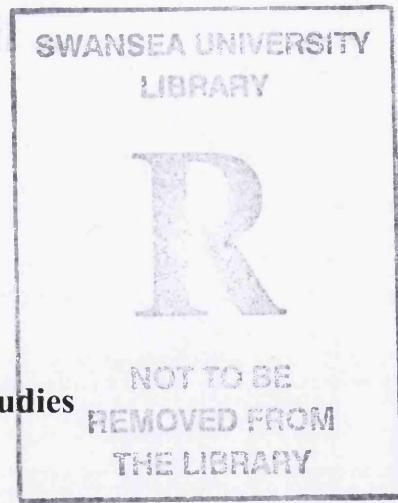
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**China's Embrace of Taiwan: Taiwanese Manufacturing and  
Services Industries in the Yangtze River and Pearl River  
Deltas of China**

**Jen-Ping Chiu**

**Submitted to the University of Wales in fulfilment of the requirements  
for the Degree of  
Doctor of Philosophy**

**Department of Politics and Cultural Studies  
School of Arts and Humanities  
University of Wales, Swansea**



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## ABSTRACT

Interaction between Taiwan and China has increased remarkably in recent decades. From being complete enemies in 1949 to the momentum created by the Economic Cooperation Framework Agreement in 2010, both countries have come a long way. This thesis focuses on the extent of interaction and cooperation between businesses and Chinese local authorities in the Chinese Yangtze River Delta (YRD) and Pearl River Delta (PRD) and their impact on Taiwanese investment. The Chinese central government has expressly set out its policies of encouragement of specific preferential treatment, and the researcher seeks to answer: to what degree in fact local governments share central government objectives and implement such preferential policies in their areas (including by way of their own policies), and what are the factors governing their decisions. It also explains how the local authorities and local Taiwanese investors (*taishang*) have interacted. To that end, it analyses an important set of relationships: that between Chinese central and local governments; between the Taiwanese government and Taiwanese business elites; and between Taiwanese investors and Chinese local governments in the YRD and PRD. This study places trans-border interactions in the context of globalization, regionalism and economic integration.

China's overriding goal of uniting Taiwan with the PRC has remained constant but the method of achieving this objective has modified, adapting to the global environment, and its vision of a growing economy through its more recent national plans. Emphasis is now on greater economic linkages with Taiwan's economy, thus creating Taiwanese dependence on China's prosperity. Beyond economic reasons it is also hoped that greater connections between Chinese and Taiwanese will strengthen their sense of shared identity, thus making for unification via a "soft landing".

This thesis examines the opportunities and constraints that Taiwanese businesses in the YRD and the PRD have in practice encountered, in order to determine whether Chinese local bureaucrats are a help or hindrance in this broader political objective of preferential treatment. It compares Taiwanese businesses with other overseas investors in both secondary and tertiary sectors in the two localities. The research methodology used has included semi-structured elite interviews in China and Taiwan between 2008 and 2010 with relevant decision-makers, namely Taiwanese investors, non-Taiwanese foreign investors, Chinese and Taiwanese government officials. In order to obtain qualitative insights into Chinese local authorities' viewpoints, attitudes and strategy of their approaches to the Taiwanese businesses in China, as well as knowledge of how Taiwanese businesses develop their business activities in China, the main method of data collection in this thesis is therefore in the form of elite interviews.

The research concludes that while Taiwanese investors generally do get preferential treatment from Chinese local governments as compared with other investors, there is no general rule which can give them assurance of this. From an examination of several criteria influencing local governments, it seems that much depends on personal relations (*guanxi*) with Chinese officials, Chinese society being still heavily influenced by traditional attitudes and relationships. Further, the application of laws is still guided by 'rule of man' instead of 'rule of law'. Company location, size and type of industry are



other important factors in the application of the preferential policies. Moreover, the incentives that Taiwanese investors have previously received are gradually decreasing, mainly for two reasons. One is the evolution of Chinese central government's plans, aiming to achieve their objectives for economic development of the country, while also making for a wider distribution of wealth and giving greater support to Chinese domestic companies. The other is because of the increased role of local governments, allowing them to set their own initiatives; their response is found to have been to put their localities' interests first and act more independently and pragmatically to changes in their local circumstances.

This thesis has made a contribution to the application of methodology by its in-depth analysis and diversity of people interviewed, and to existing literature by exploring the less-developed area of cross-strait political economy studies. However, the qualitative nature of this study and its reliance on a situation which is subject to constant change provide room for further examination by others with different backgrounds or may usefully be looked at again in the light of additional information, such as larger samples of interviews, a different methodology such as quantitative methods, different variables such as Chinese domestic companies, different regions of China, or developments in the countries and regions under study.

**DECLARATION**

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**DEDICATION**

**This thesis is dedicated to my family for their patience and support over the years.**

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## LIST OF ABBREVIATIONS

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ACP	African, Caribbean and Pacific Group of States
ANU	Australia National University
APEC	Asia-Pacific Economic Cooperation
ARATS	Association for Relations Across the Taiwan Strait
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BOCLH	BOC Lien-Hwa Industrial Gases Corporation
BRIC	Brazil, Russia, India and China
CEPA	Closer Economic Partnership Agreement
CCP	Chinese Communist Party
CEO	Chief Executive Officer
CMM	Capability Maturity Model
CPPCC	Chinese People's Political Consultative Conference
CSCAP	Council for Security Cooperation in the Asia Pacific
CSSIP	China-Singapore Suzhou Industrial Park
DBU	Domestic Bank Unit
DPP	Democratic Progressive Party
ECFA	Economic Cooperation Framework Agreement
EPZ	Export Processing Zone
EU	European Union
EU-ACP	European Union (EU) and the African, Caribbean and Pacific Group of States (ACP) Development Plan
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprise
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
HKD	Hong Kong Dollar
HKT	Hong Kong and Taiwan
HKTDC	Hong Kong Trade Development Council
HKTDI	Hong Kong-Taiwan Direct Investment
IC	Integrated Circuits
IHT	International Herald Tribune
IMF	International Monetary Fund
IPR	Intellectual Property Rights
JV	Joint Venture
KMT	Kuomintang
KPI	Key Performance Indicator
LPG	Liquefied petroleum gas
MAC	Mainland Affairs Council
MERCOSUR	Mercado Comun del Sur (Spanish) / Southern Common Market (English)
MIT	Massachusetts Institute of Technology
MOE	Ministry of Education
MOEA	Ministry of Economic Affairs
MOFA	Ministry of Foreign Affairs
MOFTEC	Ministry of Foreign Trade and Economic Co-operation (Ministry of

	Commerce of the PRC)
MoU	Memorandum of Understanding
MTD	Multi-Track Diplomacy
NAFTA	North American Free Trade Area
NCCU	National Cheng-Chi University
NDRC	National Development and Reform Commission of the PRC
NGO	Non-Governmental Organisation
NPC	National People's Congress
OBU	Offshore Bank Unit
OEM	Original Equipment Manufacturers
P&A	Processing and Assembling
PRC	People's Republic of China
PRD	Pearl River Delta
PTA	Preferential Trading Agreements
R&D	Research and Development
RMB	Renminbi
SDPC	State Planning Commission and State Development Planning Commission
SEF	Straits Exchange Foundation
SETC	State Economic and Trade Commission (PRC)
SEZ	Special Economic Zone
SME	Small and Medium Enterprises
SPZ	Special Processing Zone
STB	State Taxation Bureau
STEC	State Trade and Economic Commission
TAO	Taiwanese Affairs Office
TECRO	Taipei Economic and Cultural Representative Office
TIER	Taiwan Institute for Economic Research
TMA	Taiwanese Merchants Associations
TNC	Trans National Corporation
US(A)	United States (of America)
USD	US Dollars
VAT	Value Added Tax
VP	Vice President
WFV	Wholly Foreign-owned Venture
WTO	World Trade Organisation
YRD	Yangtze River Delta

## INTRODUCTION

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The aim of this Chapter is to introduce the thesis and to present a concise overview of its components. The Chapter is divided into six Sections. Section 1 provides the background of this thesis and the research motivation. Section 2 introduces the general overview and importance of the cross-strait relationship between China and Taiwan, and a further history review is presented in Chapter One. Section 3 introduces the importance of the research objectives and the original research questions. Section 4 discusses the significance of this thesis. Section 5 discusses the limitations of this thesis. Section 6, in conclusion, explains the whole layout of this thesis.

### **0.1. Background to the Study and Research Motivation**

In recent decades, interaction and cooperation between Taiwan and China has increased remarkably. From being complete enemies in 1949 to the momentum created by the 2010 Economic Cooperation Framework Agreement (ECFA, preferential free trade agreement), both countries have come a long way. This thesis aims to analyze and examine the specific features of this interaction and cooperation, to determine the validity of the researcher's main hypothesis and the implications of the findings: the Chinese political motivation for economic integration with Taiwan is meant to make it easier for Taiwanese business to invest in the Chinese Yangtze River Delta (YRD) and Pearl River Delta (PRD), where most foreign direct investment (FDI) including Taiwanese, is based. The motivation of

Chinese central government is both political (main) and economic (secondary). The political motivation is a long-term aim while the economic is a combination of short-term and long-term objectives. However, both economic and political motivations are inter-related. So, the Chinese central government's motivation for integration with Taiwan is primarily a longer-term political one, while the chief motivations at lower levels of Chinese government and of the ruling party (mainly regional and municipal) may be more immediately economic. One should also note that the Chinese Communist Party enacts the laws while the central and local governments execute these laws. The details of the YRD and the PRD will be elaborated in Chapter Five.

There is much literature regarding FDI in China, the risks and opportunities in the Chinese market, East Asian politics and political economy, and the study of the Taiwan-China relationship. Ho and Huenemann (1984), Chu (1985), Thobourn *et al.* (1990), Beamish (1993), Huang (1995), Kueh and Ash (1996), Takahashi (1996), Zhang and Hung (1996), Cheung (1997), EIU (1998), Yang (1998), Shaw (1998), Jefferson *et al.* (2000), Yeung (2001a, 2001b) and Yeung and Mok (2002) all discuss the effects of the Chinese government's preferential policy regarding the inflow of FDI in China. In Particular, Lin (2008), Lee (2008), Keng and Lin (2005) and Keng and Schubert (2010) focus on topics relating to the role of *Taishang* (Taiwanese business people) and the relationship between Taiwanese business people and the Chinese government. Nonetheless, there is limited research discussing the role of Chinese local government in the YRD and the PRD in the implementation of preferential policies of the FDIs, particularly in respect of Taiwanese FDI. The details of whether Taiwanese investors are treated favourably by the Chinese local government, and what the effect of its implementation of preferential policies might

be, are lacking. Therefore, the first motivation for tackling this topic is to fill the gap of this explorative area.

Another motivation, with a broader perspective, is the significant impact of situation of the Taiwan-China matrix on the peace and stability of the Asia-Pacific region, even on the entire world. Especially in recent years, the economic and political connection most countries have with China highlights the importance of understanding how political-economic relationships operate in specific areas of China. In addition, tension between China and Taiwan, resulting from the cold war, may lead to potential conflict through the escalation of any misunderstanding. Therefore, constant improvement of the cross-strait relationship via various channels such as culture, politics and economy, is vital. This thesis thus seeks to identify areas for improvements and to draw conclusions from Taiwan-China experiences from which other countries may be able to learn.

### **Implication of the cross-strait relationship for the international community**

The principal countries with interests in East Asia - namely, those from the Pacific region and Europe – have not openly challenged an ambiguous US policy or strategy relating to mainland China and Taiwan, which is outlined later on in Chapter One. All have adopted some form of ‘One China’ policy and do not support formal independence for Taiwan. All are opposed to the use of force to resolve the dispute. Most have important economic relations with Taiwan and, in order to expand those relations, have been willing to exchange visits by ministerial or higher level officials,

as well as to conclude air transport, shipping, and other agreements - even when Beijing has protested those actions.

As Wanandi (1996: 19) suggests, there is considerable admiration among the people of these countries, nearly all of which are democracies, for the success of the people of Taiwan in transforming their political system from authoritarianism to democracy. They sympathize with the desire of the people of Taiwan to expand their international space, but, like the people of the United States, they hesitate to go too far in pursuit of collaborating with this endeavour for fear of damaging the crucial relationship with the PRC and increasing the risk that Beijing's leaders might feel compelled to use military force against Taiwan.

Historically, the United States and Japan have had special connections with Taiwan. Roy (1998: 167) claimed that "as with the United States, Taiwan has strong economic links with Japan and many friends in the Japanese government." He also pointed out that post-war Japan has long harboured plans to establish a realm of influence in East Asia, including economic penetration of South Korea and the cultivation of economic and cultural ties with Taiwan, in order to pull Taiwan away from reunification with China and into an alliance with Japan. (Roy, 1998:163)

Representative of the views of many of these countries was a statement by Prime Minister Lee Kwan Yew of Singapore in January 1996, advocating that Taiwan maintain a low profile internationally, while expanding its economic and cultural links with the world and simultaneously increasing its people-to-people ties with mainland China. "Gradually, over fifty to sixty years," Lee said "the wide differences that have

developed since 1949 will narrow, especially the differences between Fujian province and Taiwan. For either side to pre-empt or pressure-cook the outcome is to risk unnecessary losses for both. On the other hand, slow, gradual but continual increases in economic, cultural and social ties will benefit both sides...Gradualism is the best way forward." (*The Strait Times*, January 2<sup>nd</sup> 1996)

As mainland China becomes stronger, economically and militarily, it will become increasingly difficult to maintain anything approaching a military balance between the forces in Taiwan and those on the mainland. The only way to prevent Taiwan from becoming increasingly dependent on the willingness of the American armed forces to intervene militarily, is to reduce the need for military deterrence by the development of a growing cooperative relationship between Taiwan and mainland China and to keep open the prospect of some form of unification. (Clough 1999) One also has to consider how reliable the USA's guarantee to protect Taiwan will be, should Taiwan get closer to China economically or if the USA is economically linked more closely with China. In either case, it would mean that the USA would have less incentive for military protection of Taiwan.

It must be stated that this thesis focuses on the impact of sector-specific (manufacturing and service) policies applied by both central and local (municipal, provincial and county) government on foreign-financed firms; and how preferential treatment of FDI is practiced by local government in specific areas of the YRD and the PRD of China, with a special focus on Taiwanese investment. FDI by Hong Kong and Macau investors is not investigated, as they are politically parts of China and in various respects come under different regulations. Furthermore, the effects of

government policy on the competitiveness of FDI and the FDI outside the YRD and the PRD of China are not within the scope of this thesis. It should be added that “FDI” in this thesis refers to wholly-owned foreign firms or joint ventures with a majority ownership by foreign corporation.

## 0.2 General View of Cross-Strait Relationship

This thesis considers the broader political initiatives undertaken by the People’s Republic of China (PRC) of encouraging Taiwanese investment in the mainland as a means of achieving unification. The ultimate goal for the PRC is that greater economic linkages will finally tie Taiwan’s economy to China’s economy, thus creating a Taiwanese dependence on China’s prosperity. Mr. Yun-Lin Chen, the Chairman of the Association<sup>1</sup> for Relations Across the Taiwan Straits, during ‘the 1<sup>st</sup> Annual Celebration of Taiwanese Investment in China’<sup>2</sup> on April 16<sup>th</sup> 2011, pointed out that “every decision and plan that the Chinese central government makes is related to its political agenda, and absorbing Taiwan into China’s orbit is one of the government’s ultimate goals.” The strategy is called ‘*Yi-Shang-Bi-Zheng*’ ( meaning “using economic power to achieve political aims” in Chinese). Beyond economic reasons, it is also hoped that greater connections between the Chinese and Taiwanese people will strengthen their sense of shared identity, thus making (re-)unification via a “soft landing” possible. This thesis examines the opportunities and constraints that Taiwanese businesses have encountered in the YRD and the PRD to determine whether the practices employed by Chinese local bureaucrats help or hinder this

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<sup>1</sup> ARATS is an organization established by China for handling technical or business matters with the Taiwan. It is a non-governmental organisation though the Chairman of the ARATS is appointed by Chinese government. Chapter One has more details.

<sup>2</sup> The details can be found at Abulou News: <http://www.aboluowang.com/news/2007/0416>

broader political objective. In order to determine whether local bureaucrats are a help or hindrance, the thesis compares Taiwanese businesses with other overseas investors in both secondary and tertiary sectors within the two localities.

Chapter One reviews in historical terms the factors for the complexity of the Taiwan-Chinese relationship and why these factors further affect both governments' policies towards each other and the relationship between Chinese local government and Taiwanese businesses.

It should be stated that this thesis does not aim to give an in-depth analysis of various theories related to the cross-strait government/business relationship but its general approach reflects that derived from trans-nationalism<sup>3</sup>. One of the concerns in this research area has been the decreasing importance of state borders when it comes to regulating the movement of goods, people, information and ideas. Trans-border interactions are increasingly difficult for states to police and control. In this study, trans-border interactions between local governments and investors and between the Chinese government and Taiwanese government are placed in the context of globalization and regional economic integration. Chapter One has a more detailed explanation of these factors affecting trans-border interaction. It is argued that transnational interactions across the Taiwan Strait have to be analysed to determine to what extent they are a consequence of a confluence of global geo-economic, geo-strategic and geo-political change.

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<sup>3</sup> When referring to sustained linkages and ongoing exchanges among non-state actors based across national borders – businesses, non-government organisations, and individuals sharing the same interests (by way of criteria such as religious beliefs, common cultural and geographic origins) – we can differentiate these as ‘transnational’ practices and groups (referring to their links functioning across nation-states). The collective attributes of such connections, their processes of formation and maintenance, and their wider implications are referred to broadly as ‘transnationalism’. (Vertovec, 2009:2)

### 0.3. Objective of the Thesis and Research Questions

#### Objective of the thesis

The speed of trans-national interaction and China's booming economy and its burgeoning influence has accelerated in the preceding decade. Essential to competitive success for foreign investments in China in the current tumultuous environment is the stability of the environment, incentives and their relationships with Chinese officials.

China and Taiwan have a 'special' relationship based on their historical and political backgrounds, mentioned in Sections 1 and 2 of this chapter. This will be elaborated further in Chapter One. This special relationship affects Chinese central and local governments' view of Taiwanese investment in China. Taiwanese investors, though identified as *Taishang* in a special category which differs from wholly foreign investors as well as Hong Kong and Macau investors, are generally guided by the laws and regulations applied to non-Taiwanese foreign investors. The central level of the Chinese government has especially encouraged Taiwanese investment in China in its FDI policies. These examples can be presented as follows and will be examined in more detail in Chapter Two and Chapter Three: In 1988, the State Council of the PRC issued *The Regulations for Encouraging Investment by Taiwan Compatriots*, and in March 1994, the Standing Committee of the National People's Congress (NPC) adopted *the Law on the Protection of Investment by Taiwan Compatriots*. In addition, in April 1994, the State Council of the PRC enacted a policy called "*Tong-Den Yo-Shien, She-Dan Fang-Kuan*" (in Chinese) meaning that they give priority to a

Taiwanese company competing with other companies in the same category and also, to some extent, ease the application process. In March 2010, during the annual meeting of the Standing Committee of the NPC, the chairman of the Standing Committee, Mr. Ban-Guo Wu, declared that one of the main tasks of the central government for 2010 was to reassure and strengthen the protection of Taiwanese investors' legal rights. (Ming-Yi Wang and Feng-Yin Yang, *China Times*, March 10<sup>th</sup> 2010) At the local level, local authorities should follow the central government policy and orders; nevertheless, they have a certain flexibility of operation at the provincial, municipal or city level, allowing them to have their own preferential policies for foreign investment, either in written form or informally. Those policies mostly relating to taxation, charges, rent and utility rates are set out in written form, whereas those relating to frequent meetings, expedition of business application, acceleration of dispute resolution, bank loans and such like are applied informally.

In addition, Chinese local authorities have a significant role in implementing central government and its own preferential policies. The emphasis of this thesis is on the role of Chinese local officials, rather than that of central government. As Guang (2000:49) noted, "the central government does not have much power to intervene in individual FDI projects' locations. The location is essentially a matter between foreign investors and the governments at the provincial and local levels". In practice, the decentralisation process has given local officials certain powers to give preferential treatment to FDIs (including Taiwanese).

In considering the researcher's aim to explore the treatment given to Taiwanese by China, the central government's policy on the issue reflects its larger objective of

ultimately achieving unification with Taiwan. In the last two decades or so, the previously rather belligerent attitude to Taiwan has been replaced by a wish to proceed through discourse and negotiations.

This thesis's emphasis is on the local situation in the YRD and the PRD and consequently looks at the extent to which the central government's ultimate aim of achieving unification with Taiwan through greater economic ties is reflected in local authorities' approach to Taiwanese investment in China; whether they are in fact given special treatment; and whether indeed this is motivated as far as the local governments are concerned by the same long-term objective of unification.

This research straddles international relations and international economics. It investigates the relationship between Chinese local government and Taiwanese investors in the YRD and PRD regions of China to determine the extent to which Taiwanese investment is shaped by the politics and the bureaucracy of Chinese local government in its relationships with Taiwanese investors. In particular, it looks at whether Chinese contract decisions simply reflect business value-for-money considerations, rather than Chinese central government's orders (edicts), or whether a preferential tendency to favour Taiwanese companies is evident. By comparing Taiwanese businesses with other foreign investors in both secondary (manufacturing) and tertiary (service) sectors within these two regions, the researcher discusses whether local bureaucrats are a help or hindrance. The thesis will focus on Chinese local governments, rather than the Chinese central government.

The objective of the thesis is important for two major reasons. First, this study helps to explore the drivers aligning the interests of FDIs and the local authorities. A

preferential policy is important for its contribution to companies' growth, organisational survival and global competitiveness. It raises awareness of the difference between expressions of Chinese local government policies and their actual implementation in practice. Possible pitfalls are also noted. Secondly, this objective would contribute to a broadening of existing literature on this specific topic.

### **Research Questions**

The central research question this thesis seeks to answer is the following: to what extent do Taiwanese companies obtain preferential treatment from local authorities (municipal, provincial and regional county levels) in the YRD and the PRD, given that the Chinese central government has explicit policies to encourage and give such treatment to Taiwanese businesses? In order to account for these developments, the paper analyses a distinct set of relationships: the relationship between Chinese central and local authorities; the relationship between the Taiwanese government and Taiwanese business elites; and the relationship between Taiwanese investors and Chinese local authorities in the YRD and the PRD.

The need to examine the factors affecting Chinese local authorities' (municipal and regional – provincial and county levels) preferential treatment policy and practice is clear, as there is limited research covering this specific topic. Thus, to address the objective of this thesis, the following questions have been developed:

Q1: From the late 1980s until now, how have Chinese policies and regulations regarding Taiwanese investors changed? Has any increase or decrease of

Taiwanese investment resulted from any change of Chinese policies or regulations regarding Taiwanese investors?

Q2: Does local government really implement the Chinese central government's policies and orders, i.e., is local action consistent with national orders and is it calculated to promote national policy objectives?

Q3: What is the interaction between Chinese local government and Taiwanese investors in the tertiary and manufacturing industries? How do Taiwanese investors feel about their treatment by local government?

Q4: What is the interaction between Chinese local governments and non-Taiwanese foreign investors in the tertiary and manufacturing industries? How do those investors feel about their treatment by local government?

The research methodology used has included 25 semi-structured elite interviews in China and Taiwan with relevant decision-makers, namely Taiwanese investors, non-Taiwanese foreign investors, Chinese and Taiwanese government officials. These interviews took place between 2008 and 2010. In order to obtain qualitative insights into Chinese local governments' viewpoints, attitudes and strategy of approaches to the Taiwanese businesses in China, as well as knowledge of how Taiwanese businesses develop their business activities in China, the main method of data collection in this thesis is therefore in the form of semi-structured personal interviews.

The first research question looks at how Taiwanese investment has been affected from the late 1980s up to the present by the change of Chinese preferential laws and policies. The second research question examines whether Chinese local officials are effective in implementing the preferential rules set locally and the Chinese central government's policies, to achieve its political agenda. The third and fourth research questions investigate the differences in favourable treatments that both Taiwan and non-Taiwanese FDIs have received. The researcher shows how various criteria affect Chinese local officials' attitudes and their interaction with FDIs and concludes that the answer to whether Taiwanese investors get favoured is not straightforward and not 'black or white'. In the next section, the significance of this thesis is discussed in detail.

#### **0.4. Significance of the Study**

Researchers such as Tomkins and Groves (1983a: 364) are critical of "most academics" who "do not often seem to use their practical experience in guiding their research in terms of topic coverage or method of investigation; at least not with respect to that published in leading academic journals." To many of those engaged at the operating level, academic research is sometimes perceived as lacking in practical substance. To combat this suspicion, the researcher hopes his empirical research can be a help in understanding the background situation and act as a link between academic research and businesses either operating or considering operating in the regions.

The researcher devoted his one-year field work in China and Taiwan for the empirical data collection, utilising an exploratory and explanatory multiple-case design to study how business people perceive their relationship with Chinese local officials and vice versa. Specific areas addressed include: what issues they feel are of concern, to what extent this has influenced Chinese local officials' decision-making, and whether they have been influenced by local government preferential policies and actual treatment, negatively, neutrally or positively. The questions asked in the researcher's interviews and the interview protocol he followed can be seen in Appendix 4.A. and 4.B. The list of interviewees can also be found in Appendix 5.A.

Although the existing literature on the cross-strait relationship is extensive, ranging from broad-brush explorations to in-depth case studies, there are still gaps remaining for further investigation. Thus, this study's examination of Chinese local government preferential treatment of FDIs (especially relating to Taiwanese) provides a different perspective on cross-strait relationship development. Furthermore, the nature of informal relationships between the political actors and economic actors is somewhat sensitive, but empirical interview data can provide, to a certain degree, an insider's view of such matters as confidential deals not normally openly acknowledged or discussed in public.

In addition, the researcher chose two areas which provide a relatively equal basis for comparison. Within these two areas, the manufacturing and tertiary sectors in Taiwanese and non-Taiwanese FDIs are compared. Since local government attitudes and preferential policies can vary considerably from place to place, the design of this research has set a boundary to the territories covered. Further, the data analysed in

Chapters Five and Six therefore compare several variables, within that boundary and conclude the discussion of findings.

## **0.5. Limitations and Improvements**

Relevant limitations, including internal and external factors, are enumerated and considered, namely access to data collection, interpretation of data and fiscal and time conditions related to the research. In addition, from a variety of methodological texts as to specific procedures to be followed, the researcher has followed a series of systematic methodological procedures. In this multiple-case study research, considerable care and attention has been given to the collection and evaluation of interview and documentary evidence, which is used in developing and drawing general conclusions. However, such research cannot be perfect, and it has encountered some limitations. These limitations can be identified in a number of respects.

First, there is the limitation of resources. The fieldwork research was carried out in China and Taiwan only. With restricted resources such as limited research budgets, limited research time and ease of access to case study sites and interviewees, the researcher concentrated on interviews with manufacturing and tertiary sectors of FDIs in the regions of the YRD and the PRD of China, governments and academia. The researcher had limited financial support and restricted access to parts of China other than the YRD and the PRD where FDIs are based. These would have enabled him to study more than two regions believed to have similar and/or different conditions, and

would have allowed comparisons to be made of the same industry in different Chinese regions. It is possible that tertiary or manufacturing companies in other regions of China (for example, Beijing municipal area) have a slightly different strategy in relation to local officials in charge. The political-social dynamics differ depending to a large extent on the proximity of companies to Chinese central government.

The second limitation stems from the nature of interviews. This entails much that is subjective in the sense that meanings may not be fully understood by either interviewer or interviewees - either because of the different political and cultural mindset or the delicacy of operating in what is still a controlled political or economic climate. In effect, what is said can be either unwittingly or deliberately imprecise or misleading. One sometimes gets the feeling of unwillingness on the part of interviewees to talk about certain matters which they may consider to be too politically or financially sensitive or imparting too much information for their organisation to share.

In order to draw conclusions which are widely applicable, it is necessary to generalise. However, the process of generalisation may be seen as a further limitation. Some of the cases cited by respondents are anecdotal and may not be generalisable to other dissimilar examples.

Gatekeepers used for the interview process can be a limitation. They can affect the way interviewees answer questions. Their status and their relationship with interviewees can affect the willingness of those interviewees to reveal information and subsequently the depth of the answers. The researcher was very careful to exclude

or minimise this possibility by thorough briefing and satisfying himself that the gatekeepers fully understood and grasped the purpose of the interview. In the case of GY2 (coding is provided in Appendix 5.A) for example, the researcher was able by inquiry to arrange for the selection of a gatekeeper who was a family member of the interviewee, so that the interview process was smooth and positive. By contrast, the researcher was only able to find a gatekeeper to introduce the interviewee GY3, though the gatekeeper had had some dealings with the latter, these had not established a strong rapport between them. So the researcher was only given a limited time for the process.

In conducting this case study, the researcher was a visitor to companies and government departments and relied largely on interviews and inter-personal chemistry. The researcher thus has to draw inferences from the interviews and documentary evidence. Although such limitations are inevitable, the researcher feels that he has overcome them during his research. In terms of the approaches he adopts, he has been watchful that his own feelings whether political or personal do not distort his findings. This is of importance in such sensitive areas which can be affected by China-Taiwan history and politics. He has taken particular care to be impartial. Furthermore, where there was a gatekeeper/or gatekeepers involved in the interview, he has tried to communicate with him/her first to gain trust and assure him/her that the interview is reliable and for academic purposes. Finally, he attempted to maximize his available time and budget to acquire primary data through interviews during the fieldwork.

This thesis aims to determine whether preferential treatment designed to be given by Chinese local officials to Taiwanese investors (*Taishang* in Chinese) actually occurs

in practice and to what extent. By filling the gap in the literature dealing with Chinese local governments' preferential policies to Taiwanese FDIs, the researcher examines if the Taiwan-China relationship is going in the direction suggested by governments of China and Taiwan – i.e. that possible political unification can be achieved by closer economic integration between China and Taiwan.

## **0.6 Structure of the Thesis**

This thesis consists of eight chapters including the introduction and conclusion. Chapter One offers a historical review of the complex China-Taiwan cross-strait relationship. This provides the background information to understand the significance of the research questions. Chapter One also sets out the difficulties of the Taiwan-China relationship over the past sixty years, in particular the One China policy, socio-political dynamics and how these multi-dimensions affect interaction between the Chinese government and Taiwanese business. The conceptual and analytical framework in Chapters Two and Three includes related general and specific literature and explains the characteristics of the Chinese political and legal system, which have a marked effect on any investment and economic activities in mainland China. Chapter Four (methodology) explains the research methods applied and the advantages and disadvantages of interview methods, and documentation. Chapters Five and Six analyse and discuss the research topic from primary data generated by interviews forming empirical research on the eastern (YRD) and southern (PRD) seaboards of China and will examine and distil them to form the findings of the research questions. Interviews are vital in answering the research questions as they provide a clearer picture of the practical situation than can be gleaned from official or

written sources, the mantle of confidentiality and informality enabling more specific and accurate views of the issues. The research deals with complex factors such as culture, social norms, politics and legal concepts. At the same time, it takes account of the limitations and downsides of such interviews because of possible subjectivity and failure to understand questions.

The final chapter summarizes the research findings, the researcher's contributions and future opportunities, and also aims to answer three key research questions:

1. Do Chinese local governments implement the central government's FDI policy to treat Taiwanese investors more favourably in the YRD and the PRD than non-Taiwan investors?
2. What influences local government preferential treatment towards Taiwanese investors in China?
3. Have Chinese central government achieved their objectives of preferential FDI policies for Taiwan?

It concludes that preferential treatment given by China to Taiwan is not a straightforward matter. It depends on various factors such as the size, industry and capital of a company, the relationship that company has with the Chinese government or the key person involved in taking decisions for investment and the location of the investment. This renders the nationality of the company less important. In other words, being Taiwanese does not fully guarantee an investor's 'most-favoured nation' status. To some extent, Taiwanese companies do enjoy preferential treatment officially accorded by the Chinese central government and Chinese Communist Party.

Nevertheless, Chinese local authorities in practice sometimes go their own way as long as they are sure they do not get punished for disregarding the edicts or wishes of their superiors. The order of importance of the criteria affecting the local governments' implementation of the preferential policies is explained in Chapter Six. As for the third key question, the reality is that it is not exactly going the Chinese CPC government's way and that its political motive of unification by way of preferential treatment for Taiwanese has not struck a significant echo in Taiwan. That is, while there are more and more Taiwanese investments pouring into China and the Taiwanese economy indeed heavily relies on the Chinese economy, the Taiwanese people still do not have a strong sense that Taiwan should be a part of China (interview data and surveys mentioned in Chapter Six), and the Taiwanese government does not feel any urgency to embark on discussing the matter of closer political affiliation or possible unification.

The researcher has drawn from various sources, in particular elite interviews and direct documentary material. As indicated previously, he has taken account of certain limitations in conducting his original study. He trusts that his findings will give a clearer view of the current background against which businesses have to operate when investing in China and government/business relationships at the present time. Chinese local government preferential treatment is affected by a rapidly changing region and world; any future research has to be able to respond to these changes. He hopes his findings can be a good starting point for business and researchers in the future.

## CHAPTER ONE

### History Review

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#### 1.0. Introduction

Cross-strait economic interaction is a complex economic and political issue. The relationship across the Taiwan Strait has long been an involved one with major global political concerns.. The present cross-strait strained relation dates to the Kuomintang-Communist civil war of 1947-1949. The political relationship between the two sides is extremely sensitive, and any misstep could trigger military conflict and potentially, even total war. But the main focus of cross-strait conflict has lately shifted from military to economic and social issues. With more than two decades' economic cooperation between China and Taiwan, will there be more stable political relations and, from China's perspectives, would this assist in bringing about ultimate reunification? This chapter approaches the paradoxical development of cross-strait relations on two levels: strategic interactions between the governments of the two sides; and economic interactions through business networks at the unofficial level. I argue that the particular historical background to the relationship between Taiwan and China leads the two countries to be very conscious of the special aspects of this relationship, especially in their contacts, in a way which is different from the way they

would approach any other country.

Before turning to the overall impact and complexity of the economic cross-strait relations, the researcher will provide a historical review of the cross-strait relations and then turn to the current state of relations.

When the Japanese government surrendered its sovereignty over Taiwan after the Second World War, the government of the Republic of China (ROC) took control. It continued to function in Taiwan after losing the Chinese civil war in 1949. However, in 1978 the United States terminated diplomatic relations with Taiwan and established formal relationships with the People's Republic of China (PRC). This had a domino effect in the USA's diplomatic stance towards Taiwan and China making Taiwan gradually lose political recognition from the major countries. As a result, Taiwan (according to Taiwan's Ministry of Foreign Affairs' report of 2007) only had diplomatic relations with 21 other countries, while the PRC had relations with 116. In 2007, the equivalent numbers were 24 countries with Taiwan as opposed to 171 countries with the PRC.

Since 1949, the political structure of Taiwan has changed from an authoritarian regime to a democracy that resembles Western democracies. The relationship with China changed from the rivalry of a civil war culminating in Taiwan's unilateral

termination of hostility towards China in the late 1980s. Since the 1990s, there has been an emphasis on dialogue and exchanges. Both sides continue a bipartite and also international debate on sovereignty issues. Despite the sovereignty controversy, it is very clear that each side exercises full control and jurisdiction over a clearly delineated territory, while not abandoning its stance on Taiwan's political status. The ROC (Taiwan) is a de facto independent and fully-functioning country.

Despite the establishment of the PRC in 1949, the Nationalists (Kuomintang, or KMT) though confined to Taiwan, Penghu, Kinmen and Matsu, still claimed to be the legitimate government of all China as the ROC. Both sides considered the civil war had not ended and continued an exchange of fire, followed by propaganda campaigns aimed at the offshore islands of Kinmen and Matsu into the 1970s. In 1991, the law on the "Temporary Provisions Effective during the Period of Communist Rebellion"<sup>1</sup> of 1948 was repealed by the Taiwanese authorities who declared that the period of Communist rebellion had come to an end, signalling that they considered the civil war to be over.

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<sup>1</sup> This was a series of temporary constitutional provisions which was passed by the National Assembly of the Republic of China on May 10, 1948 and gave President Chiang Kai-Shek extended powers amid the height of the Chinese Civil War with the Chinese Communists. The provisions halted democratic processes and allowed the presidency to be exempt from the two term limits. After losing to the Chinese Communists, the government retreated to Taiwan in December 1949. These provisions were to remain in effect until the mainland could be recovered from the Chinese Communists. However, the tension of the Cold War era gradually subsided during the 1980s as "recovering the mainland" became less possible and the National Assembly on April 22, 1991, resolved to abolish the Temporary Provisions. On April 30 of the same year, President Lee Teng-hui declared the Period of Communist Rebellion to be terminated as of May 1.

From 1979, the PRC developed the concept of the 'open-door' strategy and 'one country, two systems'<sup>2</sup> and put forward a series of proposals for reunification which would allow broad autonomy for Taiwan in return for it giving up claims of statehood. Since the accession of current leader Hu Jin-Tao, China has stopped promoting immediate reunification via 'one country, two systems' (although it remains official policy) in favour of gradual economic integration and political exchanges (Financial Times, 2005/06/15). Taiwan refused to respond to these overtures, but in the 1980s began to relax restrictions on contacts with the mainland. In 1986, as a consequence of the hijacking of a Taiwanese national carrier (China Airlines) on a flight (flight 334) en route to Bangkok, the first direct talks between the two sides were held in Hong Kong. Increasing exchanges, between the two sides since the 1990s, have become more broad-based and comprehensive, including in the areas of trade and economics.

Clough (1999) notes that the relationship between Taiwan and mainland China is dominated by two broad trends: one that draws them together and another that pulls them apart. Since the government of the ROC authorized travel to the mainland in 1987, trade, travel, investments, and other forms of cross-strait interchange have

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<sup>2</sup> This is an idea originally proposed by previous leader of China, Deng Xiaoping during the early 1980s.

grown rapidly, creating an expanding network of people-to-people links and drawing together these two Mandarin Chinese-speaking societies. But at the same time, Taiwan has continued resisting political linkage to the mainland as proposed by the PRC, to make Taiwan a special administrative region of the PRC, similar to Hong Kong, but with a higher degree of autonomy.

Economically, over a period of fifty years since 1950s, Taiwan has developed from an agriculture-based economy to a major producer of high-technology products. Nevertheless, in the cross-strait context, Taiwan's state power is constrained by globalization and the localization strategies of individual Taiwanese firms. While past efforts to restrain investment were designed to prevent China from gaining an economic or technological advantage over Taiwan (Deng, 2000), two new factors have forced the government in Taipei to rethink its strategy: a sagging economy and Taiwan's January 1, 2002 entry into the World Trade Organization (WTO). The WTO entry for both China and Taiwan is pressuring Taiwanese officials to dismantle trade barriers (Yang and Hung 2003). The Taiwan government recognizes that Taiwanese business has integrated with the Chinese market, but also needs to consider the global distribution of trade and investment outside China to avoid over-dependence on China. Taiwanese firms have developed various networks with Chinese local government,

regardless of the policies of the Taiwan central government to discourage this development. Taiwan gradually lifted their ban on 'China initiatives' in response to companies under pressure to reduce costs, but Taiwan was still hesitant to actively encourage unrestricted Taiwanese investment in mainland China due to political concerns.

As Leng (2005) noted, Taiwanese firms have developed more independent roles in forming global alliances to explore the Chinese market compared to the early stages of cross-strait economic interactions. Globalization of these firms in China has contributed to a widening gap between state goals and business interests. As well as having established themselves in the local Chinese market, they have formed a link for local Chinese enterprises with the global market, thereby extending their global reach. Taiwanese firms are embedded in the local Chinese environment, but also link local Chinese interests with global capitalism through the firm's global operations and logistics. While state goals are becoming less important, political aspects are still crucial; local initiatives have been tempered by Chinese central government, while the Taiwanese government for its part since the mid-1990s has been nervous of erosion of national security and identity.

Taiwan's "flexible developmental state" approach at times is subordinated by administrators so as to deflect political criticism. Even though cross-strait economic interaction has developed into a global rather than bilateral relationship, it is hindered by Taiwan's domestic politics and Beijing's efforts to threaten firms that are close to the Democratic Progressive Party (DPP) (Leng 2005).

Following this Introduction, this chapter is divided into five sections. The first gives the historical background to the unique political relationship between Taiwan and China, characterized by non-acceptance/non-denial of each other's legitimacy, to further understand its relevance and impact on Taiwanese investment in China. Sections two and three consider the evolution of China-Taiwan relations after World War Two and their increasing significance to the international community. Section four examines the cross-strait economic relationship and its interdependence and limitations. Sections five and six explain the regional economic integration and how the development of Taiwanese-Chinese economic interaction can offer opportunities for a more peaceful relationship. These sections also review the theoretical framework inspiring this thesis and on which it is partly based. The final part of this chapter is followed by a concluding section linking the present with subsequent chapters.

### **1.1 Why is the Cross-Strait Relationship "Awkward"?**

When the Chinese Communist Party (CCP) seized power and established the PRC in 1949, the Nationalist Party (the Kuomintang, or KMT) under Chiang Kai-shek fled to Taiwan. Despite the passing of the old guards in both Taipei and Beijing, tensions still persist between the two countries: the Communist-Nationalist rivalry has not completely faded into history. “Conflicts between the PRC and ROC continue to cast a lingering shadow over the prospects for peace and stability in the Taiwan Strait and the entire Asia-Pacific region.” (Huang 2003:25) In order to understand this conflict, it is vital to understand the One-China policy which greatly impacts the relationship between the two countries.

### **1.1.1 One-China Policy**

#### **1.1.1. (a) Development of One-China policy**

Taiwan was part of the Chinese empire until 1896 when it was ceded by China to Japan by The Treaty of Shimonoseki (or *Maguan* in Chinese). As a result of the defeat of Japan in the Second World War, Japan gave up sovereignty of Taiwan and the ROC government took over control of the island.

As presently understood, the One China policy is the policy or principle adopted by

the PRC that there is only one China including the autonomous regions, the special administrative regions and Taiwan.

The One China policy reflects and continues the Chinese empire's claim that China's 'boundaries' as defined by it are inviolable. This stance is also that taken by the PRC, which views China as including Mainland China, Hong Kong, Macau, Tibet, Xinjiang, Inner-Mongolia, and Taiwan.

From the time that the communist party took over control of mainland China, it has always maintained that Taiwan and China are one. It has used its leverage increasingly over the years as it has become more powerful in its dealings with other nations.

While much of the western bloc maintained relations with the ROC until the 1970s, most of the communist countries confined relations to the PRC. In the 1972 Shanghai Communiqué, the USA expressly refrained from challenging this position. It has been a requirement set by Beijing of all countries seeking diplomatic relations with the People's Republic of China. Although the ROC no longer portrays itself as the sole legitimate government of China, the position of

the PRC remained unchanged until the early 2000's, when the PRC began to soften its position on this issue in order to promote Chinese reunification.

During the 16th Party National Congress of the Communist Party of China, former CPC chairman Jiang Zemin stated, "There is but one China in the world, and both the mainland and Taiwan belong to one China. China's sovereignty and territorial integrity brook no division...One-China principle is the basis to discuss issues with Taiwan and for the development of cross-strait relations and the realisation of peaceful reunification". (Xinhua News Agency, November 8<sup>th</sup> 2002).

The amended policy of the PRC was enshrined in the Anti-Secession Law of 14<sup>th</sup> of March 2005 (3<sup>rd</sup> conference of the 10<sup>th</sup> National People's Congress), to the effect that there is only one China, whose sovereignty is indivisible, but does not explicitly identify this China as the PRC. This was a highly controversial move because it formalized the long-standing policy of the People's Republic of China to use non-peaceful means against the Taiwan independence movement in the event of a declaration of Taiwan independence.

In 1992, the mainland-based ‘Association for Relations across the Taiwan Strait’ (ARATS) and the Taiwan-based ‘Straits Exchange Foundation’ (SEF) – semi official bodies – with the backing of the Chinese and Taiwanese governments, negotiated in Hong Kong a resolution of practical problems relating to growing cross-strait commerce, communication and cooperation. In view of the different interpretations of ‘One China’, they overcame this problem by using the slogan “One China, Two Interpretations” (known as “the 1992 Consensus”) – thus skating over the disputed political status of Taiwan. It has been left to each country to interpret what this means.

The PRC has stated that any group in Taiwan that it has formal talks with must support the 1992 Consensus. In Taiwan, the Pan Blue coalition which was formed gradually after 2000 and includes the Kuomintang, the People’s First Party and the New Party, supports the 1992 Consensus. However, the coalition that was in power from 2000 to 2008 - the Pan Green coalition, consisting of the DPP and Taiwan Solidarity Union rejects the very notion of the 1992 Consensus, arguing that this title is misleading as no consensus was in fact reached over the issue of One China in 1992. They maintain that China and Taiwan are two separate political entities. (see the DPP policy in the DPP website, accessed on September 20<sup>th</sup> 2009)

Nevertheless (despite being a member of the DPP), the previous President of Taiwan, Chen Shui-Bian, reflecting pressures from business leaders and opposition parties, expressed his willingness to initiate dialogue with PRC leaders on “the basis of the 1992 meeting in Hong Kong” (National Day Rally speech October 10<sup>th</sup> 2004). This formulation has been seen as an effort to steer a course between accepting that “One China” was agreed in 1992 and not explicitly accepting the One China principle, and thereby as a way to establish a basis for the initiation of negotiations.<sup>3</sup>

#### **1.1.1.(b) Significance of One-China Policy to Relations with the Third Country**

Many nations are reluctant to give expressed endorsement of China’s interpretation of the policy with its larger territorial claim; this has consequently meant that much time has been given to finding a mutually acceptable form of words. So Canada for example, succeeds in merely “acknowledging” China’s stance (cf. “acknowledge”, “take note”, “understand”), while Pakistan for example, supports Beijing’s position on Taiwan’s status. A notable milestone was passed after President Nixon’s visit to China in 1972. The USA was persuaded to relax its stance over Taiwan and adopted an emollient approach of referring to the relationship in guarded terms: this is

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<sup>3</sup> Please refer to <http://www.gio.gov.tw>

summarized as ‘five points’<sup>4</sup> in the China/Taiwan: Evolution of the ‘One China;’ Policy report of the Congressional Research Service (July 9, 2007). China’s insistence on their interpretation of the One China policy raises problems for the Taiwanese government, with its own interpretation; the difficulty is overcome by conducting negotiations through organs where the talks take place at a lower level (e.g. in the ECFA negotiation starting in 2008).

Because of China’s objection to the use of “Taiwan” (seen as suggesting a separate country) and “Republic of China” (suggesting two Chinas), ‘Chinese Taipei’<sup>5</sup> is the only acceptable name in most international arenas. Many countries recognising Beijing overcome the problems of representing their interests in Taiwan by establishing “Trade Offices”; and the Taiwanese government for its part is represented abroad via Taipei Economic and Cultural Representative Offices.

In the case of the USA who has had formal diplomatic relations with the PRC since 1979, the situation is that it consequently has no formal diplomatic relations

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<sup>4</sup> (1) The United States did not explicitly state the sovereign status of Taiwan in the three US-PRC Joint Communiqués of 1972, 1979, and 1982. (2) The United States “acknowledged” the “One China” position of both sides of the Taiwan Strait. (3) US policy has not recognized the PRC’s sovereignty over Taiwan; (4) US policy has not recognized Taiwan as a sovereign country; and (5) US policy has considered Taiwan’s status as undetermined.

<sup>5</sup> Chinese Taipei is the designated name used by the ROC, commonly known as Taiwan, to participate in most international organizations. Due to the insistence of the PRC under its version of the One-China policy, ROC cannot use ‘Republic of China’ or ‘Taiwan’ to imply any independent sovereignty when participating in international organizations

with Taiwan, and resort to use such offices as the American Institute in Taiwan, similarly the UK uses the British Trade and Cultural Office.

Since the Shanghai Communiqué of 1972 when the USA did not “challenge”

China’s position on the One China policy, it has maintained its statements that the

Taiwan question is a matter for the Chinese people and their wish for a peaceful

settlement. In this way, the USA has been able, no doubt because of its primary

importance to China, to avoid a wholesale endorsement of China’s view of its

relationship with Taiwan which other nations have had to accept. Instead,

Washington simply states that they understand China’s claims that the country

claims Taiwan as its own. The US Congress in 1979 took the step of passing a

Taiwan Relations Act in response to President Carter’s break of relations with the

ROC by stating that relations were still maintained even though there was no

longer full recognition of the ROC. The USA has continued to take care not to

abandon Taiwan to the possibility of aggression by China, and indeed expressly

stated in 1982 in Six Assurances<sup>6</sup> that “The United States would not alter its

position about the sovereignty of Taiwan which was, that the question was one to

be decided peacefully by the Chinese themselves, and would not pressure Taiwan

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<sup>6</sup> The Six Assurances are guidelines used in conducting ROC-U.S. relations. They were proposed in 1982 by Taiwan during negotiations between the United States and People’s Republic of China over the Joint Communiqué on Arms Sales to Taiwan.

to enter into negotiations with China...The United States would not formally recognize Chinese sovereignty over Taiwan."

#### **1.1.1.(c) One-China Policy Impacts on Relations between Taiwan and China**

In China's 2005 Anti-Secession Law, China did not accept any suggestions of "two Chinas" or "one China, one Taiwan" and stated that efforts to divide the sovereignty of China could be met with military force.

Nevertheless, in the "Consensus of 1992" the two states agree that each had its own interpretation of the meaning of "one China". just before the 2000 Presidential Election in Taiwan, Chinese Premier Zhu Rong-Ji stated that as long as any ruling power in Taiwan accepts the One China Principle, they can negotiate and discuss anything freely. The solution ("one nation, two states") adopted in the case of Korean ultimate reunification or previously in that of the Germanies is however not contemplated by the PRC because they think they are the only legitimate government for the whole of China.

Before the 1990s, the ROC asserted that the One China was the ROC rather than PRC. In 1991, former President Lee Teng-Hui did not dispute the right of the Communist authorities to rule the mainland. The ROC no longer claimed administrative authority over mainland China; the question was that of

sovereignty of Taiwan and the surrounding islands. To many, President Lee was thought to be favourable to Taiwanese independence, a position at variance with long standing KMT policy. In 1999, he proposed a two states theory (special state-to-state relationship) for mainland China-Taiwan relations which was received angrily by Beijing authorities, which ended semi-official dialogue.

After the DPP came to power in 2000, their policy was that of calling for negotiations without preconditions. Former President Chen Shui-Bian did not explicitly reject or endorse Lee's two states theory. He gradually changed attitude and at his 2004 presidential inauguration, he rejected China's interpretation of the One China policy claiming it would imply that Taiwan is part of the PRC and called instead for talks to discuss this.

As noted at the beginning of this section, in March 2005, the PRC passed an Anti-Secession Law. This gives legal sanction to attack Taiwan should it take any steps to independence and authorises the use of force to prevent any serious threat. It authorised a large increase in military spending. But it refrained from referring to One China as synonymous with the PRC and offered to pursue political solutions.

Since 2008, the approach of current President Ma of the KMT has been more emollient. He said that “the ‘1992 consensus’ and his ‘Three No’ principle of ‘no unification, no independence, and no use of force’ have not just improved peace in the Taiwan Strait amid closer interchange with the Chinese mainland but also strengthened relations with all nations round the world.” (The China Post report, August 29<sup>th</sup> 2011, accessed on September 2<sup>nd</sup> 2011)

### **1.1.2 Views of the PRC and of the Two Main Parties in Taiwan**

The interpretation of the One-China policy varies in the PRC and the ROC (both the KMT and the DPP). We can see this from tables 1.1 – 1.4.

**Table 1.1 The PRC Position on One-China Policy**

<b>The PRC Position</b>	
1	There is only one China and Taiwan is one province of China.
2	Taiwan should be reunified with mainland China as a “special administrative region”, with its own political and economic system and its own armed forces. Under the “one country, two systems” concept, it will be granted extensive autonomy.

3	<p>The PRC encourages expansion of economic, personal, and institutional interchange between Taiwan and mainland China and urges early opening of the three links - direct communication, travel, and shipping.</p>
4	<p>The PRC wants negotiations to end the state of hostility between the two sides and bring about reunification.</p>
5	<p>Only the PRC has the right to represent China, including Taiwan, in international affairs.</p>
6	<p>The PRC opposes diplomatic or official relations between Taiwan and countries with which the PRC has diplomatic relations, but it does not object to unofficial economic and cultural relations between Taiwan and those countries.</p>
7	<p>The PRC opposes Taiwan's participation as a separate nation-state in intergovernmental organizations of which only states can be members.</p>
8	<p>The PRC opposes the sale of arms to Taiwan by any state having diplomatic relations with the PRC.</p>
9	<p>PRC consent must be obtained before any state that has diplomatic relations with the PRC establishes aviation services to Taiwan.</p>
10	<p>The PRC reserves rights to use military force to prevent the establishment of an independent state of Taiwan. The refusal to</p>

	renounce force is not aimed at compatriots in Taiwan, but at foreign forces working to bring about Taiwan independence.
<p><i>Source: State Council, Taiwan Affairs office and Information Office, The Taiwan Question and the Reunification of China, Beijing, August 1993</i></p>	

**Table 1.2 The KMT position on One-China Principle**

	<b>The KMT position</b>
1	There is only one China, but since 1949 China has been divided into two separate political entities.
2	The ROC has been a sovereign, independent state since 1912, but since 1949 has consisted of only Taiwan, Penghu and the offshore islands, it has never been a part of the PRC.
3	As a de facto sovereign, independent state, the ROC has a right to have official relations with any state and to become a member of intergovernmental organizations. The PRC has never governed Taiwan and cannot represent the people of Taiwan in the United Nations.

4	<p>Without derogating from the policy of One China, it would not be offensive to that policy if realities were accepted temporarily to allow for both parts of “China” being given seats in the United Nations.</p>
5	<p>The ROC favours expanding trade, investment, and travel with mainland China but requires that it be indirect and applies other restrictions ad necessary to protect Taiwan’s security and prosperity.</p>
6	<p>Taiwan and China should be reunified. Negotiations on reunification can be undertaken when the PRC:</p> <p>(a) becomes a democracy with a free enterprise economic system; (b) drops the threat to use force against Taiwan; and (c) stops interfering with the expansion of the ROC’s international relations.</p>
<p><i>Source: Clough R. N. (1999b), The Political Impasse, Cooperation or conflict in the Taiwan strait? p.31-33</i></p>	

The KMT’s stance has gradually changed in the past 50 years in response to changed circumstances, including global trends and cross-strait relations. The KMT position has shifted from the ‘no contacts, no negotiations and no compromise’ of the

Chiang-Kai-Shek and Chiang-Ching-Kuo period to the 1992 consensus and peace talks<sup>7</sup> in 1993 and 1998. After the 2000 presidential election the KMT became the opposition party, not returning to power until 2008. As noted earlier, the DPP President then adopted a softer approach in dealing with China, to be followed by a firmer line. A principle of the DPP is that of independence of Taiwan and this has not been generally welcomed by the CCP government. When the DPP was elected in 2000, President Chen proposed a more acceptable policy regarding the future of Taiwan, in which would not change Taiwan's status. His aim was to engage with the Chinese CCP government through a softer approach, avoiding confrontation with China at a time when the DPP just came to power. However, as time passed and the DPP gained in confidence, they began to place more focus on the perceived need for security and national identity, mainly in various subtle ways such as cultural or in adoption of nomenclature of bodies such as "Taiwan Post" emphasizing the distinct character of Taiwan.

In 2005, the current Chinese Prime Minister Hu Jintao indicated that China supports the "1992 Consensus", although he did not add the crucial words "each side can have its own interpretation". He did add, however, that 'we must resume talks on an equal footing', which some analysts are suggesting amounts to the same thing. (IHT, 19

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<sup>7</sup> The peace talks were held in Singapore between Mr. Koo Zen-Fu of Taiwan and Mr. Wang Dao-Hang of China.

April 2006:8) This is still China's general position.

**Table 1.3 The DPP Position on One-China Principle**

<b>The Democratic Progressive Party (DPP) Position</b>	
1	An independent Republic of Taiwan should be established. A decision to this effect should be reached by a plebiscite among all of Taiwan's citizens.
2	Taiwan should seek membership in the UN as a new state, not on the German patterns one of two Chinese states pending reunification.
3	Taiwan should resolve differences with the PRC by government-to-Government negotiations.

*Sources: (1)Democratic Progressive Party Charter and Program (Taipei: August 1, 1995)*

*(2) Clough (1999b), The Political Impasse, Cooperation or conflict in the Taiwan strait? p.31-33*

**Table 1.4 Current Taiwan government position on One-China**

Principle	
	Current Taiwan government's position
1	The Republic of China is an independent sovereign country. The status quo in the Taiwan Strait is that both sides across the Strait have no jurisdiction over each other.
2	There is no such issue of “independence” or “unification” between them. However, it is an undeniable fact that Beijing continues to reinforce its military preparations against Taiwan and has not renounced its basic policy of using force to pressure Taiwan into accepting China’s reunification proposal.
3	China should face up to the fact of the existence of the Republic of China and to renounce its military threat and diplomatic suppression against Taiwan. Both sides should, without setting any political preconditions and based on the principles of “sovereignty, democracy, peace and parity,” promptly conduct dialogue and negotiations to jointly consider how to promote the normal and positive development of cross-strait relations.
4	Taiwan (ROC)’s sovereignty rests with the Taiwanese people, and the

right to decide on any changes to the future of Taiwan resides solely with the 23 million Taiwanese people and not with another country or a political party.

*source: Taiwan's mainland affairs office and electronic resource is at <http://www.mac.gov.tw>*

### **1.1.3 Why Is It Important to China?**

The Beijing government still considers Taiwan a part of their territory, a renegade province that must eventually return to PRC control. However, although Taiwan and the mainland are separated culturally and politically, Taipei's adherence to the principle that Taiwan is still part of China is seen by the Chinese Communist Party (CCP) and its constituencies as not shutting the door to their ultimate goal of ruling all rightful Chinese territory (Roy, 1998). Conversely, a declaration of independence by Taiwan would destroy this hope, with serious consequences for the self-image of the Chinese Communist Party and of China as a whole; leading to the possibility of Taiwanese independence, and "a domino effect of separatism on the mainland." (Yan, 1993: 6) Beijing's approach in relation to Taiwan is that reunification is desirable, temporary separation is tolerable, but Taiwanese independence is unacceptable.

While Sino-Taiwanese political relations are still tense, liberalization of markets has progressed and indeed this has been to the benefit of the PRC in its objective of establishing increased links with Taiwan (Roy, 1998). Taipei, however, has been afraid that economic ties would make Taiwan vulnerable to political control by Beijing. Long standing fear of this led Taiwan officially to ban trade with Mainland China during the martial law period 1950-1987. Nonetheless, through the 1980s, cross-straits business flourished, much of it using Hong Kong as a middleman and stopover, with a resulting huge trade surplus with the mainland for Taiwan since 1979.

The PRC benefits from Taiwan's experience and wealth. But more important for the PRC, fostering cross-strait economic interdependence binds Taiwan to the mainland, contributing to the goal of eventual political reunification.

#### **1.1.4 Changing Attitudes of the Taiwanese about One China Policy**

Under Chiang Kai-Shek and Chiang Ching-Kuo, when Chinese from the mainland dominated the KMT, governments, Sun Yat-Sen's Three Principles of the People (*San-Min Chu-Yi* in Chinese) was the officially promulgated ideology. Sun recommended giving a high priority to economic modernization, carrying out land

reform, and promoting foreign investment and foreign trade. These recommendations became basic elements in the policy followed in Taiwan. The goal of democratization expressed in the *San-Min Chu-Yi* became a useful instrument for those pressing for political reform in Taiwan. (United Daily, 1998/05/08)

The culmination of the reform process in the popular election of Lee Teng-hui in March 1996 had a powerful effect on the view that the people of Taiwan had of themselves. They felt that Taiwan had aligned itself with the wave of democratization that swept the world after the collapse of communism in the Soviet Union and Eastern Europe. According to the survey of Taiwan-USA relationship from the National Cheng-Chi University Election Research Centre (2006), they believed that Taiwan had positioned itself to receive stronger backing from the United States and other democracies against the threat posed by the last remaining large communist power. Selection of their leader by popular vote also strengthened the widely held view that Taiwan was a de facto sovereign state, deserving of recognition by other nations.

Anti-communism persisted for decades after the Chinese Civil War. The KMT condemned communism as an alien ideology imported into China from the Soviet Union, and any manifestation of sympathy with communism was prohibited in

Taiwan. Although public support of communist ideology in the PRC was greatly weakened by the Cultural Revolution, followed by the introduction of a market economy and the opening to the outside, the fact that the Chinese Communist Party continued to profess adherence to the doctrine and threatened the use of force against Taiwan ensured that the people of Taiwan would remain firmly anti-communist. Moreover, the collapse of communism elsewhere in the world and Taiwan's impressive lead over the PRC in building a modern society were striking demonstrations that communism had little to offer.

The differences between the political establishment in mainland China and in Taiwan, although mainly of a political/ideological character, had also a deeper foundation, viz., the distinction in ethnic composition of the peoples of the two regions.

Native Taiwanese, Hakanese and aborigines constitute about 85 percent of Taiwan's population – inhabitants from China mainland (mainlanders) being in the minority.

The Taiwanese and mainland Chinese have different languages and customs. However, with the arrival of the KMT, power was concentrated in the mainlanders and for a long time they had the benefit of special privileges. This caused much resentment among the majority Taiwanese, which was greatly intensified by the brutal

suppression of a Taiwan uprising in 1947. The Taiwanese, even though they were descendants of earlier immigrants from Fujian and Guangdong, had lived under Japanese colonial rule for fifty years and had weaker ties with the mainland than the more recent arrivals. These differences were reflected in the political controversy between advocates of unification with mainland China and advocates of Taiwan independence. The former tended to regard themselves as Chinese first, members of a community of people sharing Chinese language and culture, centred in mainland China, and only secondarily as Taiwanese. The latter saw themselves first as citizens of Taiwan, which had been separated from mainland China for nearly one hundred years and had developed a distinctive language and culture. Their identification with mainland Chinese language and culture was secondary. The influence of the latter group increased as the generation that came over from the mainland in 1949 died and the Taiwanese, under the leadership of Lee Teng-hui and Chen Shui-Bian, became the dominant faction (group) in the KMT and also constituted the chief opposition party, the DPP.

Differences over identity were subordinated, however, to a common interest in the continued freedom of Taiwan's people to manage their own affairs in the world. Hence, whether mainlander or Taiwanese, the great majority oppose either unification

or independence in the foreseeable future in a pragmatic effort to avoid either being absorbed into or attacked by the PRC (Clough 1999).

### **1.2. The Post-Cold War Relationship between Taiwan and China**

At the end of the Cold War, each maintained its own ideology and principles, and the relations between Taiwan and China made little positive progress. But trends emerged to countervail this tension, one being foreign direct investment and another being mutual cultural exchange (athletics, tourism, academic and other factors). These interactions are forms of soft politics (low-profile politics) and will affect to some degree high politics in lowering the tension between the PRC and the ROC.

Numerous problems and controversies have surrounded the politics of cross-strait interaction between Taiwan and China. Taiwan has been under some kind of threat of an invasion from the PRC since 1949, and the outbreak of the Korean War in 1950 and the onset of the Cold War were fortuitous events for Taiwan. They led to Taiwan being party to an anti-communist alliance with the US. The US became Taiwan's security guarantor from 1949 to 1979, and as a consequence provided Taiwan some

breathing space in the international arena. However, following President Richard Nixon's visit to Beijing and the eventual de-recognition of Taiwan by the US under President Jimmy Carter in 1979, Taiwan's security situation changed dramatically. Suddenly finding itself diplomatically isolated, Taiwan needed to look after its own national security without being under the auspices of another country. The focus of national security has traditionally been on military issues, and less emphasis has been placed on the use of trade as part of statecraft. Indeed, while Taiwan's rapid economic growth and industrialization have been widely noted, the close link between this development and its impact on Taiwan's security has been less understood. As Chan (2001:104) commented, "increasing commercial and non-commercial contact has the effect of deepening and widening networks of cross-national interests and institutions. These networks and shared norms underpin the rise of a security community."

By firmly attaching itself to the global economy and production process, and its participation in the world's trading and financial bodies, Taiwan obtains an increased measure of security, and feels that it can rely on cooperation from fellow members of these bodies should its financial security come under threat in the same way, for example, as in recent financial crises of 1997 and 2008, nations have come together in an effort to save each other's economy. It also gives Taiwan a greater sense of

belonging. To borrow from Robert Keohane (1983: 159), these bodies or organisations provide “sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actor expectations converge.”<sup>8</sup> One way to understand the evolution of Taiwan’s national security is through the use of economic statecraft. By firmly integrating Taiwan’s economy with the international economy, Taiwan makes itself an important player in the world manufacturing and information technology (I.T.) economy. By moving from heavier industries to capital- and knowledge-intensive industries, Taiwan is less susceptible to direct competition and substitution and its trading partners have more to lose, thus tying partners more closely to each other to a greater or lesser extent. By binding Taiwan’s economic fate to the world, Taiwan can avail itself of some security as the world becomes vulnerable to instability in Taiwan.

Despite the diplomatic isolation of Taiwan, Taiwan’s total trade volume has grown steadily over the years, making it one of the world’s top trading nations. Trade with the USA has always been important to the Taiwanese economy. In fact, according the Taiwan’s Ministry of Finance and Bureau of Foreign Trade, the severing of official

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<sup>8</sup> Keohane suggests that “...within the context of a regime, help can be extended by those in a position to do so, on the assumption that such regime-supporting behaviour will be reciprocated in the future. States may demand that others follow the norm of generalized commitment even if they are thereby required to supply it themselves, because the result will facilitate agreements that in the long run can be expected to be beneficial for all concerned.” (1983:159)

diplomatic relations in 1979 between the USA and Taiwan has not affected the growth of two-way trade. Trade with Japan has also grown in total volume from \$6.81 billion in 1979 to \$57.4 billion in 2005. Since 1987, however, trade between Taiwan and the PRC has rocketed from \$0.1 billion in 1989 to \$120.78 billion in 2010.<sup>9</sup> The figure shows the trade dependency has shifted and the dependency of Taiwan on the PRC becomes exponentially greater. For example, in 1987, the share of cross-straits trade in Taiwan's total foreign trade was 1.71% whereas the share increased to 22.97% in 2010 (See Table 1.5). This results in the dilemma for Taiwan between obtaining overall continuous economic prosperity and safeguarding the national security.

**Table 1.5 The Share of Cross-Straits Trade in Taiwan Total Foreign Trade**

Period	Transit Trade between Taiwan and China via Hong Kong			Estimates by Mainland Affairs Council, Taiwan		
	Export share	Import share	Total trade share	Export share	Import share	Total trade share
	share	share	share	share	share	share
1985	3.21	0.58	2.17	3.21	0.58	2.17
1986	2.04	0.60	1.49	2.04	0.60	1.49
1987	2.28	0.83	1.71	2.28	0.83	1.71

<sup>9</sup> See MAC Cross-Strait Economic Statistics Monthly on December 30th 2011. According to Mainland China's Customs Statistics, the total trade between Taiwan and China was 145.37 billion US dollars in 2010.

1988	3.70	0.96	2.47	3.70	0.96	2.47
1989	4.38	1.12	2.94	5.03	1.12	3.31
1990	4.88	1.40	3.32	6.54	1.40	4.23
1991	6.10	1.78	4.15	9.79	0.46	5.57
1992	7.66	1.55	4.79	12.84	1.03	7.31
1993	8.82	1.43	5.32	16.28	1.31	9.19
1994	9.03	1.51	5.45	16.99	2.17	9.93
1995	8.72	1.51	5.27	17.15	2.97	10.36
1996	8.26	1.54	5.12	17.63	2.97	10.79
1997	7.82	1.52	4.79	18.08	3.41	11.03
1998	7.43	1.57	4.60	17.62	3.91	11.00
1999	6.61	1.46	4.17	17.22	4.07	11.00
2000	6.31	1.41	3.95	16.46	4.43	10.67
2001	6.98	1.57	4.48	20.27	5.47	13.45
2002	7.62	1.51	4.84	23.30	7.04	15.89
2003	7.83	1.69	5.01	25.43	8.61	17.70
2004	8.09	1.47	4.91	26.83	9.95	18.72
2005	8.60	1.44	5.17	28.36	11.00	20.04
2006	8.35	1.44	5.07	28.27	12.23	20.65

2007	8.60	1.33	5.18	30.10	12.78	21.95
2008	7.84	1.23	4.63	28.94	13.06	21.24
2009	8.85	1.71	5.56	30.49	14.01	22.88
2010	8.38	1.79	5.23	30.89	14.31	22.97
2011	7.62	2.23	5.03	29.66	15.52	22.87
Jan-Aug.						
<p><i>Note: The denominators are Taiwan's trade volume to the world; the numerators are Taiwan's trade volume to China.</i></p> <p><i>Source: 1. Hong Kong Customs Statistics</i></p> <p><i>2. Taiwan Customs Statistics</i></p>						

As to China, until 1978, China operated a 'closed door' policy in its trade with other countries, mainly confined to members of the communist bloc with a few exceptions with the outside world. With the increasing influence of Deng Xiaoping in the power structure of the Chinese government, China gradually from 1978 opened her doors to trade with other countries: real GNP expanded at an annual rate of over 9 per cent between 1978 and 1993. (Lardy 1994: 3). China became a magnet for foreign direct investment. Through 1993 the cumulative total of foreign direct investment actually undertaken reached \$60 billion and the cumulative value of foreign

investment contracts exceeded \$220 billion. By 1996 China had become the largest recipient of World Bank Loans, averaging \$3 billion a year in recent years and totalling over \$25 billion. (Lardy 1994:64).

After China began its economic opening to the outside world, the United States became an increasingly important partner. Since 1992, it took one-third of China's exports and transferred to China advanced technological skills, such as in the commercial aircraft industry. The USA has become the second largest trading partner and has been the single largest export market for firms based in China, taking over more than 30 percent of total exports produced in China. (Lardy, 2005:128) Thus, the PRC has an important economic interest in good relations with the United States. Hong Kong has been the largest investor in mainland China, supplying around 60 per cent of foreign direct investment. Since 1987 Taiwan entrepreneurs have also invested sizeable amounts, estimated at about \$30 billion from some 30,000 firms after the year of 1990. According to Chinese Economic News Service (2004) and Lardy (2005:133), there are twenty eight Taiwanese firms on the list of the 200 largest exporting companies in China, the largest one being the Taiwanese conglomerate Foxconn (*Hon Hai* Precision). All of these 28 are in electronic manufacturing sector.

The overriding mission for Chinese leaders was to press ahead with economic modernization so that China could catch up with Japan and the West and become a powerful and prosperous nation, assuming again its proper place in the world community. (the article “China and the world” in Financial Times of 3<sup>rd</sup> September 2011, which looks at the changes made in Chinese international development overseas).

Capital, technology, and managerial and marketing skills provided by Taiwan entrepreneurs contributed to the achievement of this goal. The growing economic interaction also linked Taiwan more firmly to the China mainland and improved the prospects for unification

“Beijing’s economic interest in modernization and its strategic interest in the unification of Taiwan with the mainland were consistent, in the sense that a unified China would be more modern and powerful than the PRC is today. Resources devoted by Beijing and Taipei to confronting each other could be more productively employed. But if the PRC were compelled to resort to force to prevent Taiwan independence, it would be defending its strategic interests at a high cost in terms of its economic interests in relations with Taiwan, the United States and Japan.” (Clough 1999:15)

### 1.3 Deepening of Cross-Strait Economic Interdependence and Its Limitation

How can tension between Mainland China and Taiwan be reduced after the continued failure of the USA to force China to cease their threats of military attack on Taiwan?

The threat to use force has deterred Taiwan from officially breaking away from China, and in this sense Beijing's policy has been successful. The United State's official expressions of foreign policy on cross-strait relations have varied somewhat, depending on the forum, in their emphasis on support for the Taiwanese position but have maintained their traditional stance of strategic ambiguity, preferring the status quo and acknowledging the three "No"<sup>10</sup>. Taiwan has limited international space as a result of China's diplomatic pressures and needs to maintain and foster its prosperity by not resorting to formal declaration of de facto independence. Against this background, the USA has chosen to concentrate on pressing for harmonious relations between Taiwan and China through people-to-people interaction, namely cultural exchange and economic cooperation.

In 1991 the two sides established quasi-official organizations authorized to negotiate

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<sup>10</sup> The US does not support independence for Taiwan, or 'two Chinas', or "one Taiwan, one China", and does not support Taiwan's application to any international organization for which statehood is a requirement. This was acknowledged by the Clinton administration in 1998.

with each other to resolve problems arising in people-to-people relations across the Taiwan Strait. These were the Straits Exchange Foundation (SEF) on the Taiwan side, chaired by Koo Chen-Fu, and the Association for Relations across the Taiwan Strait (ARATS) in mainland China, headed by former Shanghai mayor Wang Dao-han. These organizations dealt with practical problems only, and they were not authorized to discuss political difference between the two sides. This was the crucial step for two sides to normalize relations and establish a platform for further negotiation.

As Leng (2005) argues, in the cross-strait context Taiwan's state power is limited by the globalization and localization strategies of individual Taiwanese firms. Regardless of Taiwanese government policy of discouraging these strategies, these firms have developed various networks with Chinese local authorities. In addition, Taiwanese corporations have been a powerful lobby to persuade the Taiwanese government to reduce costs and ease constraints on their businesses by changing their opposition to certain forms of trade, investment and contacts and succeeded in a lifting of barriers by such measures as the signing of the Three Direct Links agreement in 2008.

In the past 10 years, Taiwanese businessmen have entered China on a large scale and cross-strait economic interdependence has increasingly been enhanced. According to

the Chinese Ministry of Commerce (Statistics Book), by August 2011,

Taiwan-invested enterprises on the mainland had reached 84,849, with actual

investment of USD\$53.44 billion. But according to the estimate of Taiwan's central

bank and the Investment Commission of Ministry of Economic Affairs of Taiwan,

Taiwan's investment in the mainland had reached approximately USD\$107.7 billion.

Driven by a large amount of investment, the total trade volume between the two sides

of the Strait in 2010 was at a record high. The amount has gradually increased each

year until 2011, except for 1990, 1998 and 2009 comparing with the preceding year.

In 2010, the cross-strait accumulated total trade volume amounted to USD\$120.78

billion, of which the mainland's export to Taiwan was USD\$35.95 billion and

Taiwan's exports to China was USD\$84.82 billion<sup>11</sup>. Taiwan became the fifth-largest

trade partner and the second-largest import market of the mainland. The mainland

became the second-largest export market and the largest source of trade surplus for

Taiwan. China is now Taiwan's largest and fastest growing target for foreign

investment, with the accumulated contracted amount of investment surpassing USD\$

146 billion in 2010.<sup>12</sup> The proportion of the cross-strait trade in Taiwan's total foreign

trade had risen from 1.71 per cent in 1987 to 22.97 per cent in 2010. In the same

period, the proportion of Taiwan's export to the mainland in its total export had gone

<sup>11</sup> Data source: Mainland Affairs Office, Estimate Total Trade between Taiwan and Mainland China

<sup>12</sup> Date Source: Ministry of Commerce, the People Republic of China; Investment Commission, Ministry of Economic Affairs, Taiwan; Taiwan's Mainland Affairs Council Economics Statistics

up to 30.89 per cent from 2.28 per cent. (MAC report: The Share of Cross-Straits Trade in Taiwan Total Foreign Trade 2011)<sup>13</sup>

According to the Investment Commission, Ministry of Economic Affairs (MOFA), Taiwan, during the first eight months of 2011, the number of approved foreign investments (including investment to China and the registered number which unregistered previously) totalled 814 cases and accrued US\$12.31 billion, of which US\$10.42 billion was approved for investment in Mainland China. Mainland China attracted 84.67% of Taiwan's total foreign investment such that it became the foremost destination for Taiwan's foreign investment. Approved investment to China accumulated 39,292 cases from 1991 to the end of August 2011, which totalled US\$107.74 billion<sup>14</sup>.

Conservative estimation shows that Taiwan investment to China has contributed to the creation of at least 3 million jobs to Mainland Chinese in China according to the researcher's interviews. Estimates indicate approximately 300,000 Taiwanese are regularly in China for business reasons<sup>15</sup> as against nearly 1.1

<sup>13</sup> The report data is combined from data of Hong Kong Customs Statistics and ROC Custom Statistics. It can be seen at [www.mac.gov.tw](http://www.mac.gov.tw)

<sup>14</sup> The statistics data can be seen at <http://www.mac.gov.tw/public/Attachment/11230919443.pdf>; Data is accessed on 2012/01/27.

<sup>15</sup> The figure comes from the researcher's interviews.

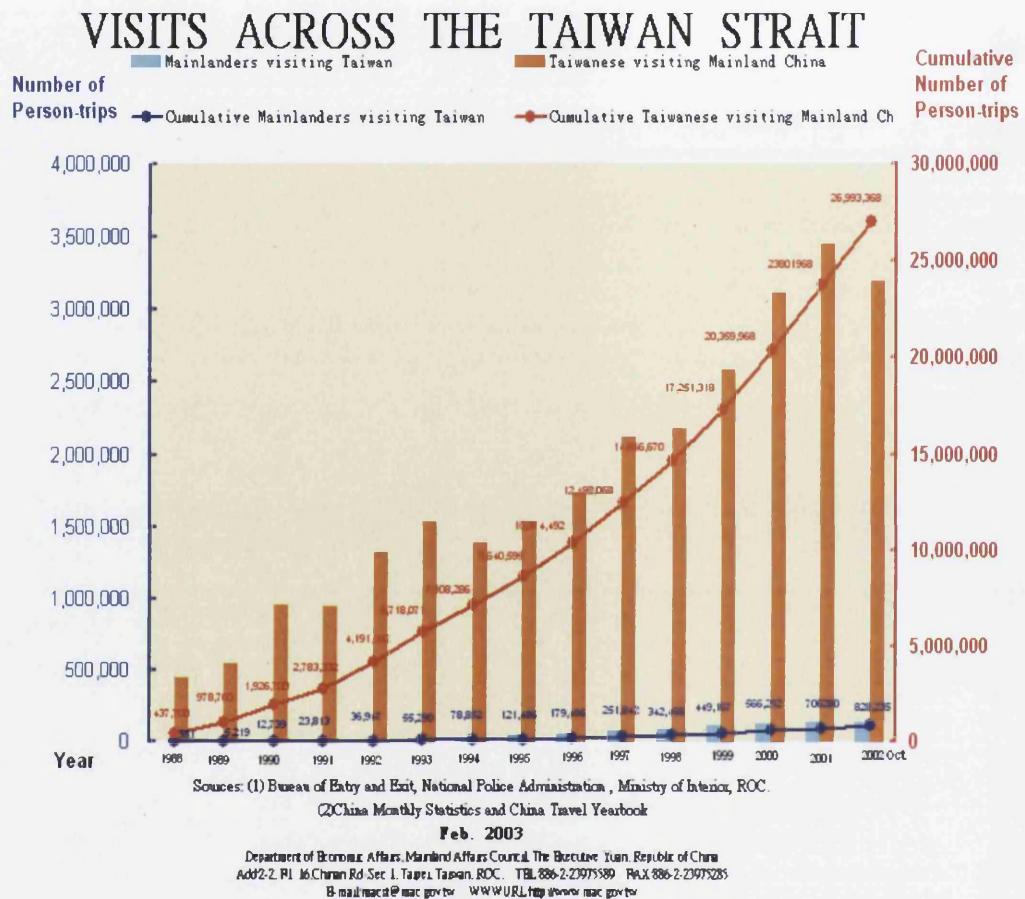
million quoted by the American Chamber of Commerce in their 2007 White Paper as living and working in China. If one adds Taiwanese tourists and visitors to this figure, the total would run as high as 600,000 to 700,000 people in China per month at any given time. Before direct air-links with China, Taiwanese were already making around 2.7 to 4.3 million trips to China per year (between 2003 and 2008). Following the creation of direct air-links in mid-2008, the most recent figures in 2011 show there were as many as 5.14 million trips in 2010. In the wake of ECFA in 2010, the huge increase in Chinese visitors to Taiwan was from 243,185 persons in 2006 to 1.58 million in 2010. (See Table 1.6 and Figure<sup>16</sup> of Mainland Affairs Council of Taiwan, 2011) Nevertheless, figures provided by *Want China Times* show that a total of 593,832 foreigners were living on the Chinese mainland at the end of 2010, according to data from the sixth national census released by the National Bureau of Statistics of the PRC on April 29, 2011. Among these expatriates, a total of 170,283 Taiwan residents were living on the Chinese mainland as of November 1st, 2010, (Xinhua and Staff Reporter, *Want China Times*, 2011/04/29) Those numbers do not include those on short-term business or sight-seeing trips. These statistics coming from a Chinese government

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<sup>16</sup> The table of number of Taiwan tourists to Mainland China can be accessed at <http://www.mac.gov.tw/public/Attachment/112309212320.pdf> ; The source of data comes from China Monthly Statistics and China Travel Yearbook.

source differ from those from Mainland Affairs Council of Taiwan referred to above.

**Table 1.6 Visits Across the Taiwan Strait**



Source: Adapted from the report of Department of Economic Affairs, Mainland Affairs Council, Taiwan.

The development of cross-strait economic and trade relations not has only been stepped up in quantity but also has undergone qualitative changes in structure. First, according to Yu (2003: 135-137), the main force of Taiwanese business movement

westward has transferred from the traditional industries to high-tech industries such as petrol-chemistry and computers. Furthermore, their traditional industries entering the mainland have switched from shoe, hardware, and toy manufacturing in the initial stage, to electrical household appliances, bicycles, and textiles. Petrol-chemistry, Taiwan's important pillar industry has begun to transfer to the mainland. The high-tech electronic information industry has moved to the mainland for production in all aspects. The output value of Taiwan-invested computer hardware has accounted for 72 per cent of the mainland's total output value of these goods.<sup>17</sup> Most companies maintain that where there is market, investment follows. With fiercer global economic competition and the pressure for reduction of cost of production, entrepreneurs look to China for investment. With increasing liberalisation of the economy in China and the lifting of restrictions on the siting of industries, together with increasing domestic prosperity and a greater demand for goods and services, the Chinese consumers give greater opportunities to foreign investors, Taiwanese in particular.

Second, a new pattern of division of labour has been formed, that is, production and supply on the mainland and marketing in Taiwan. According to MOEA's report<sup>18</sup>, a considerable part of Taiwan's export products are produced on China, for example,

<sup>17</sup> Please refer to <http://www.moea.gov.tw> and <http://www.trade.gov.tw>

<sup>18</sup> Ibid.

30.9 per cent in electronic information industry.

Third, Taiwan's business people have transferred their manufacturing centres to the mainland China. In recent years they have also gradually moved their research and development centres to the mainland because of a shortage of high-tech talent on the island. Universities and colleges on the mainland are able to train 145,000 computer engineers, whereas only 4,000 may be trained in Taiwan.<sup>19</sup> Taiwan-funded research and development centres are mainly concentrated in Beijing, Shanghai, Suzhou, Guangzhou, and Xi'an in cooperation with Qinghua University, Jiaotong University, and Fudan University (United Daily News, 2007/09/12).

Last, investment has developed from individual enterprises to enterprise groups. Whereas, previously it was difficult for one or two enterprises to succeed, core enterprises can now integrate related upstream and downstream business, forming a complete business environment. Such Taiwanese investment in special zones has gradually increased; for instance, there are more than 13,800 foreign-investment enterprises in Dongguan, Guangdong, most of which come from Taiwan.<sup>20</sup> In metropolitan Shanghai, it is estimated that there are 300,000 Taiwanese business

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<sup>19</sup> Ibid.

<sup>20</sup> Please refer to <http://www.moea.gov.tw>, <http://www.trade.gov.tw> and <http://www.mac.gov.tw>

people and a few schools for their children.<sup>21</sup>

This phenomenon is of great significance. Wallerstein, initiator of world system theory, said to a journalist with Taiwan's *United Daily News* that, "after World War Two, there were four countries divided by the Cold War in the world: Germany, Vietnam, China and Korea. Germany and Vietnam have been reunified in varying ways." (United Daily, July 28<sup>th</sup> 2001) Compared with them, China's divided region is unbalanced, especially in population distribution. He predicted that the two sides across the Taiwan Strait would be reunified in the coming 20 years. He held that in fact the two sides had been reunified in their economies, which was a crucial step. If Taiwanese businessmen want to do business on the mainland, they will naturally exert pressure on Taiwan's government and the ruling party, which may change Taiwan's political spectrum. As has been discussed previously, business is connected with politics. In their operations, Taiwanese companies have to be sensitive to the problems of dealing with competing objectives and rules of the two countries - China and Taiwan - a situation not faced by investors from other countries. They have had to be adept at finding their way through obstacles; as noted elsewhere this special difficulty is balanced by the common ethnic and cultural affinity of the two nations.

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<sup>21</sup> Ibid.

It was noted by Zhang (2005) that while the European Union, the US, and Japan (the Triad) supply 90% of global foreign direct investment (FDI) and China is the second largest FDI recipient in the world, however, most FDI into China did not come from the Triad, but from Hong Kong and Taiwan (HKT). According to Lardy (2005: 128), foreign firms from Hong Kong, Taiwan, Japan and South Korea account for two third of China's inward FDIs; however, the FDIs from the United States and the European Union consist of less than a fifth of China's inward foreign investment. Four dimensions of the dominant Hong Kong-Taiwan direct investment (HKTDI) in China are identified by Zhang (2005): China's export-promotion FDI strategy, abundant and inexpensive labour supply, Hong Kong and Taiwan's specific economic strength in export-oriented FDI, and their connections with China. Empirical results suggest that FDI from the Triad was mainly market-oriented while HKTDI was primarily motivated by Chinese low labour costs. Economic and trade flows between China and Taiwan are increasing, following Taiwan's and China's WTO accession and Taiwanese firms expanding their operations in China, especially high-tech firms such as integrated circuit manufacturers. China has become very relevant to Taiwan's economy, especially in Taiwanese firms' efforts to globalize their business operations.

However liberalizing regulations for investment in China poses the problem for the Taiwanese government of finding the mainland economy of being boosted at Taiwan's expense. Taking the semiconductor industry, one of Taiwan's most competitive industries in the world, as an example, the Taiwanese government for the past three decades has been encouraging this important industry by various incentives and mechanisms. Many business entrepreneurs are eager to set up factories in China to maintain a competitive edge and reduce costs. Yang and Hung (2003) claimed that many people in Taiwan are concerned that easing the ban on investment, semiconductor in particular, will weaken the island's economy and give China added political leverage over Taiwan. As many observers have pointed out, the continuing outflow of capital, technology, and personnel with management skills has led to the hollowing-out<sup>22</sup> of the Taiwan economy in the past two decades, and making Taiwan overly dependent on the Chinese economy.

In addition, as Lo (2003) pointed out, Taiwan cannot sign any agreement to guarantee fair trade by a normal country-to-country mechanism, with potential for an economic crisis for Taiwan. For example, in June 2010, because of this obstacle, the countries resorted to the device of "non-governmental" agencies with no direct signatures from

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<sup>22</sup> In this context, "hollowing-out" means the Taiwanese businessmen bring the capital (either loans or assets), technology and experts to China and therefore Taiwan will lose the niche for competitions and reduce the capitals for investment in Taiwan's domestic market.

both government authorities when concluding the ECFA. While China boosts its economy by attracting foreign investment in general, China marginalizes Taiwan in three ways:

(1) China has attempted to manipulate the rules of the WTO to influence third world countries. In addition, it keeps threatening other nations not sign free trade agreements with Taiwan by declaring that those who do will face serious consequences.

(2) China utilizes the ASEAN plus three<sup>23</sup> to strengthen its economic ties with Southeast Asian countries, gradually increasing its influence on these trading partners, and weakening the United States and Japan's leading positions in Southeast Asia. Taiwan has been isolated by China's intention to block Taiwan from foreign trade.

(3) With China's integration with Hong Kong and Macau and move to establish a mini China-Hong Kong-Macau triangle, Taiwan is isolated.

#### **1.4. Regional Economic Integration**

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<sup>23</sup> ASEAN plus three are namely Association of Southeast Asian Nations, China, Japan and South Korea

This thesis is neither based on, nor subscribes to, any single theory. The researcher is conducting an empirical study based on first-hand interview data and a range of documentary material to determine whether and how Taiwanese FDI is more favoured than non-Taiwanese FDI – further, whether the practice actually matches or contradicts the Chinese government's policies and whether China's fostering of economic ties between Taiwan and China is aimed to make Taiwan dependent on China in order to avoid a political confrontation.

Taiwan and China have a very special and delicate political relationship owing to their historical background. The Chinese government says it is practical and preferable to settle its Taiwan 'problem' peacefully rather than militarily. If, in fact, China gives preferential treatment specifically to Taiwanese investment, that would tend to signal that what the Chinese government says about settling its issues with Taiwan peacefully is credible or true – because China could be seen to be acting in ways calculated to promote economic integration with Taiwan, and hence "reduce the likelihood of war or postpone potential conflict".

Later chapters will be examining case studies of Taiwanese enterprises in China and

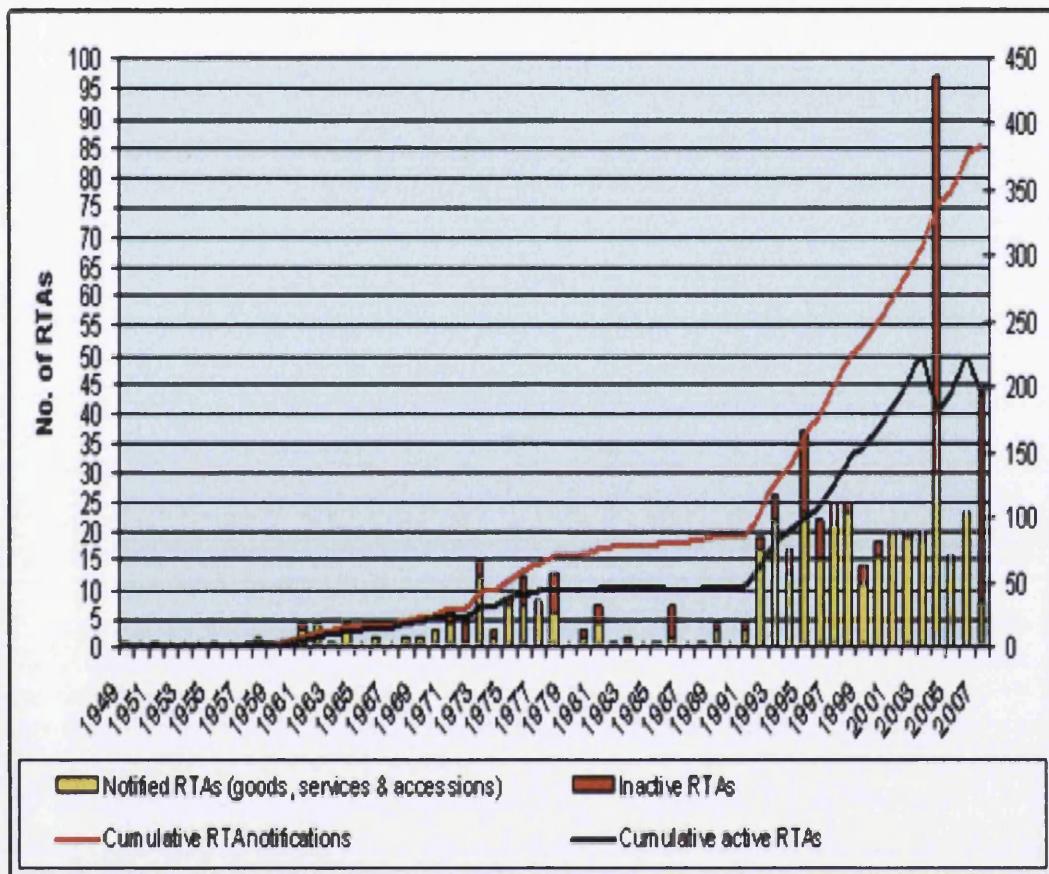
for that purpose, the researcher will examine the broad objective of economic integration, seen by nations as essential to successful working relationships. It is no longer sufficient to rely on ad hoc contacts; one needs properly structured arrangements.

In order to improve Sino-Taiwanese economic relationships, the researcher's findings suggest that economic integration is crucial. It can find particular expression at the regional level. Regional economic integration can proceed in various ways such as Preferential Trading Agreements (PTAs), Growth Triangles, Open Regionalism and Sub-national Regionalism. Economic integration is one way of achieving the aim of economic activities to increase profit and welfare (Jovanovic, 1992). Special arrangements between countries or groups of countries enable them to utilize resources more efficiently (Robson, 1987).

Regionalisation follows on the trend to globalisation (Garnaut and Drysdale, 1995:89). Mander (2001) identifies the origin of globalisation as Bretton Woods in 1994, which called for centralisation of the global economic system to facilitate global economic development. The establishment of the World Bank, the IMF, the GATT and similar organisations are related to this. The concept of regionalism

emerged as a consequence of the new climate after World War Two. Table 1.7 shows the growth of numbers of regional trade agreement from 1949 to 2007.

**Figure 1.7 Numbers of Regional Trade Agreement, 1949-2007**



Source: WTO Secretariat: [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm)

“Economic globalisation and regional economic groupings are the current trends and the purpose of regional economic cooperation is to accentuate economic competitiveness for each member country” in Arndt's view (1995:89-91).

Membership of the various formal economic bodies can overlap several regional economic groupings. The following have been created covering China and Taiwan: Preferential trading agreements (PTAs), free trade area, customs union. The region may in time adopt the closer model of a common market<sup>24</sup> and economic union formed in other parts of the world, though Taiwan will need, in the meantime, to overcome the heavy obstacles. This can mean working even closer with other countries through such entities because of China's resistance on the political front and its influence over other countries. (The obstacles are examined later in this chapter.)

**Table 1.8 Types of Economic Integration**

	Preferential trading agreements	Free trade area	Customs Union	Common Market	Economic Union
Removal of	No	Yes	Yes	Yes	Yes

<sup>24</sup> A common market allows member states' production elements such as labour and capital to circulate without restraint; while economic union - by which member states "negotiate the economic policies, including finance, industry, central bank and a common currency and exchange rate. This is the highest level of economic integration" (Guo, 2003: 16). Economic unions possess legislative powers and super-national laws having precedence over the laws of individual countries. Table 6 shows the different forms of economic integration according to their degree. (See Hassan, 2001, Huang and Tu, 1994, and Panagariya, 1994)

<b>tax and quota among countries</b>					
<b>Same custom tax</b>	No	No	Yes	Yes	<b>Yes</b>
<b>Free movement of production elements</b>	No	No	No	Yes	<b>Yes</b>
<b>Coordination of economic policies</b>	No	No	No	No	<b>Yes</b>
<b>United economic policies</b>	No	No	No	No	<b>Yes</b>
<b>Examples</b>	<b>Lome Convention</b>	<b>NAFTA</b>	<b>European Economic Community</b>	<b>Southern Common Market, MERCOSUR</b>	<b>EU</b>

Source: Jovanovic, M.N. (1992:10), *International Economic Integration*, London: Routledge.

#### **1.4.1 Preferential treatment agreement**

Such agreements provide for lower tariffs for countries affected than for non-participating states (Panagariva, 1994). With the rise of world trade, PTAs' importance has increased. Fieleke's statistics (1992) shows there were 23 types of PTAs among 119 countries comprising 82 per cent of world trade.

The aim of PTAs is to give member states concessions, create more trade opportunities and increase business competitiveness by economies of scale. This results also in attracting investment by non-member states. They all exclude non-member states. In fact, by reason of the economies thereby achieved, non-member states are often attracted to invest, despite all PTAs actually excluding those other states from advantages of membership. Any kind of economic integration has three goals: increasing benefits by the rise of income and economic efficiency, strengthening negotiation capability with other countries and facilitating regional political cooperation (Schott, 1991).

**Examples:**

The United States and the European Union have for various reasons given preferential tax treatment to certain regions or countries, such as through the US Caribbean Basin Economic Recovery Act, the Lome Convention (the EU's relationship to the African, Caribbean and Pacific Ocean developing countries) and the EU-ACP economic partnership agreements. China and Taiwan are not covered by these measures. On the other hand, China is given "most favoured nation" status by the United States. But, for politico-economic reasons, this status has not been granted to Taiwan by the US, and indeed opposition to Taiwanese participation has manifested itself, in particular, in the areas of rice import, pharmaceutical products, copyrights and patents, and telecommunications. Dent (2005) refers to American trade diplomats still arguing in 2005 that the Taiwanese legislation enacted in answer to Washington was being weakly enforced.

Nevertheless, the Taiwanese do indirectly benefit from increased export through China. Of interest in this context is the special status given under CEPA (Closer Economic Partnership Arrangement) in 2003 by mainland China to Hong Kong from which again Taiwanese companies indirectly benefit as by way of registration as

Hong-Kong companies.

#### 1.4.2 Free Trade Areas

Free trade areas remove all trade barriers, tariff and non-tariff obstacles to each country. "It is not necessary to establish a new organisation to manage the participating member states. In this regard, the free trade area is supposedly suitable for those states which do not have strong political linkages." (Panagariya: 1994:25)

From Table 1.9, it can be seen that the number of Free Trade Agreements has increased since the 1950s.

**Table 1.9- Recorded regional free trade agreements in terms of region**

	Regional FTA			Cross-continent FTA				Total
	Europe	America	Asia	Europe + Americ a	Europe + Asia	Asia + Amer ica	Europe + Asia + America	
1950	1							
1960	1	1			1			

<b>1970</b>	12	1	3			2		18
<b>1980</b>	2	1	4	1			1	9
<b>1990-</b>	26	4	3					33
<b>1994</b>								
<b>1995-</b>	69	4	1	1				75
<b>1999</b>								
<b>2000-</b>	19	3	8	6	8	8		52
<b>2005</b>								
<b>Total</b>	<b>130</b>	<b>14</b>	<b>19</b>	<b>8</b>	<b>9</b>	<b>8</b>	<b>3</b>	<b>191</b>

Source: Wang W.J. (2002/12) *The latest tendency and development of regional trade agreement, Economic situation and comments*, Vol. 8-3 and Dent C. (2006).

So far, Taiwan has a relatively isolated position vis-à-vis countries wishing to engage with mainland China; the pressure from the latter to refrain from connections which can be viewed as recognizing Taiwan's independence status has led to a lack of success in achieving membership of free trade areas – with the minor exception of certain Latin American countries. This diplomatic oppression from China to the Taiwanese international profile has reduced since 2008, when Taiwanese President

Ma adopted a policy of ‘*Wai-Jiao-Xiu-Bing*,<sup>25</sup> (Cease fire in diplomacy with China), re-adopted the ‘1992 consensus’ and re-engaged in various talks and negotiation with China at multiple levels on issues such as education, trade, politics, transportation and tourism. The nearest Taiwan has come to achieving FTA with her major partner was what can be characterized as the pseudo-FTA of the Taiwan-China Economic Cooperation Framework Agreement in 2010. China, by contrast, has made progress with agreements on a Mainland and Macau Closer Economic Partnership Arrangement of 2003, the 2008 China-New Zealand free trade agreement and an ASEAN-China free trade area in 2010. Taiwan’s FTAs with the Latin American countries noted above were Panama, Guatemala, Nicaragua, Honduras and El Salvador.

#### **1.4.3 Growth Triangles**

“The growth triangle concept was developed by Singapore in cooperation with the Malaysian state of Johor and Indonesia’s Riau Islands.” (Waldron, 1997:2) The concept is a uniquely Asian solution to the strategic and administrative problems of regional cooperation among countries at different stages of economic development

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<sup>25</sup> *Wai-Jiao-Shio-Bing* (in Chinese) is the policy guidance from the president to the Taiwanese Ministry of Foreign Affairs. Please see [http://news.bbc.co.uk/chinese/trad/hi/newsid\\_7610000/newsid\\_7610500/7610557.stm](http://news.bbc.co.uk/chinese/trad/hi/newsid_7610000/newsid_7610500/7610557.stm)

and with different social, economic and political systems (Waldron, 1997:1). Growth triangles more closely associate contiguous areas to achieve complementation and synergism in the allocation of land, labour, capital, technology, management expertise, and essential natural resources, yielding sustainable comparative advantages in export promotion (Heng and Low, 1993:3). By this means, areas with a different level of economic and social development can solve greater strategic questions. A growth triangle has developed as between Taiwan, Hong Kong and the southern Chinese province (Guangdong province).

In addition to the advantages which are common to the various forms of regional economic integration, the growth triangle offers valuable international managerial know-how to those enterprises lacking international management experience in the lesser developed sections of the region (Kivikari: 2001 and Tong: 2005).

Guo (2003:19) points to the influence of two trends: "One is to facilitate regional economic cooperation and the other one is to attract the influx of foreign direct investment." He argues that the tendency to escalation in wages from a high investment growth rate is minimised by growth triangles since they cover areas at different stages of development. Trade barriers are overcome and competitiveness

maintained for export via cooperation.

Moreover, because of the few states involved, they have advantages of greater flexibility in negotiation and operation (Guo, 2003: 19). A further distinguishing feature is that they are export-oriented as opposed to other regional organizations which are more focused on the inter-state market (Table 1.10).

Guo (2003: 20) and Tang (1994) give the following reasons for growth triangles' success. Firstly, "the complementary effect in economy" (Guo, 2003: 20) will be considered. The member states in the Growth Triangles differ in economic development and resources. In the case of the Southern China Growth Triangle, the economic status in Taiwan and Hong Kong is more advanced than that of Chinese provinces of Guangdong and Fujian. As a consequence, the labour-intensive industries are mainly to be found in the latter provinces while Taiwan and Hong Kong are concentrated on capital-intensive and technology-intensive industries. Because the growth triangle is still export-oriented, complementary economy can be obtained via investment from outside the triangle and not necessarily through member areas.

Secondly, "geographic proximity" (Guo, 2003: 20; Tang, 1994) is important. Because

of the proximity of the member states, transportation and communication costs are considerably curtailed. Furthermore, the similarity of languages and culture of the member states can reduce communication obstacles and increase understanding (Inmaculada, 2003).

A third factor is “harmony and cooperation in politics” (Guo, 2003: 20). As Fieleke (1992:12) says, “one of the key elements for the success of growth triangles is support from the governments’ own policies in the process of inter-state negotiation.” The economic growth of Guangdong and Fujian provinces of China in the Southern China growth triangle is underpinned by the Chinese government’s *open-door* policy and establishment of special economic zones. Because of this, those two provinces are capable of having close economic integration and connection with Hong Kong and Taiwan.

Fourthly, “the development of infrastructure” (Guo, 2003: 20) can accommodate the flow of goods, communication between people and further attract investment.

**Table 1.10 Comparison between growth triangles and other regional economic**

### integration

	<b>Growth Triangles</b>	<b>Other Regional Organisations</b>
<b>Degree of integration</b>	<b>Loose</b>	<b>Strict</b>
<b>Market structure</b>	<b>Export oriented</b>	<b>Domestic needs among member states</b>
<b>Openness to non-member states</b>	<b>High</b>	<b>Low</b>

Source: Guo (2003:20) *Taiwanese investment in China under regional economic integration*; Thant M. and others, ed., (1994) *Growth Triangle in Asia: A New Approach to Regional Economic Cooperation*, Hong Kong: Oxford University Press

#### 1.4.4 Open Regionalism:

This concept has not been applied so far in Sino-Taiwanese economic relationships. It was first discussed in the context of the greater Asia Pacific area and it may eventually come into play when there are closer ties between China and Taiwan.

It was initially considered during the 1991 APEC Seoul conference (Bergsten, 1997 and Guo, 2003) and officially adopted in the 1994 Bogor Declaration (Report of the

Eminent Persons Group to APEC Ministers, 1993: 27-28). It can be described as *concerted unilateralism* between multilateralism such as the WTO and bilateralism such as FTA (Hong, 2003).

Unlike other regional integration organizations, open regionalism is against exclusiveness and preferential treatment. It is “a market-driven process rather than one directed by government officials to construct formal free trade areas” (Ravenhill 2001: 141)<sup>26</sup>. It has provided a top-level forum for the discussion of common problems by member nations. It promotes global trade liberalization by cooperation between the government officials and enterprises.

Chang (1998:2-3) gave five examples of open regionalism. 1. “Open membership” - any countries who agree to abide by the regulations set by regional organization are welcome to join. 2. “Unconditional most-favoured-nation treatment” - any member state in this regional organization is treated the same without discrimination. 3. “Conditional most-favoured-nation treatment” - if the non-member states are willing to take the reciprocal measures with the member states, then those non-member states will also enjoy the benefits that member states in the regional organization have. 4.

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<sup>26</sup> Garnaut and Drysdale (1994) highlight four characteristics 1. open and not defensive, 2. recognizing existing disparity in the region, 3. promoting the interaction with a pragmatic attitude, and 4. participating members should not exclude potential members.

“Global liberalization”. 5. “Trade facilitation” - focuses on non-custom duties or tax and is non-territorial. Such fiscal measures are comparatively narrow; nonetheless it is effective in developing trade activities, in the negotiation of the tariffs and the application product and commodity standards.

However, “from a region-divergent bilateralism perspective, it could be argued that FTAs have undermined APEC’s viability by subverting its founding principle of non-discriminatory ‘open regionalism’ and essentially capturing its objectives on trade liberalisation.” (Dent, 2005:120)

#### **1.4.5 Literature on Cross-Strait Regional Economic Integration**

Following the mid-18<sup>th</sup> century industrial revolution in the Western World and with improvement of technology, global trade has expanded massively. There was greater interaction between countries after the emergence of multinational enterprises following World War II. (Guo, 2003) The regional economic integration has made substantial progress since then. “The European Community started the first process of economic integration movement in the 1950s to the 1970s. Following that, a second economic integration, begun in the 1980s, is still developing” (Hong, 2000:209).

In the 1970s, information technology emerged with a considerable impact on industries, and the 1990s saw the start of a boom in the use of the internet. The new era of the knowledge economy had arrived. The knowledge economy is an essential factor in achieving growth. In their pursuit of economic growth, cooperation between countries and companies becomes essential to overcome obstacles and obtain higher benefits. For a company, it can be done via strategic alliance. For a country, it can be achieved by joining a particular organization (such as the WTO) or signing a cooperation agreement. The situation of Taiwan and China reflects this trend.

Regionalism in the world economy is marked by a greater and deeper extent and scope of cooperation (Gao, 1993: 76-77). The European Community initiative was a new concept and its example has been followed by others notably NAFTA and APEC. At the same time, regional economic integration shows the emergence of protectionism, the European Union and NAFTA both making use of regional organizations to protect their interests. Faced with this tendency, countries in Asia started to advocate the idea of free trade areas in order to compete with another two major free trade zones on the globe.

In the case of Taiwan's trade relationship with mainland China, any progress toward integration had to face the background of a long and deep freeze following the Chinese civil war in 1949 which put a stop to any kind of economic or other contact between Taiwan and China. The concept of cooperation in the Asia-Pacific region was first mentioned in 1980 by Ji-Lien Huang who advanced the notion of *Chinese people community* (*Zhong-guo-ren gong-tong-ti* in Chinese). Zhen (1998) felt that Taiwan, China, Hong Kong and Singapore have the capacity to establish a *greater Chinese common market* which is similar to the European common market. A similar idea was mooted by Chen (1998), Gao (1988) and Hsiao (2001) suggesting that the Taiwan-China economic integration model was close to that of a common market. Gen (2001) classifies three stages to economic integration – The Chinese Commonwealth, The Chinese Free Trade Area and The Chinese Union, not reaching finality until after 2027. “Several commentators and government officials such as Ba-Jun Chou in 1989, Zou-Tong Wu in 2000, Hong Kong ex-executive Jien-Hua Tong in 2001 and Chinese ex-prime minister Zon-Ji Ju in 2001 promoted the notion of a free trade area” Guo (2003:27). The integration they advocated prioritises the economic aspect and temporarily excludes the probability of political integration. The model they seek is that of a common market of Taiwan, Hong Kong and China. The free trade area concept was first raised mostly by academia and not adopted by

politicians until after 2000, economic integration having progressed from theoretical analysis to the practical level of implementation.

In view of the fact that Taiwanese investors in China encounter competition from all other foreign investors, it is still uncertain if Taiwanese enterprises can retain advantages over them when having to face difficulties of the political divergence between Taiwan and China. However, by cooperation through application of comparative cost<sup>27</sup>, both Taiwan and China can benefit from economic cooperation.

The 2008 Taiwan Presidential election opened the way for new president Ma to venture to resume talks with his Chinese counterpart with closer economic ties with China. Direct air links, direct shipment and direct post were started and an increase in the quota of Chinese tourists to Taiwan (Now news, 2008/4/18). This has been seen as providing an opportunity for both sides of the Taiwan Strait to improve political relationship through more intense economic interaction and constructive communication (Radio Taiwan International, 2008/03/23).

“The cross-strait economic integration should be guided by the market and consequently will help the different industries to find their best integration models”

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<sup>27</sup> It is also called comparative advantage in Economics. It was first raised in “the Principle of Political Economy and Taxation” by Economist David Ricardo in 1817.

(Chen, 1995:62). The Chinese planned open policy reinforces the economic interaction among China, Hong Kong and Taiwan. In the future, the relationship between these three entities will depend on how China defines the role of Hong Kong (Chou, 1997). As Shu (1997:38) points out, "the volume of trade and increase of direct investment among China, Taiwan and Hong Kong reinforce the process of economic integration. This has provided an impetus for particular areas of industry to join in consideration of their common concerns". The economic integration of these three is a consequence of market, rather than primarily government forces. Further integration depends on Chinese economic development and stability and the consistency of the policies adopted by the Chinese government. Lin (1999) and Guo (2003) believe that the economic integration of Taiwan, Hong Kong and China is part of a trend for regional economic integration throughout the world. With closer and closer cross-strait economic relations, one needs to consider how both parties can intensify cooperation and achieve mutual all-round benefits, including those are political and economic, by comprehensive economic integration.

The first writer referring to the concept of cross Taiwan Strait economic cooperation, following the post-civil war freeze, was Huang, Ji-Lien in 1980. Huang (1980) considered that, in the Asia Pacific region, there would be cooperation between the

socialist and the non-socialist countries. Further, Zhen (1998) felt that Taiwan, China, Hong Kong and Singapore have the capacity to establish a *greater Chinese common market* which is similar to the European common market. A similar idea was mooted by Chen (1998), Gao (1988) and Hsiao (2001), suggesting that the Taiwan-China economic integration model was close to that of a common market. Gen (2001) classifies three stages to economic integration – The Chinese Commonwealth, The Chinese Free Trade Area and The Chinese Union.. “Several commentators and government officials such as Ba-Jun Chou in 1989, Zou-Tong Wu in 2000, Hong Kong ex-executive Jien-Hua Tong in 2001 and Chinese ex-prime minister Zon-Ji Ju in 2001 promoted the notion of a free trade area” Guo (2003:27). The integration they proposed/advocated prioritises the economic aspect and temporarily excludes the probability of political integration.

Some writers have evaluated China-Taiwan economic integration by reference to the European experience of integration. The concept of a *greater Chinese common market* introduces the quasi-European common market of integration among China, Hong Kong, Taiwan and Singapore (Chen: 1998). Lin and Chang (1994:27), in discussing “the potential of a greater Chinese economic circle from the cultural, political and economic spheres based on the European Common Market”, argue that

economic cooperation will markedly increase the welfare of the population. They suggest that initially it is better to embark on cooperation with a preferential custom tax agreement. Wang and Wu (1997), Chiu (1998) and Huang (2000) all indicate the suitability of the European Union experience for cross-strait economic integration.

Taiwanese investors who have long worked in China are strongly affected by the continuous alteration of policies between China and Taiwan. By analyzing the change of cross-strait policies in terms of the policy formative mechanism of Chinese economic and trade policies, Shi (1997) concludes that adaptation of party-state and interaction between the state and the societies is the key to the formation of policies.

Through the framework of historical analysis, Hong (1998) looks at the relative success of Taiwanese investors in Fujian province in two decades between 1979 and 1997. He also looked at the resources, decision-making and output of Taiwanese investors in Fujian province and their impact on the formation of government policies and vice versa.

Cross-strait relations are considered in the context of particular industries. Pong (2000) noted differences of timing for the establishment of Taiwanese companies in various countries in the areas of information technology, textile and shoe manufacturing industries. He analysed 111 investment cases and found that those investors who

made an early move have the competitive advantages of being pioneers. Wei (2001) investigated Taiwanese listed companies investing in China as target groups to test the significance for Taiwanese companies of the timing of their entry, area herding and their management results. He shows that the early herders had advantages in successful business establishment. Cheng (2002) proposed a framework more suitable for investors to enter the Chinese market: It is based on externally uncertain risks (environmental factor), internal capability and *Guanxi* philosophy (interpersonal network factor) and how these factors will influence the degree of control and the management capacity of Taiwanese enterprises when relocating to China.

This literature on the cross-strait Taiwan-China relationship, based on the theory of regional economic integration, mostly focuses on a single economic integration theory as implemented through the free trade area, common market and international operation of various industries (e.g. manufacturing and information technology). Smooth and deep economic cooperation between China, Hong Kong and Taiwan, would make it easier for Taiwanese enterprises in China. Later chapters will explore to what extent Taiwanese investors obtain preferential treatment from Chinese government at the local level compared to other foreign investors. In addition, whether such strong economic cooperation will ultimately lead to harmonious

national political relations will be considered; but one needs to bear in mind the difficulty of making prediction regarding international political development given the inherent fluidity of the relationship.

### **1.5 Economic Interdependence for peace**

Should we expect increasing economic integration to influence the political relationships and prospects for peace and stability between interdependent countries like China and Taiwan? The purpose of this section is to consider whether, within the context of the broader international relations and political economy literature, growing cross-Strait economic integration affects the likelihood of China-Taiwan military confrontation.

Deepening economic ties across the Taiwan Strait are believed by many to be a stabilizing force in China-Taiwan political relations, at least on the margin. The Chinese government does not want tension to spill over into commercial relations with Taiwan because the Chinese economy would be hurt: (Wang, 2000:111-124; Mastel, 2001:45-56; Chen and Chiu, 2001:215-235; Bolt, 2001:80-105; Sutter, 2002:522-540; Clark, 2002:753-766; Zhao, 2005:238; and Kastner, 2006). Wan (2006: 349) states that “Beijing leaders now do see economic ties as a weapon to attract

Taiwan into China's orbit."

"Over the years, Beijing government has sweetened its peace overtures with the many specific proposals and encouraged the acceleration of cross-strait economic exchanges in the hope that increased economic interdependence would help rebuild emotional ties across the Taiwan Strait and undercut popular support for the separatist cause and forestall Taiwan's drift toward formal independence" (Tian, 2006:37). Additionally, on the Taiwan side, the business lobby has been sufficiently powerful to have a marked impact on the resolve of the Taipei government to keep its distance. (For details of the progressive easing of trade restrictions by Taiwan, see Chapter Three.)

On the other hand, Taipei is afraid that cross-strait economic interaction will allow Beijing to use their economic relationship to force Taiwan to submit to its demands. But as Tian (2006) and Hirschman (1945) indicated, state policy can affect private strategy but not determine it. The way Taiwanese investment has developed in China suggests that government efforts to influence business activities and local economy have limited impact. Taipei's restrictions on cross-Strait economic operations have been countered with avoidance tactics from the private sector and the power of Taiwanese business interests has led to the government having to make concessions.

The argument that trade promotes peace has a long history (Benson and Niou, 2007).

Oneal and Russett's recent works have confirmed statistically that trade, along with democracy and international organizations, is correlated with a reduced likelihood of military violence between countries (Oneal and Russett, 1997, 1999 and 2001).

Kastner (2006:320-323) identifies three main reasons that have been advanced for the reduction of probability of military conflict by growing economic ties.<sup>28</sup> The majority of writers assert that economic interdependence promotes interstate peace (Mansfield and Pevehouse, 2000:775-808, Barbieri and Schneider, 1999: 387-404 and McMillan, 1997:33-58).

Two different but related arguments are advanced. The first justification maintains that economic integration results in the establishment of social links and leads to peace (Deutsch, 1968). The second line of argument is that trade partners wish to maximize gains from trade and do not want this benefit to be imperilled by conflict

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<sup>28</sup> First, economic ties can act as a constraint on state leaders/behaviours; the increased costs of military conflict in the presence of economic integration deter countries from settling disputes using military force or engaging in provocative behaviour that might result in military retaliation. Second, economic ties can change the goals that states pursue, so that they are less in conflict with the goals of other countries. As such, the underlying hostilities that are at the root of the military conflict can be reduced as economic integration deepens. Last, economic integration can make it simpler for states to signal their true level of resolve, thereby reducing the dangerous uncertainties that can lead to war in crisis situations. These three causal mechanisms are not mutually exclusive; but, it may be that economic interdependence promotes peace through multiple channels. (Kastner, 2006: 321)

(Benson and Niou, 2007: 36). To put it another way, conflict is a kind of tariff on trade prices. (Polacheck, 1980 and Copeland, 1996: 5-11)

### 1.5.1 Critiques

While one cannot absolutely gauge whether there has been reduced underlying hostility as a result of the process of economic integration, the indications from both nations are not very positive. China and Taiwan have different political and economic aims. Taipei has always wanted to keep its identity and sovereignty. President Ma has tended to voice this policy in a more muted way than that of his predecessors, Lee and Chen. And China, despite their encouragement and assurances to Taiwanese businesses operating in China, will not renounce the use of force as an option to prevent Taiwan from declaring independence. Chinese military expenditure has grown significantly including a large amount on developing the short-range surface-to-surface missile force directly across the Taiwan Strait.<sup>29</sup> Other hostile steps have been taken such as a white paper on the Taiwan issue (reiterating China's One China position and threatening the use of force if Taiwan indefinitely resists negotiations for unification in February 2000) and the Anti-Secession Law in March

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<sup>29</sup> For an in-depth analysis of China's missile development, see Chang-Sheng Lin and Emerson M. S. Niou, "Assessing China's military preparation to deter the US from intervening in the Taiwan Strait conflict," *Mainland China Studies*, November-December 2003.

2005. Cross-strait trade has boomed but, despite a certain easing of tension since the accession of President Ma in 2008, Taiwanese sceptical political attitude has remained and one can question whether trade has, in this case, necessarily promoted peace. If cross-strait trade should promote peace, then why is the prospect for peace no more guaranteed today in the midst of booming cross-strait commerce, than it did twenty years ago when trade between Taiwan and China was minimal?

Tian (2006:39) notes the effects of democratization in Taiwan and the establishment of a large number of firms in China, both of which are felt in Taiwan's domestic politics and its aspirations for state sovereignty. 26 per cent of respondents to a 1992 poll considered themselves "Chinese", 17 per cent "Taiwanese," and 45 per cent answered "both Chinese and Taiwanese." By 2010, those answering "Chinese" had dropped to 3.7 per cent, while those answering "Taiwanese" had risen to 52.6 per cent, exceeding those answering "both" (39.9 per cent).<sup>30</sup> There has been growing support among the public for government efforts to assert Taiwan's autonomy and demand international recognition. Economic uncertainty, fear of the negative effect of investment on the mainland on domestic industry, and rising unemployment have provided support for increased Taiwanese government restrictions and regulations

<sup>30</sup> See "Change in the Taiwanese/Chinese identity of Taiwanese as tracked in Survey by the Election Study Center," National Chengchi University, Taiwan, available at <http://esc.nccu.edu.tw/eng/data/data03-2.htm>.

over investment in the mainland. (Chen and Zhu, 1997:53)

Chu (2004) sees little evidence of economic integration influencing Taiwan public opinion decisively to accept unification. As against this, he notes that growing economic integration and the changed image of China as a vibrant economy affecting Taiwan's future, has a counter-balancing effect. Even though the increasing percentage of Taiwan citizens self-identifying as exclusively 'Taiwanese' has increased, most of them continue to oppose the adoption of policies that might trigger war with China. (Niou, 2004)

Based on the insights offered by Hirschman, Morrow, and Gartzke, Li and Boehmer, Benson and Niou (2007:51-52) have developed a comprehensive model of economic interdependence, dependence, and peace, with reference to the case of China and Taiwan. In their view, it is not possible to draw a total link between economic interdependence and conflict, the situation at any given time being complex. Interdependence provides great room for countries to bluff and counter-bluff and to use reputations, often not wholly deserved, to mask their true intents. Where interdependence exists, politics-first states can develop reputations for being economics-first through strengthening economic linkages, bluffing their opponents to

obtain trade concessions, to their economic as well as political advantage.

Gartzke, Li, and Boehmer (2001) point to possibilities of bluff being of lesser importance where in fact there is no interdependence, parties being able to read each other's hand more accurately. Misperception and false assumptions can lead to conflict and restriction of economic ties can reduce the risk, but no such signal exists for a state to call the bluff of a politics-first state trading so as to convince its opponent that it is economics-first and to induce dependence.

### **1.6 Conclusion**

As Chu (1999: 164) says, cross-strait relations represent a “perplexing duality characterized by the concurrent processes of economic convergence and political divergence.” Such dichotomous tendencies have intensified since Chu made this comment. Despite many predicaments which would face Taiwan should re-negotiation of sovereignty issues proceed, it is in both Taiwan’s and China’s interests to make efforts to remove the existing unfair trade obstacles and consolidate existing agreements thus guaranteeing Taiwanese investment in China. Taiwan’s China policy with regard to the cross-strait relations continues to be maintenance of

peace and stability, refraining from provocation. It remains confident with the relationship, and despite political differences, Taiwan has made every possible endeavour to resume dialogue with China, and manage in one way or another to develop rules of engagement to ensure stability. In the final analysis, the decision-making process is highly dependent on politics.

Both sides had a limited dialogue on the so-called functional issues in the 1990s but they did not have a real opportunity to jointly develop a framework and a set of rules governing cross-strait trade and investment between Taiwan and China, until the ECFA of 2010. In the last decades, international trade has responded to the forces of globalization by encouraging the establishment of bilateral and multilateral free trade agreements and the WTO has been seen as having an increasingly important role in furthering the process of globalization and liberalization of trade. Members of the WTO and their officials have, as in other multi-state organs such as the European Union up to the United Nations' various agencies, developed a common understanding and methods of communication and negotiation. As Tsai (2002) points out, this has led to a smoothing of trade relations among the WTO members which was previously lacking between Taiwan and China. She also notes the advantages which Taiwanese negotiators have gained by access to the international forums by

greater understanding of the methods of communicating, a process which would be more marked should access to the WTO gained. This organisation has a culture and language of its own. The contexts which Taiwanese and Chinese trade officials have had over the past 10 years have enabled them to interact with other members on numerous occasions, and they have absorbed the culture and language of the WTO. The WTO, for many, symbolised a mission to increase trade liberalisation and, therefore, access to the WTO would make for a greater mutual understanding based on the climate prevailing in these organisations.

The momentum for more formalised trade and investment contacts resulted in a clearer framework and a set of rules in the ECFA of 2010. This agreement, taken with China's quest for development of its economy, has provided for improved cross-strait economic relations. The question is whether the Chinese state's stance in this regard is reflected in actual practice at the local government levels.

With the historical and current background of Sino-Taiwan relationship, one can appreciate the importance of this thesis research questions and its objectives. This chapter helps in a comprehension of Chinese local government officials' attitudes, government-business interaction between the Taiwanese investors and Chinese local

officials, and preferential treatment accorded by Chinese government. Following chapters will further examine the literature regarding Chinese preferential policies, factors affecting Chinese government's attitudes relating to FDI and the difficulties, challenges and opportunities Taiwanese companies have encountered in their involvement with Chinese local government and the Taiwanese government. It aims to provide an understanding of the factors impacting on business practices and also to present suggestions for improvement of interaction by potential Taiwanese investors with relevant authorities, as contacts between the cross-strait partners progress.



## CHAPTER TWO

**Conceptual and Analytical Framework (1)**

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**2.0 Introduction**

“Business engagement in China is constantly affected by the country’s complexity, the cultural imperatives that intersect with doing business and the blurring of boundaries that are usually separate domains in the West – between the public and private sector, between the commercial and the personal, and between economic and societal considerations.” (Sutter, Armitage, Cheng and Memari, 2009:5)

China underwent a cultural revolution from 1960s to 1970s after centuries of Confucianism as the dominant philosophy. It experienced a radical transformation from the extremes of Communism under Mao to that of a country with ever greater contacts with the world. Many of the ingrained traditions of imperial China persisted, including the cultural traditions of personal ties and connections. The importance of such connections is felt at all levels of society from family to business and politics: expectations of favours given and received and even bribery and corruption continue to permeate society, despite advances in the modernisation of China. This chapter and later chapters examine these contradictions and their impact on the conduct of business by foreign investors, in particular Taiwanese.

Chinese domestic factors strongly affect all economic activities in China whatever their source. In relation to this, Section 2.2 explains the delicate relations between the Chinese government and the Communist Party of China (always difficult to separate) and the foreign investors. Section 2.3 describes the Chinese political structure so that one can understand how issues are steered through the hierarchical levels. Section 2.4 discusses the

characteristics of the Chinese legal system; namely, uncertainty, enforceability, dispute resolution and preferential treatment. Finally, at the end of the chapter, it is concluded that these Chinese socio-legal-political elements need to be noted in making any foreign investment decision, as they are parts of the foreign investment business package. This all helps in understanding the interaction between the Chinese government and foreign investors as described in the later chapters.

This literature review is divided into two sections: Chapter Two will examine the Chinese bureaucratic, governmental and legal situation in general. This is to illustrate the background apparatus in China which deeply affects all investment there, especially those from overseas. Chapter Three will investigate the impact of Chinese and Taiwanese governments' policies, regulations and negotiations on Taiwanese business practice and investment in the mainland in the last two decades.

In 2005, the American Business Association of China conducted a '2005 Business Survey' from 450 respondents from its Beijing and Shanghai branches. Table 2.1 shows the elements which the respondents thought were the biggest challenges to conducting business in China. Only the first element is not directly related to the government. All elements show an improvement in the position compared with the financial year, 2004 to 2005, except for the effect of local protectionism which showed a worsening in 2005. Based on a case study of Australian enterprises in China, Sutter, Armitage, Cheng and Mermari (2009:2-3) demonstrate that culture, relationships and government stand out as three factors impacting on the business environment in China. In the case of Taiwanese businessmen, government and legal-related activities are their biggest concerns as well as the cost of labour and land according to Straits Business Monthly (2009, Jan-July).

**Table 2.1 - 2005 Biggest Business Challenge in China**

		Change	
		2004	2005
1	Managerial Talents	+	+
2	Bureaucratic system	+	+
3	Unclear law and regulations	+	+
4	Lack of transparency	+	+
5	Interpretation of laws	+	+
6	Corruption	+	+
7	Fulfillment of contracts & agreements	+	+
8	Local protectionism	+	-

(+ = improving ; - = worse)

Source: Fernandez J. and Underwood, L. (2006: 254), *China CEO: Voices of Experience from 20 International Business Leaders*, Translated by Hung, H.F, John Wiley & Sons (Asia) Ltd

One big problem and concern for investors in China lies in the way laws are enacted and government policies are implemented, the laws being subject to change in the way they are interpreted and given effect. People may think they understand the intent of a law but they cannot be sure exactly how it will be interpreted locally or nationally at any point in time because of ambiguities in the law itself. In other words, local and national policies may not necessarily be congruent with the written laws.

Although local officials exercise power within their provinces, they are also nervous about the consequences of their actions or non-actions because of the sanctions that they may be

subject to for mistakes. They are subject to scrutiny both by higher levels within their own departmental hierarchy or by others in other departments at the same level so that they feel a need to refer questions both upwards and sideways/horizontally to cover themselves.

At the higher levels of government, where laws and policies are usually decided, change has to go through cumbersome and convoluted channels and procedures. So change is a slow and uphill struggle. Secondly, behind the scenes, the application of law and policy may be different from what people expect or perceive. That is, what people are told is happening may not be the reality. In addition, conflict particularly occurs between the national and local administrations. The example is shown in the case of Carrefour exemplified by Fernandaz and Underwood (2007: 260-261).

So far, the authorities in China can be both unpredictable and arbitrary. First, there is prejudice against foreign companies where their interests are perceived to be at odds with those of the regional provinces. Secondly, when it comes to the bidding for contracts, regional government may bend the rules to favour Chinese local firms. Thirdly, regional government may bend the rules to favour foreign companies that have better connections (witness the case of Carrefour reported by Fernandez and Underwood (2007:260-261) and it is explained in Chapter Five).

As a significant feature in Asian business life, connections are all important in executing and facilitating trade and investment. Asia is one of the areas where extensive informal contacts and relationships must be cultivated. Added to these challenges to doing business on the mainland has come the logical move towards closer economic relations between Taiwan and the mainland. The slow and problematic progress towards greater and broader mutual

economic activity is documented later in this chapter. Much hope for China's continued development as well as its trade relationships with other countries now depends on the way China adapts to the rules of the WTO (the World Trade Organisation).

The researcher found in interviewing a Taiwanese investor, Mr Tong-Ching Chiu<sup>1</sup>, and a British investor, Mr John Hunter<sup>2</sup>, that both shared the same attitudes on the best methods of operation for foreign companies in China despite their different backgrounds. They felt that much rested on finding the right Chinese partner for co-ventures, with (whom there was) mutual trust, respect and values, to cope with the difficulties of unpredictable governance and law and party interference.

## **2.1 Government – Business Relations**

Since 1978 devolution has focused on economic decentralization from central to local government (Shirk, 1993), with extensive power in managing FDI and trade, and in control of land use. As a result, such land use rights became saleable after the 1988 Constitution Amendment (Yeh and Wu, 1999; Zhang and Zou, 1994). Chien (2010:69) sees this as part of a process of “asymmetric decentralization” in the way China operates: viz., “economic decentralisation to the local” along with “political centralisation under the party”.

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<sup>1</sup> The interview was on August 1st 2008 in Kaohsiung, Taiwan

<sup>2</sup> The interview took place on April 28th 2010 in Swansea, UK

“The mechanism behind asymmetric decentralization is upward accountability - the greater the economic growth, the better chances there are for local leaders to receive political promotions, administrative power and many tangible and intangible perks.”

Chien (2010:69)

It has to be borne in mind that local government leaders in China are not elected but appointed by higher government levels, with upward accountability. These appointments depend on the appointees' performance relative to the economic goals set - careers depend on the economic growth rate achieved. With retention of central government's control of overall policy, there is an advantage of stability in the planning process. On the other hand, the culture of careerism in local officials has the disadvantages of misuse of power since there is not the opportunity to challenge the way this power is exercised as there would be in a fully decentralised system of government (Chien, 2010).

In contrast, Taiwan has a similar business environment to that of western democracies. Within Taiwan, local businesses can rely on predictable governance and recognised rule of law with a relatively independent civil service and judiciary and low level of corruption. Taiwanese businesses experience the same frustration and anxiety as other external investors dealing with the unpredictability and party-boss corruption common in mainland China. (Hsing, 1997)

In 1978, the previous Chinese Communist Party Chairman Deng Xiaoping described the Chinese economic system as ‘socialism with Chinese characteristics’. China these days characterises its economy as being a ‘socialist market economy’ whose economic system incorporates the Chinese market into a centrally planned economy. The Chinese economy is

in fact power-related and Chinese society is ruled according to government-set official standards; the Chinese legal system operates as “rule by law under the authority”<sup>3</sup> i.e. rule of man. In the event that an economic policy is adjusted, foreign invested projects with marvellous prospects may be terminated easily. Therefore, it can be concluded that, in the current situation, the biggest risk for foreign investment in China does not purely lie in law itself but also in power” (Li, 2007). The Communist Party is the true owner of power as it is the sole governing party. Lubman (1995) and Dicks (1996) support this argument. In Lubman’s (1995: 5-6) article, he considers that “law is still frequently conceived ...as a tool of state administration and always within close reach of the Chinese Communist Party” and “the role of CPC officials influences the outcome of individual cases at all levels of the courts”. Dicks (1996:2) states that the CPC is the main influential power over foreign investment and further argues that “the most important enclave within Chinese society that is clearly outside the jurisdiction of the people’s courts is the Chinese Communist Party “though the Constitution indicates that no individual, political parties and organisations are beyond the Constitution or the law”. Another point to be noted is that there is no coherent body of laws and regulations between the central and local governments as Amber, Witzel and Xi (2009:100) argue that “central and local governments clearly played a key role in the

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<sup>3</sup> Wang Chenguang (1997: 27-8) has felt that there are eight key theoretical or jurisprudential issues in contemporary Chinese law, namely (a) the choice between the old ‘rule of man’ as opposed to the newly advocated ‘rule of law’; (b) the conflict between rule of the party leadership and the supremacy of law; (c) the basing of the legal system upon a market economy; (d) the change in the nature of law from being a mere tool in the class struggle to the idea that law should reflect the will of all the people; (e) the division of law into public and private spheres in a society where private interests such as private property had previously been prohibited; (f) the alleged implementation of the ‘rule of law’ in non-democratic China when all previous societies that operated under that rule were democracies; (g) the implementation of the spirit of modern law with its associated notions of individual freedoms, freedom of contract, efficacy and humanity and (h) the transplantation of the legal infrastructure associated with a modern market economy on a society, political structure, and economy that have not, until recently, followed the legal or economic systems of a late capitalist, constitutional, liberal democratic society.

economy, but there was no coherent body of laws and regulations... businesses turned to building personal relationships with key government officials as a substitute."

The way power is exercised in China has clear practical implications, creating downside risks both for foreign investors and for China's own prosperity. "Since the central committee of the Communist party of China allowed privately-owned companies with three CPC member employees to establish party branches since 2002, more than 85% of them currently have branches of the Communist Party of China, which underlines the growing convergence of interests between China's private sector and its communist rulers." (Li, 2007) To participate in Chinese markets, investors must keep on the right side of authorities who may control the supply of necessary resources for enterprises. They also need the protection of authorities to minimise legal risks. The following examples illustrate the delicate nature of this government-business relationship for investors.

Geoff Dyer (2008) writes that in Wenzhou (Yangtze River Delta), the Communist Party, in an effort to maintain its power amid a growing private sector, boosted its presence in local businesses. According to state media, 3400 party cells were formed in Wenzhou businesses in 2007. Party cells are the basic units of the Chinese Communist Party in China. In Wenzhou, this had led to an odd courtship over the last decade: companies looking for official patrons and the Communist party, nervous about the creation of a new power base, seeking to penetrate the private sector.

Together with benefits come significant risks. Foreign investors should be wary of getting too intimate with the existing political power structure due to its changeable nature, as illustrated by unfortunate consequences experienced by privately-owned Chinese and foreign businesses.

The case of the ex-Shanghai mayor and CPC Shanghai Committee Secretary Chen Liangyu attests to this danger. He was known to be close to former Chinese president Jiang Zemin and a rival and threat to current president Hu Jintao's administration. When Hu came to power, Chen was dismissed in 2006 for corruption, financial fraud, abuse of power and bribery. (Areddy, Wall Street Journal, 2005) The researcher found from his own inquiry in Shanghai, that several foreign investors and Chinese domestic entrepreneurs with a connection to Mr. Chen were disadvantaged when they lost their patronage from him and his political alliance.

‘The rule of man’ carries risks not only for foreign investors but also for China’s future prosperity. Dyer also cites MIT Professor Yasheng Huang’s statement in his 2008 book *Capitalism with Chinese Characteristics* that the Wenzhou example discussed above is part of a larger trend among some in the Communist party to stem entrepreneurship since they viewed it as a threat to the party’s power.

Huang argues that by imposing more control over the private sector and withholding funding to private companies, the state risks a decline in productivity, and subsequently could harm growth in the future. He warns that China today is an “oligarchic version of state-led capitalism” (Dyer 2008:1) which could eventually be plagued by systemic corruption and overly dominating political power from the state. The impact of this characteristic on relationships between foreign investors and local governments will be considered in later chapters

“China has not seen a gradual transition from state control to capitalism over the last three decades. Instead, the real boom in entrepreneurship came in the 1980s when controls in rural areas were relaxed. But since the 1990s, the state has reasserted more control over the nascent

private sector and focused more on government-led urban investment. By starving private companies of funding, Huang argues, China is risking a decline in its productivity that will damage future growth." (Dyer, 2008:1)

In a world where state officials allocating capital followed the adage "No one ever got fired for hiring IBM", it is doubtful whether new entrants to the market would have been able to grow and succeed in the same way as Microsoft did in the 1980s and the 1990s and Google in the 2000s. In Huang's view (2003), "the Chinese economic system today could become crony capitalism built on systemic corruption and raw political power." The reality for a dynamic company is that it will need to be subservient to Chinese political culture in order to succeed.

The danger is well exemplified in the following case: Huang (2009) states that Shanghai favours multinational corporations at the expense of China-based and small- and medium sized-businesses. He points out that this bias towards multinational corporations, in an effort to become a high-tech beacon, actually hurts Shanghai's efforts as large companies are less likely to take risks and smaller companies actually spur more innovation. He argues that to support entrepreneurship, the city needs to focus on cutting government interference, ending bias in financing and regulatory treatment of businesses, reducing corruption and boosting transparency.

Huang points to the core of the problem in the Shanghai system as lying in its bias in favour of some companies while discriminating against others. It tends to shun domestic, small- and medium-sized businesses while courting multinational corporations.

“The aim of the city is to vault itself into a high-tech state overnight, but this is built on the erroneous notion that large companies are sources of technology and innovation, Large companies are risk-averse and it is the vibrancy of smaller groups that keeps the large companies on their mettle – sometimes by destroying the most lethargic and sometimes by forcing large companies to acquire smaller ones as a way of upgrading their technology. To foster entrepreneurship, Shanghai needs to go back to the basics of reducing government intervention, removing bias in its licensing, financing and regulatory treatment of business, and then moving to improve its regulatory quality, curb corruption and increase transparency.” (Huang, 2009: 5)

Taiwanese entrants to Shanghai Commerce and industrial development come from a wide range of companies, both big and small, and they need to be aware of the approach of Shanghai authorities in their dealings. While the larger companies have so far been favoured, the smaller ones need to use their drives to overcome the prevalent obstacles and foster any improvement in local attitudes.

### **2.3 Political Structure**

A brief look at the structure of Chinese political system is necessary in order to understand the complex relation within that structure. It is argued that in Western capitalist societies, politics affects law and the way it operates and this also reflects in the Chinese society.

The complex relationship and differences in commercial and political life in China are reflected not just informally but in the organisation of the Chinese party state. Constitutionally it recognises the leadership role of only one political party – the Communist

Party. Civil society outside the control of the party is not permitted. In fact, there are other political parties<sup>4</sup> in China but in reality, since they are all under the leadership of the Communist Party of China (the CPC), they have no power or influence. Wang (2000: 14) points out that “The CPC claims this political system (‘multi-party cooperation and political consultation under the leadership of the CPC’) as China’s basic political system”. In the local level such as county and municipal governments, the mayor and the CPC party secretary are the highest two pillars in the local government. The mayor acts as the day-to-day head of the region in economic and social affairs whereas the party secretary has slightly higher political authority over the mayor. (Hsing, 1997: 146) This governmental structure in the local government affects the dynamics of government/business relationship for the FDIs, which will be examined in detail in later chapters.

To understand the current legal system of the PRC, described in the latter part of this chapter, one needs to appreciate that China operates as part of a five-tiered governmental structure including, in a top-down manner, the (1) central, (2) provincial, (3) municipal, (4) county and (5) village levels<sup>5</sup> (Wang, 2000). See Table 2.2

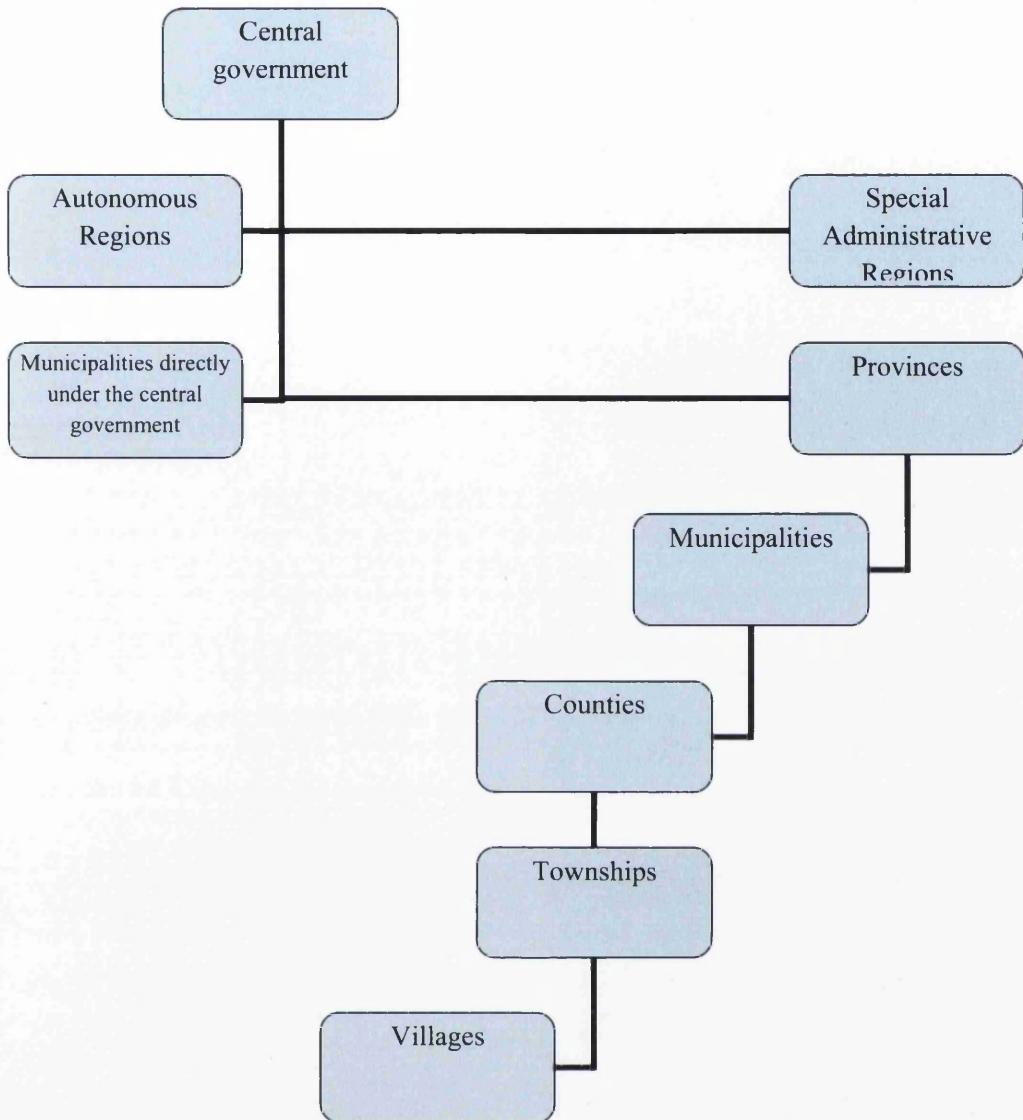
Lo and Tian (2005: 6-7) suggested that in China, there are five constituents in state power (see Table 2.1.4.2). Since China is a one-party system, all political power resides with the

<sup>4</sup> There are eight other parties in China including the Revolutionary Committee of the Kuomintang; China Democratic League; China Democratic National Construction Association; China Association for Promoting Democracy; China Peasants and Workers’ Democratic Party; China Zhi Gong Dang; Jiu San Society and Taiwan Democratic Self-Government League.

<sup>5</sup> There are 23 provinces, five autonomous regions (Xinjiang, Tibet, Inner Mongolia, Guangxi and Ningxia), four municipalities directly under the central government (Beijing, Tianjin, Shanghai and Chongqing), and two Special Administrative Regions (Hong Kong and Macao).

Communist Party. Legislative power is encapsulated within the People's Congress. The State Council and its ministries and commissions possess executive power. Judicial power is controlled by the People's Courts. Procuratorial power lies with the people's procuratorates. The following tables illustrate the complexity of the bureaucratic apparatus through various organs, of which other countries and companies negotiating or operating in China need to be aware in their dealings. This can explain the tortuous way business negotiation proceeds and later chapters will show that this fundamental attitude colours Chinese-foreign business relationships and interaction among the Chinese governmental departments.

**Table 2.2 Administrative hierarchy**

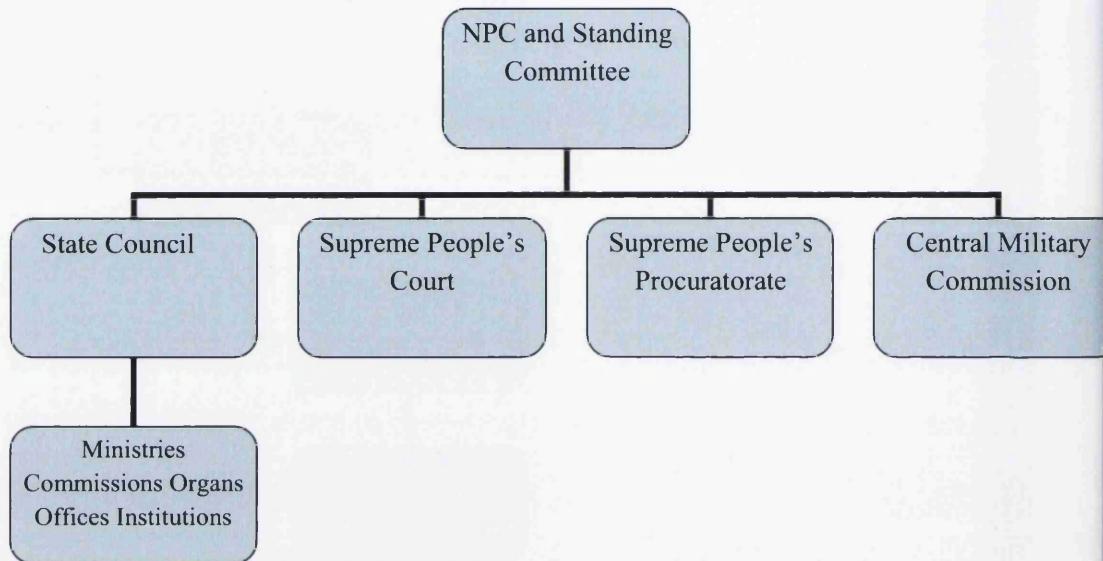


Source: Adapted from: Lo and Tian (2005:7)

Further, at the central level of the PRC, the National People's Congress (NPC) has the highest power. The State Council, Supreme People's Court, Supreme People's Procuratorate, and the Central Military Commission answer to the NPC. Under the State Council are ministries, commissions, organs, offices, and institutions. There is debate over whether China practises separation of power because different governmental agencies hold different types of power and perform different functions. One can argue that China does not,

because the NPC has the ultimate power and oversees the State Council, Supreme People's Court, and Supreme People's Procuratorate. Also, interpreting laws comes under the jurisdiction of the NPC Standing Committee. The following Table 2.3 explains the connection.

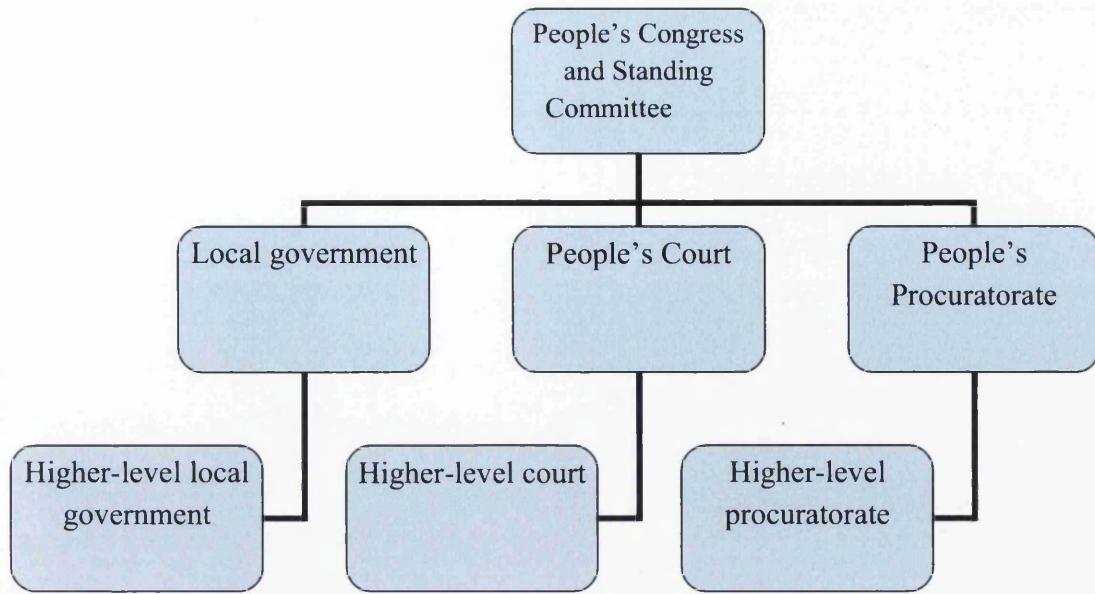
**Table 2.3 Central level of Chinese government**



*Source: Adapted from: Lo and Tian (2005:8)*

At the local levels of province, municipality, county, township, and village, the preceding structure is replicated as shown in Table 2.4. For example, a municipal government is accountable to the provincial government, and a people's procuratorate at the municipal level is accountable to a procuratorate at the provincial level.

**Table 2.4 Local level of Chinese government**



Source: Adapted from: Lo and Tian (2005:8)

Table 2.5 summarises the relationships between the various hierarchical political, legislative, governmental, administrative, judicial and prosecutorial structures and institutions of the PRC according to the basic five levels.

**Table 2.5 Structures and Institutions in the PRC**

Geographic Level	Political Institution	Legislative Institution	Government or Administrative Institution	Judicial Body	Prosecutorial Body
Central	Central CPC Congress	NPC and its Standing Committee	State Council: Premier, Ministries and Commissions	Supreme People's Court	Supreme People's Procuratorate
Provincial	Provincial CPC Congress	Provincial People's Congress	Provincial Government: Governor and Committee	Higher People's Court	Higher People's Procuratorate
	Municipal CPC	Municipal People's	Municipal Government:	Intermediate People's	Intermediate People's

Municipal	Congress	Congress	Mayor and Bureaus	Court	Procuratorate
County	Grass roots CPC branches			Basic People's Court	Basic People's Procuratorate
Village	Grass roots CPC branches			Basic People's Court	Basic People's Procuratorate
<b>Abbreviations:</b> CPC = Chinese Communist Party ; NPC = National People's Congress					
<i>Adopted from Wang (2000:14)</i>					

## 2.4 Current Chinese legal system

“Over the past quarter century, the PRC has been engaged in the most concerted program of legal construction in world history.” (William Alford, testimony before the US Congressional-Executive Commission on the PRC, 2002)

The change of Chinese legal construction has changed significantly since Deng Xiao-Ping's *open-door* policy until the present day. The legal framework for foreign investment in China consists of laws, regulations, measures and policies of both the national and local governments. In addition, a few national laws which have been passed for other purposes are sometimes relevant to foreign investment. This framework can be divided into the following four groups of laws, regulations and policies are the basis legal framework of China:

- (a) the national laws on foreign investment such as the Chinese Constitution (Article 18), the *Sino-Foreign Joint Equity Ventures Law*, the *Sino-Foreign Joint Co-operative Ventures Laws*, the *Solely Foreign-Invested Enterprises Law*, The Company Law, Income Tax Law for Foreign-invested Enterprise and Foreign-Registered Enterprises, and other laws concerning foreign investment;

- (b) the State Council Regulations and departmental rules on foreign investment, such as the Detailed Rules for the Implementation of the Sino-Foreign Joint Equity Ventures Law, the Detailed Rules for the Implementation of the Sino-Foreign Joint Co-operative Ventures Law, the Detailed Rules for the Implementation of the Solely Foreign -owned Enterprises Law, the Detailed Rules for the Implementation of the Income Tax Law for Foreign-Invested Enterprises and Foreign-Registered Enterprises, the Administrative Rules for Foreign Currency Control, the State Council Measures on Encouragement of Foreign Investment, the State Council Decisions relating to Special Economic Zones (SEZs), Open Coastal Cities and other special economic areas, the State Council Regulations for the Registration of China's legal Persons, and the Implementing Rules for the State Council Regulations for the Registration and Administration of Foreign Representative Office, etc;
- (c) the local laws and regulations on foreign investment; and
- (d) the foreign investment policies of both national and local governments. (Mo, 1997: 275-276)

These laws also apply to Taiwanese businesses and other foreign businesses investing in China. Furthermore, in 1988, the State Council of the PRC issued *the Regulations for Encouraging Investment by Taiwan Compatriots (Guowuyuan Guanyu Guli Taiwan Tongbau Touzhi De Quiding* in Chinese and please see Appendix 2.A. for full texts). Ruen (2006) thinks this law has attracted Taiwanese investment to China, strengthened the economic ties between Taiwan and China and subtly promotes reunification. In March 1994, the Standing Committee of the NPC adopted *the Law on the Protection of Investment by Taiwan Compatriots (Zhonghua Renmin Gongheguo Taiwan Tongbau Touzhi Bauhu Fa* in Chinese). This law of 1994 has established the CPC's policy on Taiwanese investment in China. In addition, special directives have been applied to Taiwanese investment. In 1999, *the Detailed Rules for the Implementation of the Law on the Protection of Investment by Taiwan Compatriots (Zhonghua Renmin Gongheguo Taiwan Tongbau Touzhi Bauhu Fa Shishe Shize* in Chinese) was formulated by the State Council, protecting all legitimate rights and interests of Taiwanese investors. Hickey (2009:38-40) argues that "the soft gets softer" and Beijing

government has softened its rhetoric and now uses economic and cultural instruments to promote ties with Taiwan.

In terms of local laws on foreign investment, as Mo (1997: 298) suggests, “local laws on foreign investment form a significant part of the legal framework for foreign investment in China. Local governments have considerable authority in approving foreign investment proposals and extensive powers in making local laws, regulations and policies on foreign investment.” The researcher had confirmation of this from the respondent Ms. Gao (2008). The Constitution allows local government to make laws, regulations and policies on foreign investment as long as they do not violate those laws, regulations and policies which are made by a higher level of government.

As Huang (2003:1) notes that:

“there is a dualist legal regime in China in that different bodies of laws and regulations apply to foreign-invested enterprises (FIEs) from those that apply to domestic firms. In general, the legal and regulatory treatments of FIEs are superior to those that pertain to domestic firms, especially domestic private firms. The dualist nature of China's legal regime is designed to insulate the economy from full effects of foreign direct investment (FDI) as well as to protect socialism”.

The Chinese central government has been giving more authority to local authorities in the sphere of economic matters. Wang (2000: 207) points out that “local government cannot afford to rely solely on the Central Government for its revenue. While local government has become more responsible for its own budget and tax revenue, it has also been given more autonomy to handle various affairs within its own jurisdiction.” In the case of the Action Plan for IPR (Intellectual Property Rights) Protection and Enforcement, Wang states that local

governments often do not support the work of the supervisors from the Central Government and sometimes assist local counterfeiters by letting them hide their production lines in safer places during the investigation period and resume their production once the IPR supervisors have left. However, Mo (1997) mentions that a FDI company may obtain better access than a local company to funding, markets, benefits, privileges, concessions relating to the use of land, facilities and infrastructure and also the advantage of reduced or exempted local tax or local levies. However, it depends on the type of industry and the nature of the investment. Mo (1997:299) declares that it is possible that “a deal can be made locally even though the national law appears to be disapprove (sic) of such a deal”. Local government is often in the balance of local protectionism and foreign direct investment benefit. This also triggers the research question whether local government do carry out Chinese central government or CPC’s policies and orders to provide easier access for Taiwanese investors.

This chapter only discusses the laws which are most relevant to foreign (including Taiwanese) investment in China. The following section will discuss the key characteristics of the Chinese legal system which affect investments in China.

#### **Uncertainty, enforceability and dispute resolution:**

As Ambler, Witzel and Xi (2009:117) noted,

“Starting with virtually no laws, after three decades of legal reform, China now is seen by some as having too many laws or perhaps too much law that has not been properly refined and worked through. The real problem is that these laws are not always consistent and coherent. This problem needs to be understood in light of a key feature of Chinese law-making: excessive generality and vagueness.”

In the event of a dispute, compliance by the local government with central government policy is, in countries such as in the West, Japan and the USA, ultimately enforceable by the courts. But, there are a number of reasons why this is more problematic in China.

First, politics is never absent from legal determination or decision: ‘the Party’s Working Committees of Politics and Law’, which operates at various levels of the court system and reviews cases before they come to formal trial (Wang, 1997). In other words, the courts are prejudicially influenced by a system which allows the Party’s Working Committees of Politics and Law to comment on cases before trial. Second, Chinese courts, in general, do not act as purely independent dispute resolution mechanisms: “separation of powers” as commonly understood in Western jurisdictions is qualified (Wang, 2000). Further, as Lubman (1999: 217) points out a Chinese legal institution such as the People’s Mediation Committee “departs widely from pre-reform assumptions about how the Party-state should address social conflict, but they also bear weighty legacies of pre-reform organization and habits of thought.” Third, China’s is a civil law rather than a common law system and therefore there is less certainty about what can be expected to result from a developed doctrine of legal precedent. The closest approximation to the doctrine in China is the issuing of authoritative interpretations of unclear or disputed legislation. This relative absence of legal certainty makes recourse to judicial resolution of disputes between business and governments at all levels much more problematic and uncertain. The uncertainty is compounded by the divided loyalties that run through the heart of the court system. Judges and their staff are formally responsible to the central government and courts are responsible to people’s congresses through defined hierarchical structures: however, salaries of all court service employees at local level are paid by local authorities and, in many cases, local judges

act in the interests of local authorities. Local protectionism influences judges, as Wang (1997: 25) states, “very often judgements are entered under pressure from local governments to bend justice for local interests or economy.” Lubman (1999: 265) also comments that “when local courts deal with legal problems arising out of reform, local officials can use the absence of a strong legal system to their advantage... Patron-client relations directly affect the application of legal rules and shape the strategies adopted by economic actors to protect themselves.”

There is a relaxed approach by the Chinese in maintaining consistency in the application of rules and regulations at different administrative levels. Potter (1996: 174) noted:

“China’s complex policy-making environment – at once revealing the diverse effects of bureaucratic processes, personalities and clientelism, bargaining dynamics and other factors – combined with continuing changes in the domestic and world economies, has made policy and regulatory consistency difficult to achieve. China’s foreign investment regime is as much a product of incremental and ad hoc responses to challenges as it is an expression of coherent doctrine. This poses particular problems for the state’s capacity to manage foreign investment in pursuit of national development goals”.

Corne (1997:186) also comments that, “the PRC legal system is today riddled with enactments that appear to be mutually irreconcilable. It is therefore apparent that at this stage of its legal development, what China desperately needs is an independently constituted body to be established with the authority to deal with this problem on an ongoing basis”.

The Constitution entrusts this responsibility to the NPC but it lacks any legislative mechanism by which it can fulfil its task. The State Council in its administrative responsibility for overseeing ministries and government departments in application of regulations in conformity with higher law, seems to be reluctant to take action when a conflict arises. Likewise, local people's congresses with similar responsibilities for their level have rarely made use of the same power. And the Standing Committee of the NPC at the superior level has done little with the powers given them. Though higher level administrative organs can annul rules made at lower levels for inconsistency, this power again is rarely exercised.

The problems of enforcement include China's unusual hierarchy of legislation, the lack of clear delineation between legal and policy norms, the great scope of discretion accorded to bodies charged with legal interpretation and implementation, the limited scope of judicial review and the resulting problems of legislative inconsistency and haphazard legal enforcement.

Ineffective supervision of officials means that persons and bodies dealing with them cannot predict relative certainty that the set guidelines will be followed. This results in the operation of the concept known as 'rule of man' in Chinese culture (*renzhi* in Chinese) rather than the notion known as 'rule of law' in Chinese culture (*fazhi* in Chinese).

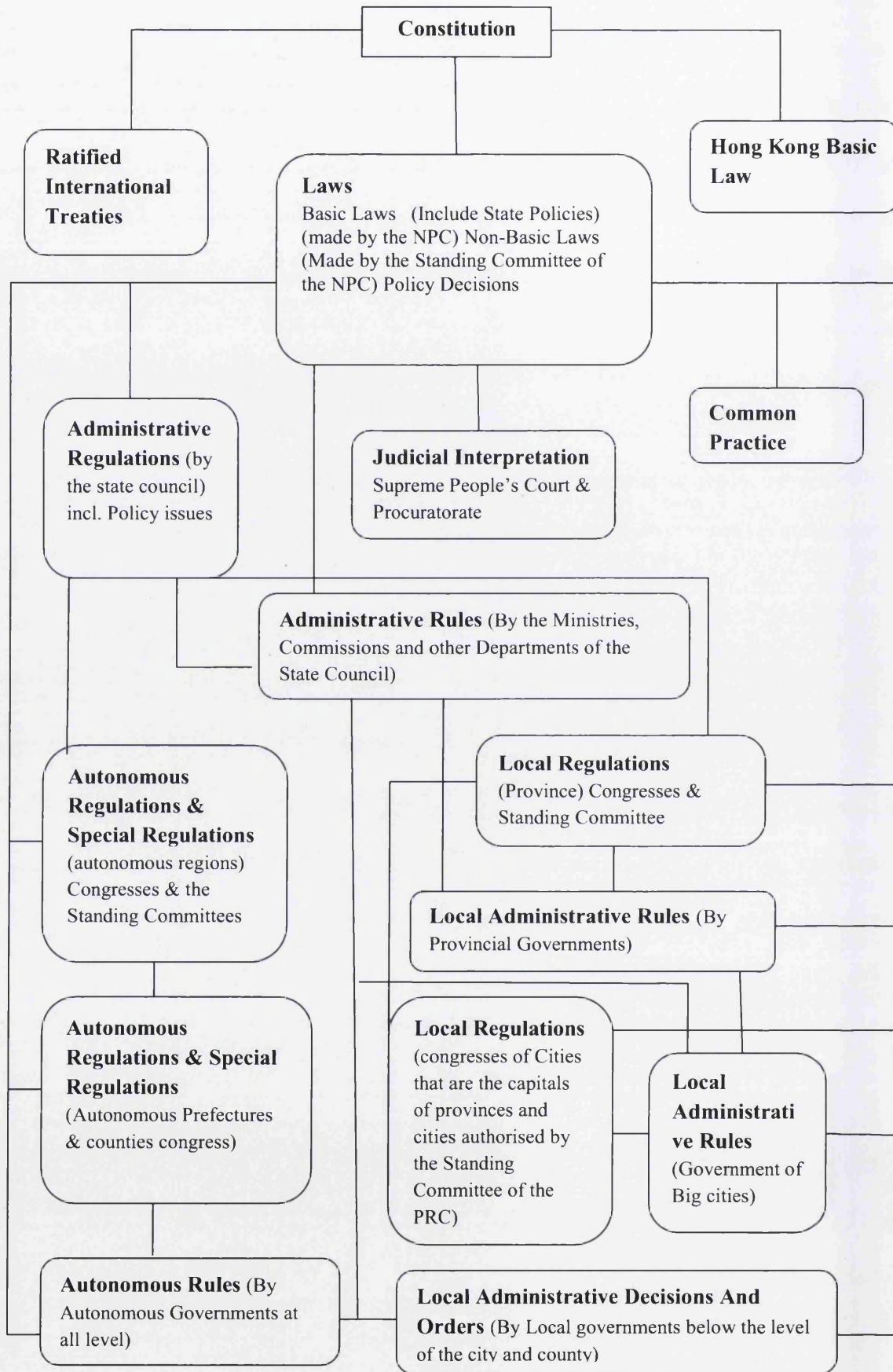
Enforcement of laws and policies by administrative agencies is hampered by lack of resources, the unfamiliarity of the population with the new legal norms, and the weak commitment to their application by officials who have inadequate training – especially at regional levels.

Laws are often ignored. The relative rapidity with which new legal concepts have been established seems to have found the Chinese people and bureaucracy slow to adapt to changes. Even when laws are implemented, the implementation is often sporadic and limited to certain areas. The Party's changes of policies in response to problems it perceives can result in local officials reacting in unpredictable ways to new policies set by the party whether by public directives or secretly ordained, pressure on them being reinforced by propaganda drives. (Corne,1997:222)

The arbitrariness with which the bureaucracy applies laws is demonstrated by various implementation campaigns. Those laws which are enforced tend to focus on areas which are thought important in order to maintain social stability, encourage economic growth and preserve the CPC in its controlling position, and these areas which are not thought to concern those regulations tend not to be enforced. This includes the regulation of foreign investment.

At the local level, some laws are purposely ignored, the local bureaucracy seemingly dealing that investors' interests would otherwise be damaged. The Chinese legal structure which investors have to be conscious of in its complexity is set out in tabular form (Table 2.6 – adopted from Wang, 1997) and provides a convenient summary of the structure and connections between the various elements.

**Table 2.6 Structure of the Chinese Law**



Adopted from Wang (1997: 19)

## Preferential Treatment

Preferential treatment pervades the operation of the Chinese legal system. Corne (1997:225) sees this as a manifestation of three factors:

1. “Ambivalent concept of equality before the laws;
2. The entrenched social norm of seeking favours through connections (*guanxi*) by appealing to nepotism, patrimonialism and the like, which are derived from the tradition of localism; and
3. The problem of institutionalized corruption, which links the interests of corrupt investors and officials.”

### Ambivalent concept of equality before the law

The imperial government operated by way of granting favours through the allocation of privileges. The concept of equality before the law is a somewhat new idea in China. It is contrary to a centuries-old legal system which reflected the Confucian view of society, as a hierarchy with duties and obligations varying according to a person's or body's place in that hierarchy. This approach has been ingrained in the Chinese psyche and it is difficult to change this way of thinking even under the new Chinese dispensation.

As a result of the party's political-legal commission headed by former party elder Peng Zhen, a new concept of equality was expressed in Article 3<sup>6</sup> of the General Principles of the Civil Law of the PRC in 1986 under Deng Xiaoping's administration. This however, went against the idea of 'living law' or 'rule of man' which permeates all levels of courts and governments and is expressed by the well-known Chinese proverb, *when those above behave unworthily, those below will do the same*. This ingrained attitude was reflected in the earlier Article 51 of the Constitution of the PRC (1982) which states that citizens' "freedoms and rights may not infringe upon the interests of the state." In practice, the old ways have persisted. Courts have resisted challenges to domination by the Party. Law is treated by administrative bodies as granting, not rights but unenforceable privileges, leaving it possible for officials to grant preferential treatment. As Lubman (1999: 171) comments, "the continued separation of Party discipline from legality not only keeps the CPC beyond the reach of the law, but it also illustrates the continuing refusal- or inability- to raise the courts above other elements of the Chinese Party- state." Similarly, in the workplace labour discipline is exacted and the idea of workers' rights was a foreign concept. The government has only recently started to respond to the new commercial climate and the government's wish to encourage domestic consumption by the enactment of Labour Contract Law in effect from January 2008 (replacing the old Labour Contract Law of 1994).

### Seeking Favours through Connections

Preferential treatment stems from a feudal tradition of granting privilege to some and not to others. Relationships in Chinese society are all important and *Guanxi* is the means to cement

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<sup>6</sup> Article 3: Parties to a civil activity shall have equal status.

relationships. Formal obstacles are thereby overcome and principles of impartial treatment are ignored. (Purves, 1992) An example is the case, reported in the *South China Morning Post*, of 80% of police recruits in Shanxi province having no training but being appointed through the “back door” at the expense of qualified graduates. Favours can become bribes voluntarily or by extortion. Cheng and Rosett (2003), who reviewed/examined the reality of Chinese legal administration in practice, concluded that, matters of degree become differences in kind at some point, the alternative connection being not simply lubricated and facilitative, and it becomes competitive and corrupting.

Ambler, Witzel and Xi (2009, 103) also demonstrate the importance of government/business relationship. They argue that “good relations with government can make the wheels of bureaucracy turn faster, even allowing you to jump the queue and get approval more quickly than you might expect. Poor relationships or none at all, conversely, can put ventures at risk.” In their study, they also find that the examples of failure of McDonald and Starbucks in Beijing in the 1990s were due to the fact that those two American companies did not secure good *Guanxi* with the relevant branches of government they were dealing.

The importance of connections is also examined later and examples are given in Chapter Five indicating how Taiwanese and other foreign investors in practice obtain preferential treatment, which though it may be prescribed by government often needs connections to ensure success.

Import and export licences are issued and “arbitration awards enforced in a discriminatory way throughout China, even when the award has been made by an arbitration body in Beijing.” (Corne, 1997:223)

### Institutionalized Corruption

The Chinese legal enforcement system is bedevilled by “problems of corruption and local protectionism.” (Wang, 2000:206) Many Chinese officials have little accountability for their actions, with a monopoly of power of allocation of goods and services. Corruption extends to local protectionism in law enforcement. The privileged status of the party is reflected in the way the courts treat corruption. Corne quotes typical instances where the top people were treated more leniently. Laws are inconsistently applied, leading to “distrust (by foreigners) with the Chinese legal system ... aggravated by the arbitrary resort to campaign-style enforcement” (Corne, 1997:241).

Laws and regulations applicable to foreign investment are often drafted to give the appearance of preferential economic treatment to foreign investors in order to induce investment. In reality, the unpredictability of decisions has a contrary effect, as foreigners “would generally prefer a predictable and consistent legal system in which everyone competes on an even footing.” (Corne, 1997: 238) Further, Hille (2011:1) noted that “European businesses have accused China of having a public procurement system which excludes foreign businesses and encourages corruption.” More transparency is needed. Bribery in return for favours is all pervading in a society where personal connections are an important means cutting through bureaucratic obstacles to acquire a share in the new wealth. Corruption therefore makes life difficult for Taiwanese as well as other investors as it leads to uncertainty in the outcome of their ventures. But, Taiwanese enterprises do have an advantage of sharing the same language and culture and being more in tune with the mainland way of thinking than other foreigners, and so are in a position to steer a path more easily to avoid the various obstacles created by corruption – indeed they may find that they

could gain advantageous treatment as a result of the corruption. Hong Kong businessmen have shown how, though used to the stricter rules of the colonial administration, they can take the Party system into account and know when *Guanxi* can be used. Taiwanese can have a similar approach to doing business in China.

A specific pattern of corruption experienced by business is rent-seeking. This in effect diverts some enterprise revenue which would normally be protected by law into the pockets of others using their special positions. It is a meeting of money and power. Howell (1993) distinguishes three types of rent-seeking:-

First, an individual official of the Chinese government and a Taiwanese or foreign company respectively exchange power (usually necessary approvals to do business) for money. Underlying these practices are the continuing uncertainties about national business policies, giving opportunities for individual civil servants and local party leaders, and a lack of information on the part of Taiwanese business people about the political-business environment in a location and ways to get into that market. But both sides get what they want: the local officials, considering it normal business procedure, get paid for helping out, and the Taiwanese company hopes to mingle with the Chinese officials and make useful friends. From the Taiwan's Mainland Affairs Council survey in 2008, some local governments co-operate well with Taiwanese companies. For example, an environmental protection unit of a Chinese local government asked product suppliers or manufacturers to buy protection devices and components from a specific company. Amber, Witzel and Xi (2009:100-101) note that some Chinese officials "could give advance notice of new development plans, tell which had government support and which did not, get access to other officials, help arrange permits and

licenses, help with planning permission and a whole host of other highly necessary things – all perfectly legally... It was not just businesses that benefited. Government departments and agencies, themselves foundering as they tried to bring about a new economic order, were grateful for these relationships too.”

The second type of rent-seeking occurs when local officials use their authority arbitrarily in their administrative procedures and applications for approvals. By doing so, they can often pocket a Taiwanese company's supposed settlement fee for applications. According to a survey in 1995 made by the Association of Taiwanese Investment Enterprises on the Mainland, 14% of the interviewed Taiwanese business people said that they had been blackmailed or been asked for a bribe. They felt that high-level officials were easier to deal with and some of the lower-level officials could deliberately make trouble.

The third type of rent-seeking is the worst. It concerns occupation of land. Local government may make assessments followed by re-assessments to permit illegal actions or approve land use beyond their authority in some cases. Some assessments are formally passed by administrative order, or are just decided by a group of officials or even made by gentlemen's agreements. This kind of rent-seeking wastes social capital and damages government function and reputation. From 1993, local officials have been prohibited by the State Council of the PRC from issuing fines to foreign companies to gain interests and benefits (Howell, 1993).

In summary, while China has moved in recent decades to give at least an appearance of liberalising the law relating to the state and private individual and business, the reality is that equality under the law still faces great obstacles. It is undermined by countervailing pressures

such as the lack of enforcement of government edicts; the latitude allowed to lower administrative organs, officials and courts to apply the law; the ingrained centuries-old acceptance of *Guanxi* as governing relationships both personal and official; and the inability of the state to make great advances in eliminating the wide-spread corruption, especially against the comparatively tolerant attitude to corruption at the highest levels.

## 2.5 Conclusion

This chapter has reviewed literature throwing light on the background against which Taiwanese businesses operate in Yang-Tzu River Delta and Pearl River Delta. In particular, it has looked at the way China's bureaucracy operates, characteristics of the Chinese legal system, potential risks and opportunities for investors in operating under these systems and how the regulations and policies of both Chinese and Taiwanese governments impact on Taiwanese investment in China and cross-strait economic activities.

The purpose of China's economic reform, according to the Chinese government's propaganda, is to transform the so-called planned economy to a market economy. However, whether one talks of a planned economy or a market economy, concealed is the actual economic environment. Chinese economy has been shifting from a planned economy to a power-oriented one and overall power still remains with the Communist Party and state apparatus.

Laws in China are opaque because of their volatile nature and the way they are implemented. In addition, they are also affected by *Guanxi* and power relationships. In order to do business in China and deal with the Chinese government and Chinese business partners, one must be

conscious that preferential treatment is common and to understand the elements of preferential treatment. They include an ambivalent concept of equality before the law, seeking favours through connections and institutionalised corruption.

“The strategic imperative for China is all about being flexible, but not naive, in relation to critical external influences, such as culture and the significant role of government.” (Suter, Armitage, Cheng and Memari, 2009:5)

In the past two decades, economic integration between China and Taiwan has intensified, though there have been ups and downs. Shown in the following part of this chapter, regulations and official policies of both governments have evidently substantial roles in facilitating this mutual development. In general, China welcomes foreign investment to boost its economy and has given preferential treatment to foreign and Taiwanese investments. China is keen on economic growth by any means. However, its government, legal system and some of norms ingrained in Chinese culture, to some extent, become obstacles to China’s consistency of development.

Outside investors in China, including those from Taiwan, have to work in this special climate of business and trade in that country. China, although branded as “Communist”, is in fact not conventionally Marxist and operates according to its own agenda, much of which is a legacy of centuries of entrenched customs and attitudes. These have to be carefully studied to understand the reality of operating in the Chinese commercial environment, with its local biases and connections.

The literature on foreign investment in China covers general topics not specific to Taiwan and explaining political and economic background against which companies need to operate.

But there is a dearth of literature separately treating the special issues of Taiwanese investment in China. Exceptions relate to the general political-economic situation for Taiwanese investment in China as a whole or in particular cases, e.g., a power plant in Fujian province; or focusing on certain geographic areas or on specific industries, e.g., the semiconductor industry in Jiangsu province, manufacturing such as textile, toys and footwear industries in Guangdong province. However, the special theme of this dissertation is not completely addressed and will be examined through case studies in Chapters Five and Six.

The next chapter deals with the gradual development of Taiwan governments' policies and regulations relating to Taiwanese investment in China since the late 1980s, and also examines the interaction, cooperation and negotiation between Taiwan and China in economic and political issues. These affect the way Taiwanese investors operate in China in addition to the influence from Chinese government.

## CHAPTER THREE

**Conceptual and Analytical Framework (2)**

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**3.0 Introduction**

Economic integration doesn't mean political integration. Consensus must be built in Taiwan among its business communities, interest groups, the press and politicians. Needless to say, increasing economic exchange across the Taiwan Strait during the past decades has gradually drawn the two countries close to each other. In the absence of military threat, the high degree of mutual dependency may in a foreseeable future connect the two economies into a common market. A stable and gradually improving relationship between the two sides of the Taiwan Strait is in the interests of all.

The purpose of this chapter is to survey the literature covering cross-strait trade and investment from 1987 to 2010 and to analyse the factors influencing Taiwanese trade policies and investment in mainland China since late 1980s, to examine the consequences for the economies of both sides and to probe scenarios and implications for their future development. This survey leads the researcher to examine these factors in more detail and come to conclusions. At the outset, the general characteristics of cross-strait economic interaction are described.

This chapter begins with an examination of how the resulting economic integration has affected Taiwan. The evolving debate about the effects on Taiwan over cross-strait relations is summarized. The overview of Taiwanese trade and investment in China will be elaborated in two ways: one in terms of Taiwan's government trade policies and the other in terms of concerns for Taiwanese investors in China. The first one will concern trade policies, and Taiwan-China relations will be discussed in five succeeding periods of time. The latter will be examined with three dimensions.

The final part argues that, given Taiwan's latest mainland China policy, economic interactions will probably intensify in the early 21st century. Furthermore, increasing economic ties and low-level political engagement between Taiwan and the mainland should help create a shared "shadow of the future" that would provide increasing incentives for the two sides to resolve disagreement on their areas of sovereignty at the higher political level. The role of the Chinese local governments in Taiwanese direct investment in China will be considered.

### **3.1 Characteristics of cross-strait economic interaction**

According to Sturdivant (1985: 4), enterprises consider four main factors in their

business practices: “economics, society, regulations/politics and skills”. “Economic factors include the company’s productivity and profitability, external environment, product price and pricing policy. Societal factors comprise common practice, culture, tradition, education and quality of manpower. Political factors cover encouraging or restraining regulations such as tariff duties, immigration, tax law, low-interest loans, development of industrial zones, R&D subsidies, antitrust and environmental law, the protection of consumers, political stability and politics-business relations. Skill factors consist of various technologies regarding production and management”. Furthermore, Taiwan Semiconductor Manufacturing Co. President and current Taiwan President’s Advisor Zhang Zhongmou (China Times: 03/06/2007, Yi-Shen Chen) stated that the real problem of Taiwan’s economy lies in its competitiveness having been lessening. In the 1990s, the greatest competitiveness of Taiwan was based on the following points: ‘First, diligence, lower wages, high productivity; Second, outstanding human resources with science and business background; Third, initiative and adventurous spirit; Fourth, the government’s support and positive intervention to enterprises’. According to Lijun (2002), Chiu (2000) and MAC report (1991), the main factors that account for the continuous economic flow from Taiwan to mainland China include:

- the strong complementary nature of the two economies;

- a sustained booming Chinese economy with its abundant cheap land and raw materials; cheap labour force with a great number of well-educated and skilled employees; the huge market; political stability; common language and culture; the advantages of ethnic affinities; geographical neighbourhood; improved infrastructure; and favourable government policies;
- the worsening economic situation in Taiwan and a slumping international market;
- the search for international competitiveness in this globalization era.

Key events during this period (post-1987) affected economic relations between Taiwan and mainland China including:

- (1) bans<sup>1</sup> on the three links with mainland China (direct flight, transportation and communication);
- (2) restrictions on Taiwan investment on the mainland under the so-called “go slow, be patient” policy (*Jieji Yongren* policy). *Jieji Yongren* policy was instituted in September 1996 by ex-president Lee Teng-Hui. The policy prevents

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<sup>1</sup> The bans have been lifted since 2009.

Taiwanese from investing in infrastructure building and some high-tech industries in mainland China. They cannot invest in any projects in the mainland over US\$50 million, and they cannot pump more than 20 percent of their total assets into their projects there;

- (3) the 1996 coastal missile test crisis with mainland China;
- (4) the Asian financial crisis in 1997;
- (5) the announcement of the special state-to-state policy, initially by ex-president Lee Teng-Hui, in 1999;
- (6) in the 2000 Presidential election, the political changeover from the KMT to the DPP,
- (7) China and Taiwan's accession to the World Trade Organization (WTO) respectively in 2001 and 2002.

Given these events, economic relations across the Taiwan Strait are still vigorously developing. In 1998, Taiwanese investment on mainland China surged by \$420 million, more than four times the previous year. Table 3.1 illustrates that total trade figures for the two sides have been increasing continuously.

Table 3.1 Trade between Taiwan and Mainland China

Unit: US\$million

Period	(A) Taiwan Exports to China	(B1) Taiwan Exports to HK (F.O.B)	(B2) H.K. Imports from Taiwan (C.I.F.)	(B1-B2) Difference between (B1) and (B2)	(c) Transit trade from Taiwan to Mainland China via HK	Estimated Taiwan Exports to Mainland China*	Taiwan Imports from Mainland China**	Estimated Total Trade between Taiwan and Mainland China
1987-1989	-	16752.7	16574.5	178.2	6365.2	6800.6	1354.5	8155.1
1990	-	8556.2	7446.7	1109.5	3278.3	4394.6	765.4	5160.0
1991	0.1	12430.5	9563.0	2867.5	4667.2	7493.5	293.2	7786.7
1992	1.1	15415.0	11301.2	4113.8	6287.9	10547.6	747.1	11294.7
1993	16.2	18452.6	12203.7	6248.9	7585.4	13993.1	1015.5	15008.6
1994	131.6	21262.3	13936.3	7326.0	8517.2	16022.5	1858.7	17881.2
1995	376.6	26105.9	16572.6	9533.3	9882.8	19433.8	3091.3	22525.1
1996	623.4	26787.6	15795.1	10992.5	9717.6	20727.3	3059.9	23787.2
1997	626.5	28688.1	15967.6	12720.5	9715.1	22455.2	3915.3	26370.5
1998	914.9	25398.2	13342.9	12055.3	8364.1	19840.9	4113.9	23954.8
1999	2602.1	26825.3	12875.2	13950.1	8174.9	21312.5	4528.9	25841.4
2000	4391.5	32741.7	15919.5	16822.2	9593.1	25009.9	6229.3	31239.2
2001	4895.4	28712.7	13837.0	14875.7	8811.5	25607.4	5903.0	31510.4
2002	10526.9	32959.6	14859.8	18099.8	10311.8	31528.8	7968.6	39497.4

	2003	2004	2005	2006	2007	2008	2009	2010	2011	Jan-Aug
	22890.8	30868.3	16051.7	14816.6	11789.4	38292.7	11017.9	49310.6		
	36349.4	32896.2	19719.5	13176.7	14761.9	48930.4	16792.3	65722.7		
	43643.7	34035.6	21567.5	12468.1	17055.9	56271.5	20093.7	76365.2		
	51808.6	37381.2	24989.4	12391.8	18707.2	63332.4	24783.1	88115.5		
	62416.8	37979.7	26295.2	11684.5	21206.6	74245.9	28015.0	102260.9		
	66883.5	32689.9	24620.7	8069.2	20035.1	73977.8	31391.3	105369.1		
	54248.7	29445.2	22519.1	6926.1	18029.4	62090.9	24423.5	86514.4		
	76935.1	37807.1	2881505	8990.5	23013.1	84832.2	35952.2	120784.5		
	57586.7	26633.8	20430.8	6203.0	15855.2	61701.3	29795.1	91496.4		

Note: 1. A negative figure in column (B1-B2) will be treated as zero.

2. From Jan 2006, the Compilation of Customs Trade Statistics adopts the United Nations' International Merchandise Trade Statistics (IMTS) Compilers Manual, 2004. Total Exports include exports and re-exports, total Imports include imports and re-imports.

Source: Adapted from MAC cross-strait economic statistics Monthly

1. The data for (A) and (B1) are collected from ROC customs statistics, (B2) and (C) are from Bureau of Foreign Trade, ROC.
2. \*\* HK Customs statistics before 1993; ROC Customs statistics since 1994.
3. \*before 2001 the estimation method of Mainland Affairs Council (MAC) as: (B1-B2)+C.  
But since 2002, MAC and Bureau of Foreign Trade decided to change the formula and switch to  $A + (B1 - B2) * 80\% + C - r * A$ .

" $r$ " presents the average ratio of the import from Taiwan to Guangdong to all in China according to China Customs Statistics. Now the " $r$ " is 33% from 1999 to 2002.

The nature of this foreign investment has become more established. From the late 1990s, Taiwan investors gradually switched from joint ventures to wholly-owned enterprises and began to build their own factories. The structure of these ventures was also upgraded from simple assembly to "upstream" heavy and more capital intensive, or high-tech, production. In particular, by the mid-to-late 1990s the mix of Taiwan investment in the PRC began to shift from predominantly small businesses in labour-intensive exports to much larger businesses seeking to penetrate the Chinese market in heavy industry (e.g. Formosa Plastics) and consumer goods (e.g. President Enterprises) (Clark, 2001). There was also a geographical spread of Taiwan investment from an original concentration in Fujian and Guangdong Provinces to Shanghai, and then to almost all regions in China. Even state corporations became involved in major deals.

The complex and evolving economic integration of Taiwan, China and Hong Kong by the mid-1990s created what came to be called "Greater China" by David Shambaugh and others - or the "China Circle" by Barry Naughton - encapsulating the phenomenon of concurrent economic convergence and political divergence. Naughton's China Circle focuses more on narrow economic issues than Shambaugh's model. He argues that a number of different China Circles of varying sizes and

intensity of interaction can be discerned, with considerable economic integration occurring in the middle-sized one that encompasses Hong Kong, Taiwan, Shanghai and Fujian and Guangdong Provinces in the PRC (Clark, 2001). Shambaugh meanwhile also posits a model of social and cultural, as well as economic, ties: although social and cultural factors certainly present a major explanation for the emerging economic integration of the 1990s. Huntington (1993: 28) also claims “Cultural commonalities increasingly overcome ideological differences, and mainland China and Taiwan move closer together”.

### **3.2 Overview of Taiwanese Trade and Investment in China**

The Taiwan issue has taken on a character of fluctuating stability and instability, balancing or upsetting the equilibrium that had existed among China, Taiwan, Japan and USA for the previous two decades. As Zhang (2005) and Su (2002) noted, the interactive effects of China's growing economic power, Taiwan's political transformation and the international systemic change due to the end of the Cold War have created a new dynamic of the Taiwan question, which has at times brought about instability and renewed confrontation across the Taiwan Strait. This situation has gradually changed after 2008 when two states have had more frequent negotiations on

various issues, mainly in economic, cultural and social aspects. The political aspect at issue is temporarily put aside and withheld by the two concerned parties, China and Taiwan. Any agreement or mutual understanding that both parties have is not documented in public. In addition, "Beijing's balancing act has thus far rested on a two-pronged approach: encouraging Taiwan's economic integration with the Mainland through trade and investment interdependence, and containing Taiwan's movement toward political independence. A primary question is, what is the overarching rationale linking these two dimensions in a calculated and coherent fashion?" (Zhang 2003: 384-385)

Taiwan's investments and trade in China were essentially conducted indirectly through a third party. One is therefore not surprised to observe a large gap in the FDI statistics reported by the authorities in Taiwan and China. Taiwanese investment first appeared in China in the early 1980s, but remained small and also was not recorded in official statistics until the end of the 1980s. By the end of 1999, the total number of approved Taiwanese investment projects reached 43,945, and total contract investment amounted to US\$44.67 billion, accounting for 7.8% of the total investment fund absorbed by China (Statistics summary analysis, Investment Commission of Taiwan's Ministry of Economic Affairs and Almanac of China's Foreign Economic

Relations and Trade). The value of realised Taiwanese investment has reached US\$24 billion. Taiwan is the fifth largest investor in China after Hong Kong and marginally behind British Virgin Islands, Japan and the U.S. (See Table 3.2.; Almanac of China's Foreign Economic Relations and Trade). According to Taiwanese government diplomatic missions data in 2010, 51.5 % of Taiwan's total outward investment apart from mainland China was directed to the Virgin Islands and the Cayman Islands. If indirect Taiwanese investments to China through these islands are taken into account, then the total share of Taiwanese investments in China's total FDI in 2010 was 23.8 % which would put Taiwanese investment as the 2<sup>nd</sup> largest investor in China.

**Table 3.2 China Cumulative Realized Foreign Direct Investment by Country**

**(Area)**

Country (Area)	1979- Aug., 2011 Cumulative		
	Projects	Realised Amount (US\$100 million)	Percentage
H.K. and Macau	344,062	5,125.95	45.52
British Virgin Islands	21,473	1,189.67	10.57
Japan	45,364	779.19	6.92
USA	60,568	669.44	5.95
Taiwan	84,849	534.41	4.75

Singapore	19,265	505.83	4.49
Republic of Korea	53,118	491.29	4.36
Cayman Islands	2,697	230.27	2.05
Germany	7,248	180.32	1.60
UK	6,914	175.60	1.56
Netherlands	2,585	115.40	1.02
France	4,238	112.97	1.00
Canada	11,980	81.63	0.72
Malaysia	5,028	58.62	0.52
Others	59,260	1,009.58	8.97
Total	728,647	11,260.16	100.00

*Source: MAC Cross-Strait Economic Statistics Monthly; China Monthly Statistics of the PRC Ministry of Commerce.*

Cross-strait trade motivates the Taiwanese investment in China and the Taiwanese investment intensifies and increases the cross-strait trade. Both Taiwan and Chinese government play an important role in facilitating the interaction. Let us take a look at Taiwan government's policies regulating Taiwanese indirect trade with China in

various periods of time.

### **3.2.1 Taiwan's Government Trade Policy**

From authoritarian regime to democracy, Taiwan has passed substantial milestones in the last three decades. Despite the political deadlock between Taiwan and China, in terms of economic relations the two sides of Taiwan Straits have gradually discarded hostility and more willingly embraced each other through several non-official talks to make progress in economic and cultural cooperation. The following Taiwan trade policies can witness this compromise. According to Chiu (2000), Mac Report (2005) and Zhang, Xu and Zhang (2003), the trade policies can be discussed in five different periods:

#### **3.2.1 (a) Before 1992- “temporary expediency”**

Under the KMT administration, Taiwan government had a dominant role in Taiwan companies' indirect trade and investment in China. Skocpol (1979: 29) claimed that “the state power is an authority foundation for a country to distribute the value and interest of the society and also to monitor the international relation and the interaction

with foreign countries. Administrative and coercive institutions provide a foundation for a country to exercise state power". In other words, as Baddie and Birnbaum (1983: 34) demonstrated, the basic condition of the government is that it stands for the central authority. This central authority accumulates political resources and is able to neutralize the power of the peripheral actors in the society.

From "Three No's Policy"<sup>2</sup> to "The Guidelines for National Unification"<sup>3</sup>, Taiwan official stance toward China changed. The cross-strait economic and trade relations had shifted from being completely prohibited to be unofficially acknowledged by Taiwan's government.

Under "Temporary Provisions Effective during the Period of Communist Rebellion"<sup>4</sup>, the Taiwanese government possessed absolute power to control business practice and did not have much active interaction with enterprises. Before 1987, the concern of the government was mainly focused on national security and in the protection of domestic economic activities. After 1987, the government aimed to supplement the complementary demands resulting from the cross-strait industrial structures by the

<sup>2</sup> It was the KMT and Chiang Ching-Kuo's Mainland strategy- no contacts, no negotiations, no compromise with the Chinese Communist Party.

<sup>3</sup> The Guidelines were written by the National Unification Council, an advisory body of Taiwan's government, regarding the reunification of China. The Guidelines for National Unification were adopted by the Executive Yuan Council on February 23, 1991. The guidelines have a three step process for the gradual unification of the PRC and Taiwan. The detail of Guidelines can be accessed at <http://www.mac.gov.uk>

<sup>4</sup> This was a series of temporary constitutional provisions passed by the National Assembly of Taiwan on May 10, 1948 and gave Taiwan previous President Chiang Kai-Shek extended powers amid the height of the Chinese Civil War with the Chinese Communists (CCP).

investment and trade from Taiwanese small and medium enterprises.

As for the companies, on the one hand, they worried about the appreciation of the New Taiwan Dollar, the rising salary and environmental cost causing their international competitive advantages to decrease. This made them have little choice but to seek other markets, and the natural option most of them were inclined to make was China. On the other hand, the brand-new Chinese market was foreign to them. Thus, most of the entrepreneurs took cautious measures to reduce the business risks and obtained the quick return by means of small scale investment and short-term management. Before 1990, Taiwan government lacked integral planning and thorough regulatory structure in cross-strait trade and investment and this economic interaction was superintended by administrative decrees. In 1992, after "Act Governing Relations between Peoples of the Taiwan Area and Mainland Area"<sup>5</sup> was launched, Taiwanese investment in China started to increase in terms of scale, character, area and sectors. During this period, most companies who had investments in China were small and medium enterprises or foreign registered companies, including through tax havens such as British Virgin Islands, Cayman Islands and Bahamas. Some investments were through personal funding or Hong-Kong based companies.

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<sup>5</sup> This law was passed on the 21<sup>st</sup> of July, 1992.

### 3.2.1 (b) Between 1992 and 1996- Institutionalisation

*The Act Governing Relations between Peoples of the Taiwan Area and Mainland Area*

is the principal regulation on cross-strait non-governmental association. In addition,

the government launched *Regulations Governing Permission of Trade between*

*Taiwan Area and Mainland Area* which provided the guidelines for Taiwanese

investment in China. Previously, as well as needing to conform to Taiwanese

requirement that this should be channelled through a third country/territory, prior

authorization was needed from the two governments; the first requirement was being

relaxed since 1991. The termination of the *Temporary Provisions Effective during the*

*Period of Communist Rebellion* announced on May 1<sup>st</sup> 1991, by previous Taiwanese

President Lee Teng-hui also encouraged more Taiwanese investors to enter the

Chinese market. In addition, the end of these temporary provisions also signified that

the Taiwanese commercial activities in China were no longer considered as crimes

(Lee, 2008). After the termination of the martial law in 1987, 1991 was marked as the

year of the second relaxation of Taiwanese government policy for Taiwanese

investment in China.

“The One China, respective interpretation” formula of 1992 consensus has paved the

way for the cross-strait positive interaction. Both sides of Taiwan Strait loosened their fundamental aim for a win-win result. Taiwanese government gradually relaxed the examination procedure and increased the number of items permitted to be invested in China and to be exported and imported in bilateral trade. The Chinese counterpart introduced several regulations in Taiwanese companies' favour to attract more investment and trade.

During this period, there were six developments in Taiwanese investment in China (Yen, 1993; Wei, 1995; Jien, 1995; Lin, 1995, Zhang, 2005):

- (1) Location: It has noticeably moved from the southern coastal provinces and municipalities where investments accounted for over 80% of Taiwan's FDI in the Mainland in 1992–2001 to the YRD region and only marginally to north-eastern and inland China (which accounted for only slightly over 10%), inland China (except Sichuan province) experiencing a rapidly declining share since the mid-1990s (Appendix 3.B). Between 2010 and 2011, it can be seen that Taiwanese investment increased in the areas outside the YRD, the PRD, Fujian province and Beijing capital region. It is noteworthy that Jiangsu and Shanghai saw a rapid expansion of their shares in attracting

direct investment from Taiwan, increasing from about 14% in 1992 to 51% by 2001. This is due in part to the establishment of the Pudong New Zone (a super special economic zone “SEZ”) in Shanghai in 1990 where many Taiwanese owned companies are based. Fujian and Guangdong, on the other hand, experienced a sharp drop of direct investments by Taiwanese investors, down respectively from 12% in 1992 to 4% in 2001 for Fujian and from 45% in 1992 to 28% in 2001 for Guangdong (Appendix 3.B). This arose from a wish from some investors to explore the Chinese domestic market, and as a consequence of increased cost of labour and rent of land.

(2) Range of investment items: Among all the industries invested, the top three sectors were electronic and electric appliances, food and beverages processing and plastic and rubber products (Appendix 3.C). The investment projects had expanded and shifted from labour-intensive industries to electronic and electric appliances, information and high technology and capital-intensive industries. Service industries also attracted the attention of investors. These accounted for the bulk of Taiwan’s total investments in China in 2000 and 2001. Among others, two factors contributed to this change (Zhang et. al. 2003): first, China has changed its FDI policy from location-based to technology-based policies since the early 1990s. The

Chinese government gave priority to FDI in energy and infrastructure such as transportation and telecommunication, key manufacturing industries with new, advanced technology and large-scale investment, and agriculture. Second, besides the easing of investment rules in Taiwan, and competition with other rivals in the Chinese expanding market, diversification of political risks became another important major driving force for Taiwanese investors when making long-term investment commitments in China.

(3) Diversification of the mode of investment: Investment shifted from joint ventures to privately owned companies. Taiwanese companies in China widened their focus from the export market to include supplying the Chinese market as well. In addition, Taiwanese investors, previously accustomed to exploring the Chinese market independently, embarked on collective cooperation and investment and gradually extended the range of their mutual contacts and activities with a view to increasing their overall knowledge of the local market in which they operate.

(4) Scale of investment: Conglomerates became the leading actors in Chinese investment and gradually replaced the small and medium enterprises in total Taiwanese investment in China. In response to Taiwan's domestically saturated market, while the principal factor for small and medium enterprises

was cost advantage, in the case of conglomerates, the Chinese inbound market was a very important consideration as well.

(5) Investment term: The investment term generally increased. According to Chiu (2000) and the survey by Commonwealth Magazine (1996), the investment term for conglomerates is normally 20 to 50 years and for small and medium enterprises 15 to 20 years. In addition, factories were procured or built by Taiwan's investors rather than being rented as in the past.

(6) Brand names: Over several years, more and more enterprises have built up their own brand names, such as President Corp., Wei Chuan Corp., Chef Kang, and Tsann Kuen Electronics.

According to Zeng (1995) and Kao (1995), the political situation is significant for enterprises in evaluating the merits of establishing themselves in a new locality. However, the point is that they believed that business benefits and revenue resulting from trade and investment can somehow exceed and balance out the cost originating from political factors. Therefore, even with disadvantages and difficulties, Taiwanese companies would still choose to invest in China.

For the government, the concerns focus on several areas: the balance of national

security and economic interests; promotion of industrial transformation; benefits for domestic industrial structural complement; response to international liberalization and regionalization. (Zeng, 1995; United News, March 31<sup>st</sup> 1998)

### **3.2.1 (c) Between 1996 and 1998- JieJi YongRen Policy (Go Slow, be Patient)**

In 1995 and 1996, in response to Lee Teng-Hui's personal visit to the USA, China reacted offensively and coercively by twice firing missiles and engaging in military manoeuvres directly opposite Taiwan and in sea exercises off the coast of Taiwan.

These actions took place before and latterly during the Taiwanese Presidential election.

This confrontation triggered 'the first Taiwan Strait crisis since 1958', which involved Beijing, Taipei and Washington in a military face-off (Zhang, Xu, Zhang, 2003). The potential impact of these incidents on economic and political relations between these two rival governments drew world-wide attention and raised zealous policy debates in Taiwan among the business community, government and academies. The central issues were: (Chai & Chai, 1996)

- a. whether trade should be altered from indirect to direct and totally legalizing investment on the mainland China;
- b. whether large-scale direct trade would make Taiwan's economy excessively

dependent on mainland China;

c. whether increased investment on the mainland would cause capital flight and industrial hollowing in Taiwan;

d. whether Beijing authorities at some point in the future would make use of trade and investment as a political lever for bringing Taipei to the negotiation table under Beijing's terms.

In order to prevent "hollowing out" of the Taiwanese economy and its over-dependence on the Chinese economy, the Taiwanese government proposed the "Southward Policy" to encourage businessmen to invest in South East Asia and thus to reduce the economic and political risks. Nevertheless, one of the reasons to cause Taiwan's "Southward Policy" not to be as successful as the investment in China was the degree of similarities in culture, languages and work ethics between Taiwan and host countries in South East Asia having been lower than that between Taiwan and China. Huntington (1993: 28) noted that common culture facilitates the rapid expansion of economic relations between mainland China, Hong Kong and Taiwan. Appendix 3.D shows the relative trade interdependence between Taiwan and China. Even with a few crises from the Chinese missile exercises (1995 and 1996) and 1998 President Lee's "special-state-to-state" rhetoric, China-Taiwan economic ties still

increased. According to the appendix, China is much more important as an outlet for Taiwan's exports rather than as a source of supply for Taiwan's imports, even though Taiwan's share of the latter has been growing since the mid-1990s. Taiwan's dependence on the Mainland market as an outlet for its exports grew rapidly to over 16% in 1995 and to about 20% by 2001 (Zheng, 2003). In contrast to this trend, imports from Mainland China only accounted for 0.62% of Taiwan's total imports in 1990, about 3% in 1992, and 5.5% by 2001. Such unbalanced trade interdependence is clearly a result of Taiwan's "relaxing exports control and restricting imports" trade policy towards China.

In terms of investment cap, for individual investment ventures, the maximum amount of money is 50 million US dollars. If the capital is over 50 million dollars, the company would be identified as a listed company. It needs to be evaluated by relevant authorities. During this period, though the government took a cautious approach toward investment and trade and discouraged firms from making large investments in sensitive sectors, such as hi-tech manufacturing and infrastructure, the total Taiwan-China trade still steadily progressed.

A few points need to be noted during this period of time:

- a) The growth slowed down because the industrial structure was changing in China. The structure was no longer based only in manufacturing when service industry was allowed to invest.
- b) Taiwanese investment and trade was declining because they were facing the 1997 Asia financial crisis, a price war with South East Asia, JieJi YongRen policy and Chinese regulations.
- c) Formerly, the small and medium enterprises (SMEs) imported raw materials from Taiwan. But the conglomerates tended to use local raw materials and changed from vertical production line to horizontal ones.
- d) As opposed to most (SMEs) sending their revenue abroad, the conglomerates chose to keep their revenue in China to increase their market share.
- e) Investment focus was shifting from labour-intensive and manufacturing industries to heavy, chemical, service and electronic industries.
- f) Cross-Straits trade relations were gradually changing character from complementary to competitive.
- g) Taiwan authorities and the business sectors took different views on how much regulations should be relaxed by the government for greater trade

normalization. This divergence caused a clash between private companies and the government.

### **3.2.1 (d) Between 1998 and 2008 – JiJi KaiFan YouHsiao GuanLi (Active Opening, Effective Management)**

Taiwan's Bureau of Foreign Trade of the Ministry of Economic Affairs statistics showed that China was Taiwan's 46<sup>th</sup> trading partner in 1989, whereas it became the 1<sup>st</sup> trading partner in 1996-1997 surpassing the United States and Japan (see Appendix 3.E and 3.F). This sharp contrast reveals that China-Taiwan economic cooperation is inevitable and will only be intensified. The following Table 3.3 shows that the greater China area including mainland China, Hong Kong and Macau is the most crucial grouping to trade with Taiwan and its total share from 12/2010 to 11/2011 is 28.804 per cent and more than double of the second biggest grouping - ASEAN. The order of ranking of the groupings is as follows: Greater China, ASEAN, Japan, USA, European Economic Area, Middle Eastern Countries and Korea. This Table also reveals the volume and share of the important individual countries and groupings that have trade with Taiwan.

**Table 3.3 Volume and Share of Taiwan's Trade by Major Countries and Groupings**

Unit: US\$ billion; Period: 12/2010-11/2011

<i>Countries</i>	<i>Ranking</i>	<i>Amount</i>	<i>Share (%)</i>
Total Trade		590.337	100.00
China	1	128.01	21.685
Japan	2	70.94	12.018
United States	3	62.32	10.557
Hong Kong	4	41.78	7.079
Republic of Korea	5	30.52	5.17
Singapore	6	24.43	4.140
Germany	7	16.51	2.798
Saudi Arabia	8	15.67	2.655
Malaysia	9	15.45	2.618
Australia	10	14.52	2.460
Indonesia	11	12.21	2.070
Vietnam	12	10.86	1.841
Thailand	13	10.62	1.800
Philippines	14	9.41	1.594

Netherlands	15	7.94	1.346
India	16	7.62	1.292
Kuwait	17	7.27	1.232
United Kingdom	18	6.48	1.098
United Arab Emirates	19	5.84	0.991
Angola	20	5.37	0.911
<b>Groupings</b>			
Greater China (China + Hong Kong + Macau)	1	170.06	28.804
ASEAN (Singapore, Malaysia, Indonesia, Vietnam, Thailand, Philippines, Myanmar and Brunei Darussalam)	2	83.24	14.11
Japan	3	70.94	12.018
USA	4	62.322	10.557

European Economic	5	56.148	9.513
Area (EU, Norway, Iceland and Switzerland)			
Middle Eastern	6	39.811	6.747
(Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Iran, Oman, Iraq, Bahrain, Jordan, Syria and Yemen)			
Republic of Korea	7	30.528	5.171

*Source: Directorate General of Customs, Ministry of Finance, Republic of China (Taiwan)*

In January 2001, the Chen administration initiated and authorized the opening of the direct sea links (the so-called “mini three links”) between Taiwan’s offshore islands of Kinmen and Matsu and Fujian Province of China. Since then, ‘this travel has expanded rapidly with about half a million transits taking place in 2005’ (Brown, 2007a:88). The government further eased investment rules and new direct postal and

shipping links.

Another real challenge and opportunity to Taiwanese government, Taiwanese firms and Taiwan's economic security comes from the WTO. Many issues of cross-strait economic interaction are governed under the WTO framework after Taiwan and China succeeded in entering this multilateral trade regime. Membership by Mainland China and Taiwan in the WTO, in 2001 and 2002 makes for a more official basis for intergovernmental coordination within these two economies.

In 2004, "Regulations Governing the Permission of Commercial Behavior in Mainland China" listed allowed and forbidden items for trade in China. In April 2006, Taipei approved investments in China in the fields of small LCD screen production and computer chip packaging and testing. The measures were amongst an extensive category of investment liberalization that Taiwan investors in China had been seeking for almost two years. Meanwhile, applications for the building of 12-inch semi-conductor wafer fabrication plants are still pending (though plants for the manufacture of smaller sized wafers have been previously approved): this area of technology is of particular importance to the Taiwanese economy; hence, the hesitation in establishing daughter companies in China in view of the local

employees' access to the know-how. Domestic politics and election strategy strongly influence Taiwan's mainland Policy. Following the Democratic Progressive Party's (the DPP) electoral setback in Dec 2005, the Chen administration adopted a new policy to balance the demands of the basic DPP's supporters who are opposed to closer ties with the mainland, emphasizing their wish to restrict Taiwan's interaction with China, and the group composed of opposition party and internationally minded firms who continue urging the removal of obstacles on their cross-strait investment and trade with the mainland. This was thought to cater to both sides' demands; however, it is not satisfactory for most non-governmental sectors.

To sum up, there are two different voices heard on the Taiwan government's mainland policy. Both supporters have their own reasons. The one who advocates economic ties with China regards progress on the outstanding transportation and tourism issues would be very much in Taiwan's own interests. Brown (2007b) and Cabestan (2002) argued that the decisions on the cross-strait investment liberalization issues pending in Taipei would both strengthen the competitiveness of Taiwan firms and contribute to economic performance and foreign investor confidence in Taiwan. After the first

Taiwanese (Chinese Taipei) formal trade policy reviews<sup>6</sup> in WTO in June 2006, the diplomatic language of the WTO staff report stated, ‘The growing importance of cross-strait movement of goods in Chinese Taipei’s economy would seem to indicate the need for further liberalization of cross-strait traffic; such liberalization would contribute to improving the efficiency of the Chinese Taipei economy and its attractiveness to inbound direct investment” (WTO website, accessed on January 20<sup>th</sup> 2008). However, the other voice which advocates tighter economic interactions with China thinks Taiwanese identity needs to be strengthened and is crucial for Taiwanese consolidation. The restrictive policy on economic ties is thought to counteract China’s 2005 Anti-Secession Law and its blocking of Taiwan’s international participation. In addition, Taiwan may lose its bargaining chips when it compromises too fast. (Stockwin, 2002).

### **3.2.1 (e) After 2008, Closer Economic Integration between Taiwan and China**

#### **with the Effectiveness of the ECFA in 2010**

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<sup>6</sup> Trade Policy Reviews are exercises, mandated in the WTO agreements, in which member countries’ trade and related policies are examined and evaluated at regular intervals. Significant developments that may have an impact on the global trading system are also monitored. For each review, two documents are prepared: a policy statement by the government of the member under review, and a detailed report written independently by the WTO Secretariat. These two documents are then discussed by the WTO’s full membership in the Trade Policy Review Body (TPRB). These documents and the proceedings of the TPRB’s meetings are published shortly afterwards.

After 2008 Taiwan's Presidential election, economic and political interaction has had a distinct watershed than previous periods. There is now an ongoing process of greater engagement between mainland China and Taiwan, specifically in trade matters. This trend is particularly noted after the President Ma came into power in 2008, which has more friendly views and policies toward Chinese government as compared to the DPP's China Policy. Consequently, the events of the three direct links between Taiwan Strait starting from December 15<sup>th</sup> of 2008 and of the commencement of ECFA in 2010 have made the breakthrough for China-Taiwan relationship moving one positive step further. Because of this agreement, it made possible to Chinese capital to be invested in Taiwan with certain limitations. This change has shifted the dynamics of more one-sided cross-strait investment which Taiwanese investment is allowed in China whereas Chinese inward investment in Taiwan was prohibited. The following section is going to elaborate the concerns being occasioned mainly by China to Taiwanese investors and the economic integration in the last twenty years to date.

### **3.3 Concerns of Taiwanese investors in China**

#### **3.3.1 Three Direct Links**

Until the end of the 2008, the "Three links", namely direct trade, transportation and

communications links between China and Taiwan, were completely (with the exceptions of the “little three links”- postal, transportation and trade- between the Taiwanese islands and Fujian province from 2001) completely “frozen” for the past half century. Those wishing to travel for business and other purposes between the two countries had no alternative but to conduct their activities via a third country. Hong Kong has been the most important intermediary for trade between Taiwan and China.

In May 2004, the Taipei American Chamber of Commerce’s annual White Paper stated that Taipei’s reluctance to open direct transport links with China was harming the Taiwan economy. Brown (2004:95) noted that many Taiwanese and foreign firms in Taiwan had shifted the focus of their operations to the Taiwan domestic market “because of the absence of direct travel and transport links with China made it inefficient to run regional operations from office in Taiwan”.

A further step in the easing of restriction on communications between Taiwan and mainland China was taken in 2003. Limited charter flights were then allowed to be operated between the two countries for each Chinese New Year.

A great improvement in the relationship between the two governments took place

when President Ma assumed office in May 2008. Talks were held between the two governments with a view to establishing direct links. On the 4<sup>th</sup> July 2008, the first weekend charter flights began between some cities in mainland China and in Taiwan. Full restoration of the Three Links officially commenced on 15 December 2008, with inaugural direct shipping, direct flights, and direct mail. On the 29<sup>th</sup> June 2010, China and Taiwan signed 'The Economic Cooperation Framework Agreement' (abbreviated ECFA) which is a preferential trade agreement between the People's Republic of China and Taiwan aiming to reduce tariffs and commercial barriers. The pact was seen as "the most significant agreement since the two sides split after the Chinese Civil War in 1949."<sup>10</sup> (Hogg, 2010) It will subsequently boost the current huge bilateral trade between both sides of the Taiwan Straits. The detail of the ECFA can be summarized in Table 3.4.

**Table 3.4 Economic Cooperation Framework Agreement (ECFA)**

<b>Location and Date of Signing</b>	29 <sup>th</sup> June 2010 in Chongqing, RPC
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<b>Background</b>	<p>In 2009, in order to avoid Taiwan being marginalised from regional economic integration, especially ASEAN plus 3, the KMT administration in Taiwan proposed the idea and draft of a Comprehensive Economic Cooperation Agreement (CECA) to discuss with the Chinese authorities. China also thought this was a way to benefit both sides' economy and further facilitate the ultimate political unification.</p>
<b>Rationale</b>	<p>The stated objectives are:</p> <ul style="list-style-type: none"> <li>“1. To strengthen and advance the economic, trade and investment cooperation between the two Parties;</li> <li>2. To promote further liberalization of trade in goods and services between the two Parties and gradually establish fair, transparent and facilitative investment and investment protection mechanisms;</li> <li>3. To expand areas of economic cooperation and establish a cooperation mechanism.”</li> </ul>
<b>Agreed items (Taiwan to China) and estimated value</b>	539 US\$ 13.8 billion
<b>Agree items (China to Taiwan) and estimated value</b>	267 US\$ 2.9 billion

<b>Positive Impacts</b>	<ol style="list-style-type: none"> <li>1. It is an important strategy for Taiwanese overall economic competitiveness and industrial upgrade.</li> <li>2. It has great advantages to certain industries in the list and can occupy a share in the Chinese domestic market. This needs to be substantiated by Taiwanese own protection measures for more vulnerable industries.</li> <li>3. In the beginning, it will increase the employment opportunities in Taiwan.</li> <li>4. It will facilitate the conclusion of a FTA between Taiwan and other countries so long as such countries do not encounter Chinese pressure.</li> <li>5. Taiwan still needs to strengthen the relationship with other countries such as USA, Japan, the EU and India.</li> </ol>
<b>Negative Impacts</b>	<ol style="list-style-type: none"> <li>1. High political risk: increasing the speed and possibility of “one-China”. This is the</li> </ol>

biggest price that critiques mention that

Taiwan would have to pay.

2. Taiwan may not get the protection of the

WTO multilateral negotiation mechanism

framework, as the ECFA is purely a

bilateral agreement between Taiwan and

China.

3. The open policy will have an impact on the

Taiwanese market: a higher unemployment

rate in the long run, lower salary levels, a

bubble economy in Taiwan, closure of

some vulnerable industries, widening gap

between rich and poor.

4. Under-recognised potential victims. The

party in power did not explain how and to

whom the government subsidies are to be

paid.

5. Adaptation to the impact of the ECFA

might take longer than anticipated.

	<p>6. Limited economic progress for Taiwan under the ECFA without the benefits of FTAs with other countries.</p> <p>7. Over-reliance on the Chinese economy is a big concern to commentators whether in Taiwan or elsewhere. Taiwanese exports to China account for more than 41% of total exports.</p> <p>8. Lack of direct participation by businesses and other sectors of the Taiwanese population in the negotiation and monitoring of the ECFA.</p>
<b>Special Notes</b>	<p>The ECFA was signed by non-government organisations authorised by Taiwanese and Chinese government. It was not signed under the WTO framework and not by both Taiwanese and Chinese official governments. This arrangement was in order to avoid a political sovereignty disagreement and controversy which might arise</p>

	<p>from the higher status of a quasi- or free trade agreement which is generally signed by two or more sovereign governments. The agreement is officially written in Mandarin Chinese and other language translations are for reference only.</p> <p>Taiwan should balance its relationship with China - not too close or too far. Taiwan should always be aware of China's ambition and intention and protect itself with sufficient deterrence and defensive weapons against any Chinese potential military attack.</p>
<p><i>Source: Ministry of Economic Affairs, Taiwan; Chinatimes and Liberty Times, 2010; Randall Shriver (2010/07/20)</i></p>	

### 3.3.2 Unsound Regulations and Bureaucracy in China

Liao (2001) noted the commercial law system in China has not been transparent. The

major reason is the PRC government's failure to realize the complications of formulating business contracts; the government seems to legislate first and make amendments at a later date when necessary. This framework makes the Chinese authority develop its regulation policies gradually; but it thereby faces business investments with uncertainty over the future. Moreover Chinese laws and regulations often are unexpectedly released to certain newspapers, business periodicals and governmental bulletins. Some internal ordinances are unavailable, and some foreign companies, whose interrelated practices are directly impacted by these secret stipulations, are unable to know these stipulations.

Due to its lack of transparency, the law is not applied to each case identically and is strongly influenced by sectionalism. Among various regions, interpretations of the national law greatly vary and even sometimes transgress the national policies. What is more, the law often favours local industries and is biased against foreign companies; for instance, in regard to requests of technology transfer, exporting quota and local content. Foreign companies are still often discriminated against by the administrative units who tend to protect local industries, even though the law itself avoids discrimination. The rule of law (described by Keith (1994:5), as "the notion of a check against tyranny", and also "a noble principle, such as...equal justice for all

under the law") is still not generally put into full practice among ordinary Chinese, especially in inner parts of the country.

Spero (2001) argued that the fundamental structures, excessive bureaucracy, and difference between workers' attitudes and managers' perceptions are obstacles for many joint ventures in China.

According to Leng (2002:269), "accession to the WTO also provides opportunities for Taiwan to fully integrate with mainland China's economic development". Arbitration mechanisms within the WTO framework will provide further protection for Taiwanese business interests. For a long time, mainland China has refused to sign an investment protection agreement with Taiwan because such a move implies 'international' instead of 'domestic' economic relations. Arbitration mechanisms within the WTO framework will help put cross-strait economic relations in a multilateral, rather than bilateral framework of protection under international norms.

As the legal system in China slowly becomes more rational and sounder over years, Chinese people's legal consciousness will accordingly be fostered. Under these circumstances, personal networks (*Guanxi*) would be undermined even though

Confucianism still influences the behaviour and outlook of Chinese people. For example, it is not easy anymore for Taiwanese businessmen to obtain profits from cheaper rents achieved through personal relations. Only those Taiwanese businessmen, who benefit from informal personal contacts, will maintain the same ease of operations. However, Taiwanese companies may not continue to be given special treatment by some local Chinese authorities and have to be reconciled to being treated in the same way as other foreign companies, for example, in respect of their rights of purchase and lease of real estate. On the other hand, as a consequence of greater application of legal principles and systems, the rights of most law-abiding Taiwanese companies' investments in China will become protected to the same extent as other foreign companies.

### **3.3.3 Financial Interflow and Fixed Exchange Rate**

Spero (2001:369) mentioned that the “strict Chinese foreign exchange control made it difficult for interflow revenue and to some extent for the foreign investment”. According to TIER report, China's excessive exchange control would facilitate ongoing export but there would be a risk of deflation in China. A 2006 White House economic report criticizes the Chinese government peg of its exchange rate to US

Dollar and its control of the exchange rate to prevent the appreciation of Renminbi (RMB). These measures will only hinder fair trade with foreign companies and broaden the US balance of trade deficit vis-à-vis China.

Financial interflow and cooperation is the weak part of cross-strait economic interaction. The situation of indirect financial interflow in the past phase has been slightly changed after Taiwan and China joined the WTO in 2002. The government is advised gradually to agree direct financial exchange between Taiwan and China. Based on the banking rules revised in November 2002, the offshore banking units (OBU) of Taiwanese local banks are allowed to remit funds directly to OBUs of foreign banks in the mainland as well as all branches and OBUs of mainland Chinese banks. The measure allows local companies that have set up plants or business operations in the mainland to manage their capital more efficiently, and may open a channel through which Taiwan-invested firms in the mainland could remit their funds back to Taiwan. Several OBUs of local banks, including Bank of Taiwan, China-trust Commercial Bank and First Commercial Bank, obtained approval from the Ministry of Finance to launch direct remittance services. In total, there are 38 Taiwanese banks to be authorized as DBU (appointed foreign exchange bank) to deal with remittance between Taiwan and China and other foreign countries. (Banking Bureau, 2004) From

2008 onwards, Taiwan and China have enjoyed more smooth relationship due to the closer cooperation between the two parties. One of the achievements is an event on November 16<sup>th</sup> 2009: a financial service pact 'Memorandum of Understanding (MoU)' is signed by China and Taiwan allowing Taiwanese banks to tap China's massive market and paving the way for banks on both sides to invest in each other. This pact mainly covers the financial supervision between the two countries. Table 3.5 lists the increase in Taiwanese remittances to and from China from 2002 to 2011. The significance of the change can be seen in 2010. The total amount of remittances of 2010 is almost one third of that of eight years between 2002 and 2009.

**Table 3.5 Taiwan Remittance to and from Mainland China**

Unit: US\$100 millions

Period	Remittance to Mainland China	Remittance from Mainland China	Total Amount
2002-2009	8,904.04	5,011.83	13,915.87
2010	2,512.15	1,507.95	4,020.10
2011			
Jan.	253.20	129.98	383.18
Feb.	190.99	108.46	299.45
Mar.	288.53	175.47	464.00

<b>Apr.</b>	246.94	135.81	382.75
<b>May</b>	247.66	136.34	384.00
<b>Jun.</b>	276.38	158.05	434.43
<b>Jul.</b>	258.89	149.94	408.83
<b>Aug.</b>	279.03	157.98	437.01
<b>Jan-Aug</b>	2,041.62	1,152.03	3,193.65
<b>Total</b>	13,457.81	7,671.81	21,129.62

*Note: 1. Prior to September 2006, statistics of cross-strait remittances were limited to only that of the Designated Foreign Exchange Bank in Taiwan. Since then statistics has extended to include those of Designated Foreign Exchange Bank, Chunghwa Post. Co., Ltd, and Offshore Banking Unit.*

*2. The statistics of cross-strait remittances of Offshore Banking Unit has started since July 2001.*

*Source: Financial Supervisory Commission, Executive Yuan, ROC.*

By agreement between China and the WTO, China allows the foreign banks to operate *Renminbi* (Chinese currency) and arrange loan facilities with domestic or foreign companies. Subsequently, after 5 years from 2002, China allows foreign banks to deal with personal savings and loan transactions. (This change has been progressed since, with certain restriction) The loan requirements of Taiwanese businessmen can thus be resolved and this new change will alleviate the problems of large capital flows from Taiwan to China. It minimizes the need for indirect banking interaction. This should eventually increase cross-strait financial interflow and make for easier

interaction. It would not be surprising if in the future it will broaden the scope of cross-strait financial interflow and smooth interaction; this would need approval of the Taiwanese authorities to set up Chinese bank branches in Taiwan.

### **3.4 Taiwan's Economic Relationship with China**

There have been different phases of Taiwanese investment in China from the late 1980s to date because of the stance on mainland China policy of different Taiwanese ruling parties.

Both Chinese government regulations and policies toward Taiwanese business and Taiwanese government policy concerning investment in China and the type of Taiwan investments in China are shown in this section. The chart below is the watershed for each phase of Taiwanese investment situation in China.

It can be seen that '*The Regulations for Encouraging Investment by Taiwan Compatriots*' in 1988 by State Council of China is to encourage Taiwanese investments in China rather than protecting them. However, when time passes by, the process of cross-strait economic integration inevitably has created various

disagreements and contradictions. In order to protect Taiwanese business people's legal rights, Chinese government (NPC; National People's Congress) enacted a law called '*The Law on the Protection of Investment by Taiwan Compatriots*' in 1994 to further encourage and protect Taiwanese investments in China, though it is not a preferential regulation. In April 1994, the State Council of China created a policy called "*Tong-Deng Yo-Shien, She-Dan Fang-Kuan*" (meaning that they give priority to Taiwanese company if it competes with other companies in the same category and also moderately ease the application process). In the same year, in October, the State Council made another decision that the Taiwan Affairs Office (TAO) should establish a department to deal with complaints and mediation from Taiwanese business people. This has greatly resolved the complaints related to the inter-provinces' issues and inter-governments. This measure creates a better and important legal environment for Taiwanese investment in China (Liu, 2003). Another important feature of this interaction which is mentioned in the previous and later chapters is Chinese government's political initiatives about Taiwanese trade dependence on China. This proposition is discussed by various scholars including Keng and Schubert (2010). They argue that the PRC government plans to "use business to steer politics" (*yishang weizheng* in Chinese) or to "use economics to promote unification" (*yijing cutong* in Chinese). These policies allow China to use its political leverage over Taiwan by

making utmost use of Chinese economic influences and clout.

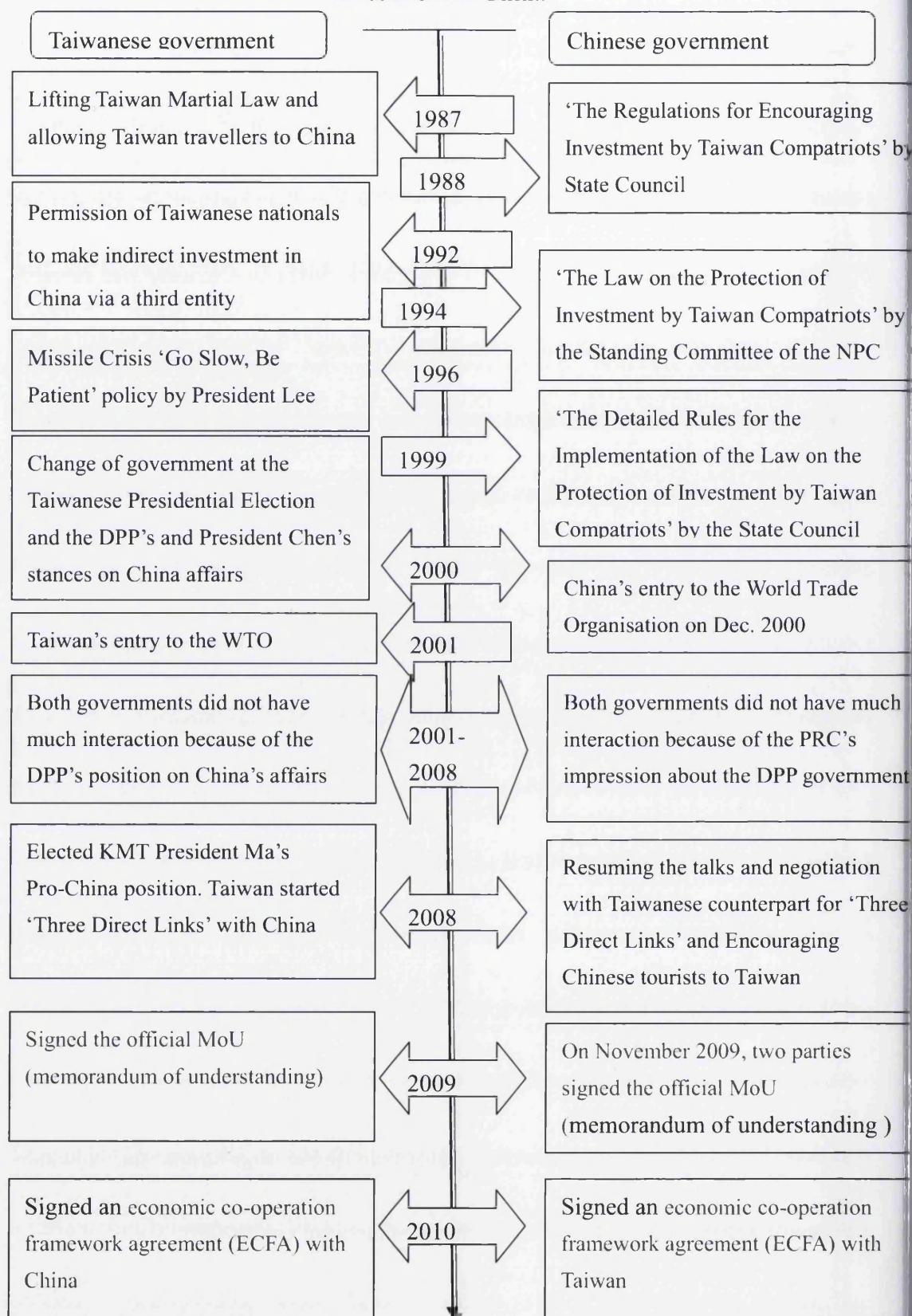
Another change in the Chinese laws regarding foreign investment is that the Standing Committee of the Chinese NPC passed “*Regulations for Foreign Investment in Business Area*” (*waishan touzi shanye linyu guanli banfa* in Chinese) and revised “*Foreign Trade Law of the People’s Republic of China*”<sup>7</sup> in May 2004. These were the measures that China took to fulfil its promises before joining the WTO. These two laws allow the wholly-owned FDIs investing in the retail, wholesale, importing and exporting industries. These laws also lifted the restriction on the locations where foreign retail or wholesale companies can be based. These new regulations have brought the FDIs and Taiwanese investors more opportunities in China.

Literature on the impact of the Chinese central government’s preferential regulations of 1988 and 1994, is lacking. Ruen (2006) has a detailed study on Chinese government policy to Taiwanese business in China and he discusses the situation that Taiwanese business people face in China in response to those policies and regulations. However, whether local governments implement those regulations and whether Taiwanese business people benefit from these policies are not tackled.

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<sup>7</sup> Foreign trade law of the PRC was first promulgated in May 1994.

**Table 3.6 Progression of legal and economic incidents regarding Taiwanese investment in China**



Source: Researcher's analysis

From the chart above (Table 3.6), it can be seen both sides have worked together to reach common interests and win-win results. Although the Chinese and Taiwanese regulations or policies toward each other are not completely reciprocal (for example, Taiwanese can invest in China, but investment from the mainland are restricted and supervised, especially in real estate market and sensitive industries).

The parliamentary and presidential elections in January and March 2008, correspondingly, caused a policy change in Taiwan politics, in which Kuomintang (KMT), the historical nationalist party, now led by Ma Ying-Jeou, regained power.

Mr. Ma's arrival to power gave consistency to the prior policy called "Lien-Hu Communiqué", and radically changed the landscape of relations between China and Taiwan.

After lengthy negotiations, two sides of the Taiwan Strait signed the ECFA in 2010 and are trying to gradually eliminate the inequality and restriction existing in China-Taiwan economic relations. Furthermore, in November 2009, after sensitive and lengthy negotiations, Taiwan and China eventually signed a memorandum of understanding (MoU), making it possible for Taiwanese banks to open branches in

China and vice-versa and to conduct lending onshore. The MoU covers co-operation on monitoring operations involving banking, securities, futures, and insurance services, according to Taiwan's Financial Supervisory Commission, a framework has been established to allow banks to conduct credit investigation and auditing operations in their offshore markets. Currently, eight Taiwanese banks have representative offices in China but are limited to conducting research.

Furthermore, in the wake of these regulations, the political atmosphere and the global financial impact, the impact of the cross-strait economic activities and Taiwanese investment can be elaborated in Table 3.7. It is worth noting from the statistics in the attached table that a marked and almost immediate impact on the levels of trade and approved investment can be seen.

Table 3.7 Cross-Straits Economic Statistics

Cross-Straits Economic Statistics		(1) Exports from Taiwan to China			(2) Imports from China to Taiwan			(3) Approved investment in China		
Year	Amount	Change (%) *	Amount	Change (%) *	Cases	Amount	Unit US\$1 million			
1987	-	-	-	-	-	-	-			
1988	-	-	-	-	-	-	-			
1989	-	-	-	-	-	-	-			
1990	4,394.6	-	765.4	-	-	-	-			
1991	6,928.30	66.1	1,126.00	47.1	237.00	174.16				
1992	9,696.80	40	1,119.00	-0.6	264.00	246.99				
1993	12,727.80	31.3	1,015.50	0	9,329	3168.41				
1994	14,653.00	15.1	1,858.70	83	934.00	962.21				
1995	17,898.20	22.1	3,091.30	66.3	490.00	1092.71				
1996	19,148.30	7	3,059.80	-1	383.00	1229.24				
1997	20,518.00	7.2	3,915.30	28	8,725	4334.31				
1998	18,380.10	-10.4	4,110.50	5	1,284.00	2034.61				
1999	21,221.30	15.5	4,526.30	10.1	488.00	1252.74				
2000	26,144.00	23.2	6,223.30	37.5	840.00	2607.14				
2001	24,061.30	-8	5,902.00	-5.2	1,186	2784.15				

<b>2002</b>	29,446.20	22.4	7,947.40	34.7	5,440.00	6723.06
<b>2003</b>	35,357.70	20	10,962.00	37.9	10,105.00	7698.78
<b>2004</b>	44,960.40	27.2	16,678.70	52.2	2,004.00	6940.65
<b>2005</b>	51,773.20	15.2	19,928.30	19.5	1,297.00	6006.95
<b>2006</b>	63,662.40	12.5	24,783.10	23.3	1,090.00	7642.3
<b>2007</b>	74,279.10	17.3	28,019.20	13.1	996.00	9970.55
<b>2008</b>	73,982.10	-0.4	31,415.90	12.1	643.00	10691.38
<b>2009</b>	62,090.9	-16.1	24,423.5	-22.3	590.00	7,142.59
<b>2010</b>	84,832.2	36.63	35,952.2	47.2	914.00	14,617.87
<b>Total</b>			231,664		38,685 *	97,320.92 *

Note: \* Changes (%) compared with the same period of the last year. \*\* Includes investment cases and amounts registered late with the investment Commission of the MOEA according to March 1, 1993, May 14, 1997 and April 24, 2002 amendments to the Statute Governing Relations between the People of the Taiwan Area and the Mainland Area. Late registered cases are indicated in parentheses.

(1) + (2) Figures on Taiwanese exports from Taiwan to China and imports from China to Taiwan up to 1992 are based on statistics from the Hong Kong customs bureau. Figures for 1993 and after are based on statistics from the Taiwan customs bureau.

Sources: (1) (2) are from Board of Foreign Trade, MOEA; (3) is from Investment Commission, MOEA.

### 3.5 Conclusion

“The fundamental differences between Beijing and the Chen administration over the ‘one China’ principle will prevent the resumption of political dialogue”. (Brown, 2004: 96) Although the political change tends to widen the Taiwan Strait, divide or disturb the societies, and interrupt economic activities, economic forces in the form of increasing trade and investment tend to bridge both countries, integrate the two societies, and dilute political control (Zhang, Xu, and Zhang 2003). Brown (2007b) also mentioned that given the political impasse, the private sector plays a large role in cross-strait dealings, and ties are growing in many sectors.

Taiwanese investment in China makes up a great percentage of total foreign direct investment in China, although officially China does not consider Taiwanese investment as foreign direct investment (Dutta 2006). Despite the uncertainty about Chen Shui-Bian’s administration on China-Taiwan policy, Beijing does want to expand bilateral economic and cultural ties and will look for ways to accomplish this goal by working with the Taiwan’s private sector and opposition parties. Given the vicissitudes of cross-strait developments, Brown argued (2007a:88) that “pragmatism benefits both sides”. The administration of Presidents Chiang Ching-Kuo and Lee Teng-Hui (1987 -1995) adopted a more conciliatory approach to China in their

pronouncements and contacts. But in 1995 President Lee Teng-Hui changed the tone of his speeches and called for international community to recognize “two states”. President Chen during his tenure (2000-2008) took a more pragmatic approach, mid-way between the more confrontational scenario<sup>8</sup> (1995-2000) and the more conciliatory one (1987-1995), preferring on the whole not to depart from the status quo (apart from occasional provocative speeches). As seen in the changes with the Three Direct Links, President Ma has resumed a softer attitude to China.

Taiwan's businessmen are pawns in this China-Taiwan nexus? Inter-governmental communication between Taiwan and China is generally carried out by private non-governmental agencies between Taiwan and China. However, Taiwanese entrepreneurs have become the middlemen of both sides to convey messages, and in this regard, they face dilemmas, as they need to strike a delicate balance. As Schubert (2010: 73 and 96) states, “the *Taishang* is a rather apolitical figure who does not see much leeway to develop autonomous political leverage” and “the *Taishang* tends to keep a rather low political profile and expend the bulk of his/ her political energy dealing with local officials and customs authorities. In that sense, the *Taishang* is an apolitical figure”. However, this may change gradually as the cross-strait relationship

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<sup>8</sup> This term came from Zheng, Xu and Zheng's paper on “the dynamics of political and economic interactions between Mainland China and Taiwan”, *Papers in Regional Science*, 2003

has improved after the mid-2008 when both states changed political attitudes and approaches. The messages the *Taishang* covey to both governments are related to each government's goals, stances and directions. The messengers are normally large companies' representatives or Taiwanese Merchant Association executives. The role of the Taiwanese business people (*Taishang*) in China will further be examined in Chapter five. In trying to expand their business on the most favourable terms, Taiwanese business entrepreneurs must take account of the special socioeconomic and geopolitical circumstances from both Taiwanese and national and local Chinese requirements and points of view.

Although present literature has considered the impact of Chinese local government on foreign direct investment, this needs to be amplified, examined in more detail and brought up to date. The researcher will endeavour to do this in chapter Five and Six. Relevant literature regarding the government/business relationship between Taiwanese businessmen and Chinese local government include Keng and Lin (2005), Lee (2008) and Keng and Shubert (2010). However, the questions in relation to whether preferential treatments from Chinese governments are received by Taiwanese businesses in China, and the implications of these preferential policy implementations

are not deeply investigated. Therefore, this research aims to broaden and fill this gap of existing literature.

## CHAPTER FOUR

**Research Methodology**

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**4.0 Introduction**

This chapter explains the methods employed in the research process from initial concepts to the collection to analysis of the data. This research straddles international relations and international economics and investigates the relationship between Chinese local government and Taiwanese investors in China to determine the extent to which Taiwanese investment is shaped by the politics of the Chinese local bureaucrats-Taiwanese investor relationship. In particular, I am looking at the question of whether Chinese contract decisions simply reflect business value-for-money considerations rather than Chinese central government's directives to the subordinate level authorities or whether a preferential tendency to favour Taiwanese companies is evident. This thesis examines the opportunities and constraints that Taiwanese businesses have encountered in the Yangtze River Delta (the greater Shanghai area) and the Pearl River Delta (Guangdong province) to determine whether the practices employed by Chinese local bureaucrats help or hinder this broader political objective as a means of achieving unification. By comparing Taiwanese businesses with other foreign investors in both secondary (manufacturing) and tertiary sectors within these two regions, the researcher will reveal whether local bureaucrats are a help or hindrance. The research method has incorporated numerous interviews in China and Taiwan with relevant Chinese and Taiwanese decision-makers (See appendix 5.A for a list of interviewees). In addition, company and governmental documents are used as another method to examine the cases for its validity and reliability.

This chapter is divided into five sections including the introduction. Section 4.1 presents the advantages, restraints, validity, and reliability of the case study research. Section 4.2 explains the case study design, including the preparation tasks and case study sites. Section 4.3 gives details concerning the data collection and management methods. Interviewing is presented in the opening subsection as the main method used for collecting data and its appropriateness in this context is evaluated. The procedures of interviewing are then described. Documentation, as the secondary resource of data collection, is presented in the following subsection. The final section provides a conclusion to the chapter.

This thesis will show to what extent Taiwanese foreign direct investment is favoured over non-Taiwanese FDI, on the grounds of economic or others (i.e., systematically in cases that cannot be explained by a superiority of the business case in the Taiwanese proposal as against competitor proposals). This thesis does not, however, subscribe to any single theory. The researcher is conducting an empirical study based on extensive documents and first-hand interview data, in order to analyze from the practical phenomena, whether practices actually match or contradict the Chinese government's policies and claim to create strong economic ties between Taiwan and China and make Taiwan dependent on China, as a way of avoiding a political confrontation.

#### 4.1 Case Study Research

Using case studies can be expressive for many different schools of thought in social science (Hägg and Hedlund, 1979). Various definitions of a case study are shown in Table 4.1 to gain a clear understanding why the case study is adopted.

Table 4.1  
Definition of the Case Study

Researcher(s)	Definition
<b>Hägg and Hedlund (1979: 136-137)</b>	(1) A case is "what actually exists or happens" (i.e. a case study attempts to get at what really goes on (2) One case is different from another case due to differences in surrounding conditions
<b>Stake (1994: 236)</b>	(1) A case study is a choice of object to be studied (2) case study draws attention to the question of what specifically can be learned from the single case
<b>Huberman and Miles (1994: 440)</b>	A "case" is a phenomenon of some sort occurring in a bounded context – the unit of analysis, in effect
<b>Creswell (1998: 61)</b>	A case study is an exploration of a "bounded system" or a case (or multiple cases) over time through detailed, in-depth data collection involving multiple sources of information rich in context
<b>Yin (2003: 13-14)</b>	(1) A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident (2) The case study as a research strategy comprises an all-encompassing method: covering the logic of design, data collection techniques, and specific approaches to data analysis

A case study is a preferred research strategy when *how* or *why* questions are being proposed, when the researcher has little control over events, when the focus is on a

contemporary phenomenon within some real-life context, when the boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidence are used (Yin, 2003). “The case study method is especially appropriate for research in new topic areas and can contribute critical insights as well as identify important factors.” (Montoya-Weiss and Calantone, 1994: 413). Also, “case studies have been used to develop and critique diverse theories … case studies have illuminated virtually every subject studied by political economist.” (Odell, 2001:161). Thus, the scope of the case study is useful to this thesis.

There are other methods of conducting a case study. For example, a postal survey was considered but rejected by the researcher. It has several limitations, including the possible ambiguity of questions, the lack of control over who actually answers the questionnaire, and the potentially low response rates (Collis and Hussey, 2003). Due to the complexity of the research questions and likely unwillingness of some informants to answer truthfully or accurately, the possibility of ambiguous answers was considered to be high. Also, a survey method does not allow for the kind of in-depth questions to reveal the real story of foreign business-Chinese government interaction. It offers no opportunity to clarify issues or to encourage if there is any disinclination to answer particular questions. In addition, there is the danger of a low response rate, especially when respondents have no individual concern in the topic of the questionnaire.

Any research must take people’s beliefs, goals and the values which motivate behaviour into account when developing and evaluating why people perform and believe as they do. However, a survey method ignores the role of human

consciousness, goals, purposes and values as significant sources of people's action (Yin, 2003). Thus, interviews are used as an appropriate way to undertake the problems of non-response and ambiguous answers.

A further reason for rejecting postal surveys as against other methods is that there may arise much discussion which is difficult to handle (Hickson, Butler, Cray, Mallory, and Wilson, 1986). Although surveys can give practical insights, such methods are to some extent limited regarding the ability to probe into interesting issues that occur during the progression of the research, and the exploration of the inconsistencies that arise between respondents. A case study method affords the opportunity to examine, in-depth, the links between Chinese local government, Taiwanese investors in China and non-Taiwanese investors in China. However, in choosing an interview method research, the case-study research design specifically for this thesis needs to be carefully constructed to make certain of sufficient thoroughness.

Case study research involves the examination of phenomena in their natural settings (Veryzer, 1998). Yin (2003: 15) summarises five diverse applications of case studies. A case study, firstly, can explain the presumed causal links in the real-world. Secondly, a case study can describe an intervention and the real-life context in which it occurred. Thirdly, a case study can illustrate certain topics within an evaluation, again in a descriptive mode. Fourthly, a case study familiarizes the researcher with the topic enabling him or her to explore those situations in which the intervention being evaluated has no clear, single set of outcomes. Fifthly, a case can be an evaluation study. The exact use of case study depends on the nature of the research questions, the

epistemological and the methodological assumptions of the topic (Collis and Hussey, 2003; Yin, 2003).

Case studies could offer richer descriptions of business-government relations (Yin, 2003). For this thesis, the researcher first generated initial ideas and propositions, which formed the basis of an explanation of the particular business environment in China and then explained the existing empirical business practices in their specific regions in China. Also, by using the case study and interview research method, the researcher attained deep understandings and descriptions of Taiwanese business in both the Yangtze River Delta and Pearl the River Delta, as well as foreign business in these areas. The nature of this multiple-case study is not only exploratory but also explanatory. This will be explained more in the later sections.

#### **4.1.1 Advantages of Case Study**

The case study takes the form of research, solving at least four problems: what questions to study, what data are relevant, what data to collect, and how to analyse the results (Philliber et al, 1980). For a qualitative empirical researcher, constructing a case study which involves field research that brings the researcher into direct contact with organisational practitioners perhaps is the most frequent starting point (Ferreira and Merchant, 1992).

By good detailed in-depth case studies, researchers can obtain an interpretation of what is going on more directly, and gain insights into all the relevant views (within relevant frameworks) of the phenomenon being researched by initially not excluding too many variables from the list of concerns (Hägg and Hedlund, 1979). Case studies can generalise theoretical propositions and achieve the goal of the case researcher to expand and generalise theories (i.e. the analytic generalisation) (Yin, 2003). Hägg and Hedlund (1979) argue that while case studies are appropriate for generating theory but not for testing it, yet, if the observation of the phenomenon being researched needs in-depth investigation, hypothesis testing research can most appropriately be conducted using case studies as well.

#### **4.1.2 Limitations of Case Study**

Adapted mainly from Hägg and Hedlund (1979) and Yin (2003), four types of limitations and complaints of case studies are discussed from the different viewpoints of critiques and concepts in Table 4.2.

Every research method has its strengths and weaknesses, so does the case study. From Table 4.2, it is clear that sometimes so-called limitations could be just incorrect concepts or might be diminished by a valid and high-quality case study design. Since the researcher has concluded that the case study is more useful for this research topic, what he should do is to overcome the limitations, not avoid them.

Table 4.2  
Limitations versus Critiques versus Concepts of Case Studies

Limitations	Critiques	Concepts
<b>Little basis for scientific generalisation</b>	<ul style="list-style-type: none"> <li>• “How can you generalise from a single case?”</li> <li>• “A case study is not statistically valid”</li> <li>• It is difficult to generalise from one case to another</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Analytic generalisation: case studies are useful and appropriate for generating theories, hypotheses, or theoretical propositions, but not for testing them</b></li> <li>• <b>Case studies provide good description: with real-life conditions, it is probably difficult to conduct experiments in the social science</b></li> <li>• <b>Multiple-case studies</b></li> </ul>
<b>Few rules or systematic procedures to follow</b>	The lack of rigor of case study research	<ul style="list-style-type: none"> <li>• <b>The role of case studies has a view of social reality as dynamic</b></li> <li>• <b>The case study is a comprehensive research strategy, a plan of research (i.e. the case study itself shows the process of research)</b></li> </ul>
<b>Experienced case researchers required</b>	To an inexperienced external person, it is difficult to review the work and understand exactly what has been going on and how valuable might be the research (i.e.	<ul style="list-style-type: none"> <li>• <b>References from experienced case researchers (i.e. textbooks of case study research and articles)</b></li> <li>• <b>A valid and high-quality case study design</b></li> </ul>

	replication of case studies is difficult)	
Time-consuming and huge, unreadable documents	<p><b>Case studies need to spend much time and usually get lots of indecipherable documentation</b></p>	<ul style="list-style-type: none"> <li>• To relate specific hypotheses to some general framework(s): to prevent blindly following inappropriate paths</li> <li>• Propositions help identify the relevant information (i.e. the more a study contains specific propositions, the more it will stay within feasible limits)</li> <li>• Depends on the topic being researched</li> </ul>

#### 4.1.3 Validity and Reliability

McKinnon (1988) generally sees validity as concerned with the question whether researchers are studying the phenomena they claim to be studying; that is, when case researchers accidentally design or conduct research covering either more than or less than the phenomena they claimed to be being researched, validity might be impaired. Yin (2003) argues that reliability is related to the question of whether other researchers, doing the same case over again, could reach the same findings and conclusions. Similarly, McKinnon (1988) broadly defines reliability as being dependent on the question whether researchers are obtaining data on which they can rely. Reliability might be questioned if a later case researcher followed the same procedures as described by an earlier case researcher and conducted the same case study all over again, not by replicating the results of one case but by doing another case study, but the later case researcher cannot get the same findings (Yin, 2003).

For achieving and designing a valid and high-quality multiple-case study, there are four criteria – construct validity, internal validity, external validity and reliability – which need be considered (Miles and Huberman, 1994; Yin, 2003). This multiple-case study is both exploratory and explanatory in nature; therefore, the researcher considered construct validity, internal validity, external validity, and reliability criteria altogether (see Table 4.3). The purpose of considering validity and reliability is to minimise the errors and biases in designing and conducting this exploratory and explanatory case study research.

Table 4.3  
Validity and Reliability versus Strategies and Tactics for Case Study

Criteria	Purposes	Threats	Strategies and Tactics
<b>Construct validity</b>	To establish correct operational measures for that being researched	<ul style="list-style-type: none"> <li>• Data access limitations</li> <li>• Subjective judgments on collecting data</li> <li>• Observer bias</li> <li>• Complexities of the human mind</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Use multiple data collection methods (two or more sources), but approach the same set of facts or findings</b></li> <li>• <b>Establish a chain of evidence</b></li> <li>• <b>The draft case study report reviewed by key interviewees</b></li> </ul>
<b>Internal validity</b>	To establish a causal relationship	<ul style="list-style-type: none"> <li>• Incorrectly conclude that there is a causal relationship between x and y without knowing some third factor – z</li> <li>• A case study involves an inference but is it the inference correct?</li> </ul>	<ul style="list-style-type: none"> <li>• <b>The quality and procedures of data analysis</b></li> <li>• <b>Use logic models, flowcharts and explanations</b></li> <li>• <b>Matching empirically observed events to theoretically predicted events</b></li> <li>• <b>Use convergent evidence</b></li> <li>• <b>Use Cross-case analysis</b></li> </ul>
<b>External validity</b>	To establish the area in which a study's findings can be generalised	A study's findings are generalisable beyond the immediate case study	<ul style="list-style-type: none"> <li>• <b>Use theories in single-case studies</b></li> <li>• <b>Use replication logic in multiple-case studies</b></li> </ul>
<b>Reliability</b>	To demonstrate the operations of a study which can be repeated with the same results	Repeating the data collection procedures cannot arrive at the same results	<ul style="list-style-type: none"> <li>• <b>Use a case study protocol (see Appendix 4.A) (Yin, 2003)</b></li> <li>• <b>Develop a case study database</b></li> </ul>

Sources: Adapted from McKinnon (1988) and Yin (2003).

These complaints might be appropriate, given the researcher's experience in doing case studies in the past, but they could also conversely be helpful to this multiple-case holistic design at the present, and it is not necessary that case studies must suffer in

the future. Certainly, to conduct a valid and high-quality case study, as many researchers (Creswell, 1998; Hägg and Hedlund, 1979; Yin, 2003) strongly recommend, a case researcher needs to be a skilful question-asker and interpreter of extensive data, a confidence builder, a paradigm shifter and a scholar in many different disciplines and appreciative of the practical aspects of what goes on in the situation being researched.

#### **4.1.4 Selection of Sample Cases<sup>1</sup>**

Criteria and replication sample strategies are used for choosing the sample companies for this thesis. The purpose of using a criterion sample strategy (Kuzel, 1992; Miles and Huberman, 1994; Patton, 1990) is to make sure all cases meet some criteria. The researcher aims to confine the core contingency factors, such as nationality of company, personal relations, type of industry, type of company (foreign wholly-owned company or joint venture) and location.

Thus, the researcher sets out to identify companies fulfilling the following three criteria: (1) belonging to the same industrial sector either in the tertiary or secondary sector; (2) being a Taiwanese brand-name company or a non-Taiwanese overseas company; (3) having business or office in the YRD or PRD area.

Twenty companies in the secondary and tertiary sectors, located in the Jiangsu province, Shanghai (YRD area), Shenzhen and Dongguan (PRD area) fulfilling the first, the second and the third criteria were selected. They were approached with the

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<sup>1</sup> Each company is unique and diverse; however, for comparability and examination of the research objective, the researcher selected companies with similar backgrounds.

help of academic professors and the researcher's relatives who helped in establishing contacts with company directors, managers or public relation officers in explaining the proposal to carry out this research. Later they all agreed to participate in this study.

#### **4.1.5 Multiple-Case Study Design**

To design and conduct a valid and high-quality comparative multiple-case holistic design, this approach involves three steps:

(1) Preliminary contacts: The researcher contacted the companies which matched the three criteria. The contact person of these companies gave authorisation to conduct interviews and held friendly conversations with managers or executives in order to understand their thoughts, perceptions and impressions about the Chinese government in relation with their companies or perhaps the industry. After getting access to these companies, telephone calls were made to human resource managers or contact persons at each company to explain the objective of this research; obtain a general understanding of their companies; set dates for case study visits; and identify the most suitable interviewees for the quality of data collection. (2) Case study visits: For each participating company, one-day or two-day visits were carried out to conduct interviews with informants who are familiar or play key roles in the relationship between the company and the Chinese local bureaucrats. Normally, the researcher visited each case study site roughly 30 minutes preceding each interview to assimilate the atmosphere and working environment, and spent the first few minutes with the interviewee make him/her comfortable. Also, the researcher had good opportunities

to examine internal documents before interviewing individuals. Multiple sources of data – interviews and documents – were collected in order to maximise construct validity. The more detailed interview process is discussed later at section 4.4.2 of this chapter. (3) Data analysis and post-visit contacts: After each visit, preliminary analysis and data reduction (filtering of important data from interviews) was conducted so that the researcher could get deeper or more useful information during the next visit to each case study site. Starting from a within-case analysis, a detailed description of each case and subjects within the case was provided. Following the completion of all visits, a cross-case analysis was performed. During this step, there was also a high degree of involvement of the participating companies for checking case descriptions. As for contacts of the Chinese local bureaucrats, the researcher followed the above-mentioned procedures.

Although the conduct of this multiple-case holistic study was time-consuming and needed significant resources (e.g. money and access to key informants) to conduct, having several cases nevertheless was more effective and of wider validity, and the evidence from this study should therefore be considered more convincing, and robust. This study follows replication logic to see whether the findings and conclusions could still be duplicated by other case researchers in the future. Each individual case, based on criterion sampling strategy, was carefully selected for a specific purpose within this overall study so that it could predict either similar results or contrasting results but for predictable reasons.

## 4.2 Data Collection Methods

Table 4.4  
Processes of Data Collection

Processes	Applications for this case study
Identify phenomena	<ul style="list-style-type: none"> <li>Collecting data on the meaning of phenomena: motivation and incentives of the investment, interactions of the local government and the investors, reward, restriction and difficulties.</li> <li>Qualitative variables: name, job title, employment status</li> <li>Ordered qualitative variables: social class, job position</li> </ul>
Select samples	<ul style="list-style-type: none"> <li>The unit of analysis: non-Chinese company</li> <li>Sample description: location of the company; company size; type of the company</li> <li>Purpose: to decide an interviewee list</li> </ul>
Select type of data	Qualitative data mostly
Choose collection methods	<ul style="list-style-type: none"> <li>Interviews</li> <li>Documentation</li> </ul>
Conduct this case study	<ul style="list-style-type: none"> <li>Preliminary contacts</li> <li>Discussion of collection methods</li> </ul>
Modify collection methods	<ul style="list-style-type: none"> <li>Interviews</li> <li>Documentation</li> </ul>
Collect data	There is no exact timing to collect relevant data

### 4.2.1 The Primary Method – Elite Interview

The sources of data were collected in two stages: the primary and secondary. The primary method involves a series of qualitative or in-depth interviews with those occupying key positions in Chinese government and foreign companies, which focused mainly on topics regarding the relationship between the companies and the government and whether the policy or attitude of the government affects the companies' business practice and revenue.

According to Taylor and Bogdan (1984), the purpose of face-to-face encounters

between the researcher and informants is to understand informants' perspectives on their lives, experiences or situations as expressed in their own words.

In-depth interviews for this thesis were based on semi-structured or open-ended research questions. The model of in-depth interviews is illustrated in Table 4.5. With the interview, one can understand the interviewee's real thoughts from a more objective perspective; therefore establishing the reliability of the interviewee becomes the main cause for the research validity. So, how can one ensure what the interviewee says is true?

Table 4.5: Interview model		
Structured Interview	Semi-structured (or focused) interview	Unstructured interview
Standardized interviews	In-depth interviews	In-depth interviews
Survey interview	Survey interview	Clinical interviews
Clinical history taking	Group interviews	Oral or life-history interviews

Source: Minichiello *et al* (1995), p.62

The hypotheses of in-depth interview are: (1) the repeated encounters between the researcher and informant may prolong the research time; (2) unlike the imbalance relation in survey research between the researcher and informant, these in-depth interviews make for a more balanced and productive interchange of facts and ideas; (3) the interview is from the informant's point of view and this is given high value; and (4) the meaning of questions and answers can be adapted during the interviews according to responses obtained and ambiguities or misunderstandings elucidated.

The interview is a tool to collect information. If the interviewer can control the situation and make appropriate arrangements, he or she will be able to probe the interviewee's thoughts and obtain full and accurate answers. Interviews can be formal

or informal. They can gradually touch the core of the topic by the means of non-standard, non-structural and open-ended questions. The interview method can also facilitate the analysis of complex issues with standard, structural or close-ended questions.

In-depth interview is normally used in the following occasions: (1) Social activity or incident – the researchers cannot understand or experience themselves and have to grasp what goes on from interviewees' perspectives; (2) personal life-history – it is also called case study. By the cooperation between an interviewee and a researcher, special events from life experiences can be explored; (3) availability of obtaining broader perspectives of a situation, people or locations by interaction between a researcher and an interviewee; (4) clinical application; (5) in-depth interview can be conducted with several interviewees at the same time. In that, one can observe the echoing effect or contradiction from the group interaction (Minichiello et al., 1995).

Therefore, this in-depth and semi structured interview method fits the author's research questions.

The reason why a series of qualitative or in-depth interviews were conducted was in order that the researcher could build an in-depth picture of this study and the aim of interviews is to develop an understanding of the facts and key interviewees' perceptions and opinions about the local government and business situation in China. Furthermore, government-related information such as bureaucracy and favours is confidential and commercially sensitive such as under table deals. The participating companies and local bureaucrats preferred to talk during face-to-face interviews and one-on-one situations, and thereby willingly provided the documents such as personal

diaries and notes the researcher asked for after each interview or case study visit, whereas, these companies would not feel comfortable and may be reluctant to answer further if the researcher used survey or interview-questionnaires. Therefore, in-depth interviews were conducted, in view of the practical problems.

#### **4.2.1.1 Advantages of Elite Interview**

The advantages of the in-depth interview are that researchers can investigate and understand the real story and information relating to the cases, the meaning of the stories, the impact and future development of the incidents, and solutions of problems. The case study interviews focused directly on the case study topic – the relationship between foreign investors and Chinese local government. In-depth questions provide interviewees, who were deliberately identified to help to answer the research questions, the opportunity to talk about the issues in a manner they could control such as what they do in their company, what they think about their performance related to the Chinese government and impact from the local bureaucracy, preferential regulations and informal interaction, or what they feel about their political-business situation and the relationship with the Chinese government. Such in-depth questions were useful in letting the informants express what they really think and talk with greater richness and openness. In addition, the interviews offered the opportunity to see a diverse range of people related to the research topic so that the researcher could obtain considerable wide-ranging information, and subsequent clarification of words and concepts were straightforwardly accomplished.

Interviews also gave the opportunity to pursue questions further and allow the interviewer to simplify or clarify difficulties for interviewees to understand or accept what was intended by a particular question. During interviews, the interviewer could concentrate on the replicated verbalised thoughts of the interview questions, thus gaining valuable and deep insight into the subjective understanding of the worlds of interviewees. Besides, during interviews, although audio recorders were partly used, the researcher still took notes as well, because note taking can not only provide a record of the interview, but also may inspire more follow-up questions on the issue being discussed.

#### **4.2.1.2 Disadvantages of Elite Interview**

The information gleaned from each interviewee needs to be tested and cannot be accepted without examination including by comparison with other testimony or by ascertaining whether all relevant facts were in that person's possession or considered by him; it is well understood by those involved in courts or tribunals for example, that witnesses' recollections may be mistaken. Therefore, the researcher must be sensitive to the responses and be alive to any gaps in knowledge or experience to supplement such deficiencies either by further questions or interviewing other people or by further background checks. This is a main reason for carrying out a multiple case study.

The downsides of conducting interviews are to an extent a mirror image of their advantages. The interview is much more expensive than postal questionnaires, travelling costs and telephone follow-ups being examples of some of the interviewing expenses. Another common disadvantage is the time-consuming problem at the data

collection stage: for example, during or after interviews, coding, classifying and briefing the collected data. The third disadvantage is, if questions are inappropriate or poorly constructed, answers could be biased or reflexive. That is, even where a consistent line of inquiry is pursued, answers may not be adequately probed or followed up. The fourth disadvantage is that the interviewees may not completely reveal their thoughts, information and feelings and they may not fully understand the interview questions if inappropriately phrased or the interviewer does not explain them properly.

Following the advice of Creswell (1998) and Yin (2003), throughout the interview process, the researcher followed his own line of inquiry, as reflected by his case study protocol (see Appendix 4.A), and asked the actual questions in an unbiased<sup>2</sup> manner that also served the needs of his line of inquiry. For example, the researcher actually wanted to know *why* a particular event occurred as it did, so at the same time as posing friendly and undemanding questions so as to provide a better rapport, the researcher can satisfy the needs of his line of inquiry in case study interviews. Although interviews have some disadvantages, these could be overcome, so they still provide a useful data collection method.

#### **4.2.1.3 Procedure of In-Depth Interview**

In preparation of an interview, the researcher went through the following steps: In terms of the process of the in-depth interview, the interviewer first should adjust his

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<sup>2</sup> For example, the researcher did not make his personal views on any person, company or government known in order to ensure the interview he conducted was unbiased.

mood without losing his objectivity. Second, the interviewer should pay attention to the details of preparation. Third, the interviewer may have a rehearsal for his interview. Fourth, appointment of the interview should be arranged accordingly. Fifth, during the interview, the interviewer should be able to control the atmosphere. Finally, the interviewer will conduct analysis and write an organized report.

**Adjustment:** The researcher tried to be impartial and did not interfere in the process of the interview or express his thoughts during the interview in the hope of not disturbing the interviewee and subsequently affecting the objectivity of the interview.

**Preparation:** Before conducting in-depth interview, the researcher has collected the information from various sources including theses, periodicals, newspapers, magazines, broadcast and internet sources. By doing so, he can have a thorough understanding about the interview content. In addition, his contact with academia, industries, government and friends is maintained with a view to further research when appropriate.

**Rehearsal/Trial interview:** A trial interview or a dress-rehearsal was conducted with a former vice-president of a Taiwanese semi-conducting company in China to refine the form of questions to be carried out and to familiarize myself with the process.

**Appointment of interview:** Having a good inter-personal relationship with the interviewee (or at least presenting a good impression of the researcher to the interviewee) is crucial. The researcher used his personal network, friends' referral and government and some associations' assistance to secure the appointments for

interview. Basically, the appointments were done by personal invitation, fax, telephone and email. From the researcher's experience, it is easier to secure the appointments by inviting the interviewee in person or by phone.

The interview was conducted in a structured way. As Wang (2004) points out the interview atmosphere is crucial and he underlines the importance of listening. Careful listening can lead to more detailed information from the interviewee than the interviewer foresaw. The researcher probed the questions gravitating from general to specific questions.

As far as the recording is concerned, this depended on interviewees' preferences. Some people did not mind being recorded, whereas others were not willing to be recorded. When a recorder was used, the researcher still took notes of the interview as much as he could, as the recorder is merely a back-up device. In the questioning process, the advantage of the initial preparation and the establishment of a good rapport noted above should be reflected throughout and he was careful to be alert with time management of the interview.

Report of the interview: Tidying up and transcribing the interview notes is the most important task and was carried out soon after the interview when the researcher's memory was still fresh. By doing so, it will avoid the need to ask for a follow-up meeting at a later date to clear up important questions missed during the interview or the transcribing period.

#### **4.2.2 The Secondary Method – Documentation**

Documentation is relevant to every case study topic. As stated earlier, the purpose of collecting documents is to achieve the big picture about participating companies and to cross-check the reliability of the case study interview. Documents relevant to the cases were collected during on-site visits and after case study interviews. In some cases, the researcher had access to company reports or publications to verify critical events and to confirm and supplement information from these sources.

#### **4.2.2.1 Advantages of Documentation**

This case study research has taken longer than two years and. the researcher needed to review data repeatedly. The first advantage of documentary information to this study is its stability. Secondly, existing private and public documents are not created for this case study, so they are appropriate to cross-check the consistency of case study interviews. Thirdly, the internal reports and information can help the researcher to examine the fitness of academic articles and real business-government practices. Fourthly, private or public documents encompass broad reporting and events. Over the period of data collection, more and more interesting issues came out which brought valuable further research directions.

#### **4.2.2.2 Disadvantages of Documentation**

Researchers need to be alive to the danger of over-reliance on documentary information in case study research, because they could mistakenly assume that corporate documents invariably contain the unmitigated truth (Yin, 2003). Internal documents are likely to be more reliable, but were written or created for some specific

purpose (e.g. internal decision-making or public reporting) or audience (e.g. senior managers or subordinates) other than for this case study research and the researcher. The researcher had access to review and copy internal confidential documents as and when the researcher needed. The researcher always discussed the purpose of the documents with the person who provided the information before using it. By identifying its purposes, the possibility of being misled by documentary information is minimised.

#### **4.3 Data Management**

The collection, identification, management, analysis, and interpretation of qualitative empirical information are systematic, ongoing, and complex processes. Before selection of samples, the researcher gathered, identified, refined, and displayed qualitative empirical raw data. During interviews, using audio recorders and note-taking in case study sites, the record, classification, storage, and retrieval of qualitative empirical data were processed. After collecting data, following data analysis strategies advanced by qualitative researchers, the analysis, interpretation, and presentation of qualitative empirical data is the heart of multiple-case study research.

Huberman and Miles (1994: 428) define “data management pragmatically as the operations needed for a systematic, coherent process of data collection, storage, and retrieval.” However, there is no accurate timetable or particular defined procedure for qualitative researchers to gather and manage relevant qualitative empirical data. Qualitative research that is based on ethnographic methods tends to view such a complex social reality in terms of processes (Bryman and Bell, 2003). Process is “a

sequence of individual and collective events, actions, and activities unfolding over time in context." (Pettigrew, 1997: 338) It is very difficult to follow specific procedures for qualitative research for every different case situation. Therefore, the researcher focused on processes to determine the results.

"For qualitative researchers, concepts and theories are usually inductively arrived at from the data that are collected." (Bryman and Bell, 2003: 298). Qualitative research is subjective and the qualitative data that was collected was not measurable. Thus, the management and analysis of data is indispensable and should not wait until the data has all been collected. Even with only a one-page document on hand or one interview conducted, categorising, coding, and theme finding could be carried out (Kvale, 1988). In addition, the researcher did not attempt to collect too much data, where only one or two pieces of transcribed text were useful to answer the research questions (Bryman and Bell, 2003). Thus, the potential for too-widespread data was reduced in a preventative way by the researcher's choice of research questions, cases, and techniques of data analysis (Huberman and Miles, 1994).

#### **4.3.1 Management of Documents**

For each case, the researcher identified and collected published data materials on the company. During and after data collection, the researcher recorded the name and position of the person who produced the document, the purpose of documents, and then separated the data into public and private documents (see Table 4.6). These were all available in electronic form either on the participating company's website or in the National Central Library in Taiwan, so the researcher did not spend much time

on the collection of relevant documents. Instead, the researcher put greater effort into organising and analysing texts of documents in order to give a true picture of operation of the companies and government gleaned from the complicated but readable data.

The researcher followed three steps to manage the data. First, for every case, the researcher developed a form of index to develop more general themes identified from research questions and interviews. Next, the researcher repetitively examined all of the information that was collected and then separated it into events. Finally, based on every theme, the researcher systematically put all of the relevant data into different matching pattern categories proceeding from the broad perspective to the smallest aspect of the company to the completion of interviews. This will be discussed in the following chapters.

Table 4.6  
Public versus Private Documents

Public Domain	Private Domain
<p><b>1. Mass Media Sources:</b></p> <ul style="list-style-type: none"> <li>•Newspapers such as Asian Finance, China Times, Taipei Times and U.S. News</li> <li>•Magazines such as Asia Business, Business Week, the Economist, Far Eastern Economic Review, Harvard Business Review, Time, and World Executive's Digest</li> <li>•Internet sources (World Wide Web)</li> <li>•Television programs such as BBC or CNN</li> <li>•Books written about the participating company</li> <li>•Business school case studies about the Chinese local government dealing with foreign investment</li> </ul> <p><b>2. Organisational Sources:</b> Annual reports, mission statements, speeches by chief executives, internally produced publications, advertisements and public relations material</p>	<p><b>1. Personal Documents:</b></p> <ul style="list-style-type: none"> <li>• Notes of managers</li> </ul> <p><b>2. Organisational Sources</b> (Confidential materials must be obtained directly from the company):</p> <ul style="list-style-type: none"> <li>• Organisational charts and policy statements</li> </ul>



Who produced the documents? → Why was the document produced? → Was the person or group that produced the document in a position to write authoritatively about the subject or issue? → Is the material genuine? → Did the person or group have an axe to grind and if so can you identify a particular slant? → Is the document typical of its kind and if not is it possible to establish how untypical it is and in what ways? → Is the meaning of the document clear? → Can you corroborate the events or accounts presented in the document? → Are there different interpretations of the document from the one you offer and if so what are they and why have you discounted them? (Source: Adapted from Bryman and Bell, 2003: 419)



1. Obtaining valuable background information about the company
2. Using each different source of data as a method of examination against the others
3. Examining any inconsistent answers in interviews based on printed documents

The key purpose of documentation is to check the accuracy of interviewees' answers. Without reviewing the background information of the cases, it is very difficult for researchers to ask deep and meaningful questions. Thus, before conducting interviews and asking in-depth questions, the researcher examined the current available materials and then self-questioned how, why, what questions to check, what other information the researcher should ask for and/or what kind of questions the researcher should ask during interviews. Examining documents that were obtained from public or private sources and self-evaluating questions after studying the available materials were continuous and repetitive processes if the researcher obtained new data.

#### **4.3.2 Management of Interviews**

The process of in-depth interview was flexible, because the researcher treated the interviewee as an informant and the informants' views were central in explaining and understanding events and forms of behaviour, i.e. the emphasis was on how the interviewee, as a witness, frames and understands themes and events (Bryman and Bell, 2003). Before conducting interviews, the researcher considered how to conduct interviews so that the meaning could be analysed in a coherent and creative

way (Kvale, 1988). During each interview, the researcher listened, observed, and thought about not only what the interviewee really wanted to express but also the way that the interviewee expressed himself or herself, and then in a friendly way confirmed the interviewee's meaning of what was said with the interviewee (Bryman and Bell, 2003). Thus, the stress was on what the interviewee chose to express about what the researcher wanted to know (Kvale, 1988).

In the interview, the researcher followed up the subjects of interest unveiled in what the interviewee said and in the way that the interviewee said it, to get a sound and more precise understanding. The researcher took notes during the interview, and concentrated on getting down notes on what was said in order to verify any inconsistencies in the interviewee's conversation and to encourage the interviewee in really wanted to say (Bryman and Bell, 2003). As previously mentioned, audio recording and transcription shortly after were used to ensure accuracy. In fact, throughout such "*on-the-spot-verification*," the analysis of interviewing should be verified during the interview itself and should be done when the audio recorder was shut off (Kvale, 1988: 92 – emphases in original).

The researcher listened to the audio-tapes closely more than twice initially, and then transcribed only those portions that were useful or relevant to the research questions.

After transcribing living conversations of interviews into written texts, the interview transcripts tend to become “an oral mode of discourse.” (Kvale, 1988: 100) The researcher intuitively read the transcripts and then employed the concept cards which Prasad (1993) uses in her study to put the written texts into appropriate coding categories – that is, printed documents and interview transcripts both eventually go into related coding categories (see Appendix 4.C). As for the researcher, the interview texts were categorised according to their themes and patterns.

In the research process, the coding of interview transcripts generally entailed making marginal notes and progressively refining those marginal notes into fitting coding categories. Coding was helpful to shape the understanding of the data that was obtained as well as to think about the meaning of the data and then to reduce the mountain of data faced by the researcher to obtain information relevant to research questions (Huberman and Miles, 1994). The research generated some broad thoughts about the data. By using concept cards, the researcher concentrated on the structure of meanings the interviewee expressed and then identified imperative concepts in the data.

Continuing and keeping the concept cards was an iterative process that began early in the research process. Adapted from Prasad (1993), the researcher accumulated incidents, quotations, opinions, events, or pieces of conversation that related to a specific theme and put them together under a meaningful label on a concept card (see Table 4.7). As more interviews were conducted and more data were collected, new concepts were generated and further new elements, if any, were added to the concept cards whenever possible. Simultaneously, the researcher considered whether re-coding or resorting old materials, which no longer belonged where they were formerly categorised, was needed.

Table 4.7  
Sample of Concept Card

Data Source	Interviewee	Incident, Quotation, Opinion, Event
Co. 1: Interview	Public Relations Manager	<p><b>Describing how to keep a good relationship with the local bureaucrats:</b></p> <p><b>"We don't need to do much ...but we need to send them gifts for specific holidays...when they have hints, we will treat them for meals..."</b></p>
...	...	...

When sorting written texts into different themes, the researcher did not just summarise interview transcripts but explored some concepts so that all the relevant and useful

conversation about a particular theme was kept in the same place and could be viewed together whenever the researcher needed, or when updating materials were added. Reviewing old material first before adding together new relevant data (including documents and interview transcripts) by this systematically manual method was helpful to organise or confirm where all the data was, so that step did not become lost, miscoded, or misplaced. Concurrently, the researcher looked for links between themes, and also checked whether a link or a pattern between coding categories was really there.

#### **4.3.3 Data Storage and Retrieval**

The storage and retrieval of relevant materials are important to data management and future academic research in order to keep track of reliable data, and so that secondary analysis of qualitative data can be verified and replicated by future researchers. A good storage and retrieval system was useful to review all organised materials and allocate further relevant information to appropriate types of files. In addition, the researcher cross-referred across different files, defined codes and then arranged relevant data into the best fitting place for easier identification and access at later dates.

The researcher prepared files for case interviews. The files were to a common format for easier comparison of cases and were used to contain any subsequent interview notes or other materials relating to each case. The organisation of data for retrieval is indicated in Table 4.8 following the proposals of Huberman and Miles (1994) and also Miles and Huberman (1994): these made for ready storage and retrieval as necessary.

Table 4.8  
Data retrieval

What to Store	Where Retrieve from
Raw material	Asking and examining: notes (from interviews), audiotapes (recording in interviews), printed public and private (confidential) documents.
Processed data	Linking ideas together: structured write-ups, interview transcriptions. After interviewing, partially processed write-ups managed from original interview notes.
Coded data	Using categories to code data and then examining each category to see what it is referring to: write-ups with specific coding categories attached, including the coding format in its successive iterations.
Analytic material	Comparing these cases and all materials to see how they are different and similar: the researcher's reflections on the conceptual meaning and linkages of the data.
Retrieval records	Re-thinking about the data and to see more general shapes in the data: records of links among coding categories.
Data displays	Matrices, charts, or networks used to display retrieved information in a more compressed, organised form, along

	<b>with the associated analytic text.</b>
<b>Report text</b>	<b>Tracing all interview answers and related documents for a research question and then searching key conceptual ideas expressed in the responses: successive drafts of what is written on the design, methods, and findings of the study.</b>
<b>Index</b>	<b>A piece of paper that indexed all the above material.</b>

*Source: Huberman and Miles (1994); Miles and Huberman (1994)*

The qualitative study of cases was logically designed as a basis for due analysis of the data. As Huberman and Miles (1994) argue, focusing and bounding functions such as choices of theoretical or conceptual framework, of research questions, of sample cases, and of methods all involve preventative data reduction and become indispensable aspects of qualitative data analysis. Good research design assists in not only collecting relevant data but also in analysing and interpreting qualitative materials. Therefore, because this study is exploratory and explanatory in nature, so it was felt necessary to establish and explain a pattern of relationships. This could be done only with a set of particular analytic pattern matching categories (Miles and Huberman, 1994; Mishler, 1990).

#### **4.3.4 Analytic Induction**

The inductive analysis method involves an iterative process of collecting data from interviews and public and private documents -, developing, or refining new ideas,

relating new ideas, and selecting further data or reformulating the hypotheses or research questions for the next phase of analysis (Huberman and Miles, 1994). Data analysis using thematic analysis (Boyatzis, 1998) focuses on understanding why companies have success and failure due to political reasons, why the local government officials have different policies toward different foreign investors, what procedures companies take to improve their relationship with the Chinese local and central government authorities or overcome problems affecting them, what measures the Chinese government officials take toward foreign investments, and how the Chinese local government authorities employ China's political initiative of unifying with Taiwan by easing or hindering Taiwanese investment in China.

Analytic induction is a very rigorous method of analysis, because "the selection of cases must be sufficiently diverse as to have adequately challenged the theory." (Bryman and Bell, 2003: 426). In this qualitative research, the researcher looked into something not previously much explored and through interviews dug deeper to reveal the real significance of the data and what might appropriately be coded from the empirical materials. So the inductive approach helped to establish what the data reveals. The researcher devised a flowchart for the process of the inductive method (see Appendix 4.C) in order to show how the researcher conducted this research.

#### **4.4 Conclusion**

In this chapter, the researcher explained why the survey method was not adopted since the findings from such a method could be unreliable. Therefore, although adopting a case study as a research strategy has its limitations of reliability and validity, this method is adopted because it is consistent with the aim of this thesis to explore the extent to which Taiwanese companies operating in the region of Yangtze and Pearl River Deltas (YRD and PRD) get preferential treatment from the Chinese local government officials as compared with non-Taiwanese overseas investors in the case study companies. For this purpose, companies' operations in these two regions were examined with particular emphasis on interviews. The interview method was chosen for this research because such work can both provide critical insights and lay a foundation for future research on related topics. By examining previous literature, the researcher was able to formulate sharper and more searching questions on the research topic and many inquisitive follow-up questions were added during the progress of in-depth interviews. One must be mindful of the pitfalls of the interview process including interviewees' misunderstanding of the questions, their reluctance for political or other reasons to give the whole truth, or their inability to convey their intended meaning.

Documentation played a secondary role in data collection for this case study research, providing little insight into issues of *how* and *why*. So, the researcher adopted interviews to find out what informants do and what they perceive; while the researcher examined documents in order to see whether informants' perception corresponded to what records showed. After collecting and managing the data, the researcher analyses and interprets it. In subsequent chapters, the researcher will develop a list of themes drawn from this previous analysis, code the data and provide detailed analysis of the interviews with participating companies and government, together with findings derived therefrom.

## CHAPTER FIVE

**Results and Findings (1)**

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**5.0 Introduction**

This chapter and Chapter Six deal with Taiwanese and non-Taiwanese foreign investment in the Yangtze River Delta (YRD) and the Pearl River Delta (PRD). The (practical) challenges faced by foreign investors are explained, as well as the special roles of trade offices, associations and other facilitating agents. This chapter will then focus on the experiences of selected investors and officials to gain further insight into the practical difficulties and business climate experienced by them. Both the YRD and the PRD areas have been at the forefront in the opening out of the economy, Chinese trade with foreign companies and investment from foreign investors. Decentralization of the economic policy has given greater scope to local government authorities to encourage this trend and process, this being particularly the case in the Special Economic Zones (SEZs)<sup>1</sup>.

The geographic, political and economic configurations of the YRD and the PRD are described and their importance to China as a whole considered. The interview data are

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<sup>1</sup> Shenzhen, Zhuhai, Shantou and Xiamen

set out and analysed later in this chapter and next chapter, details of interviewees being shown in Appendix 5.A; the results of these interviews then will be separately discussed, and the varied nuances of investors' relationships with the Chinese and the standpoint of Chinese officials are analysed. The interviewees make many similar points but there are also notable differences, these in part being a natural consequence of their different experiences and viewpoints. After consideration of the PRD, a comparison is made between the YRD and the PRD.

Stemming from analysis of the researcher's interview data and documents, eight key factors are identified as having impacts on the correlation between Chinese local officials and foreign investors with regard to the Chinese government authorities' preferential treatments. These are as follows:

- negotiation and communication with Chinese government (*Guanxi*);
- nationality of the company;
- new/old Chinese bureaucracy;
- decentralisation of Chinese government;
- uncertainty of regulations;
- locations of investment;
- sectors of industries;

- the size of companies.

The first four elements are discussed in this chapter whilst the last three will be elaborated in Chapter Six. In earlier chapters, the research motivation, purpose, literature review and methodology were explained, and this chapter provides the empirical evidence to the research questions in order to verify the hypothesis. The findings of this thesis are presented by a comparison of literature discourses and empirical qualitative data in Chapters Five and Six. The first criterion relates to both Chinese government and the FDI while nationality, location, sector and size of the company are more related to the FDI itself. The other three criteria – decentralisation, new/old Chinese bureaucracy and uncertainty of regulations - are more directly related to the government authorities.

### **5.1 Financial Incentives and Special Economic Zones**

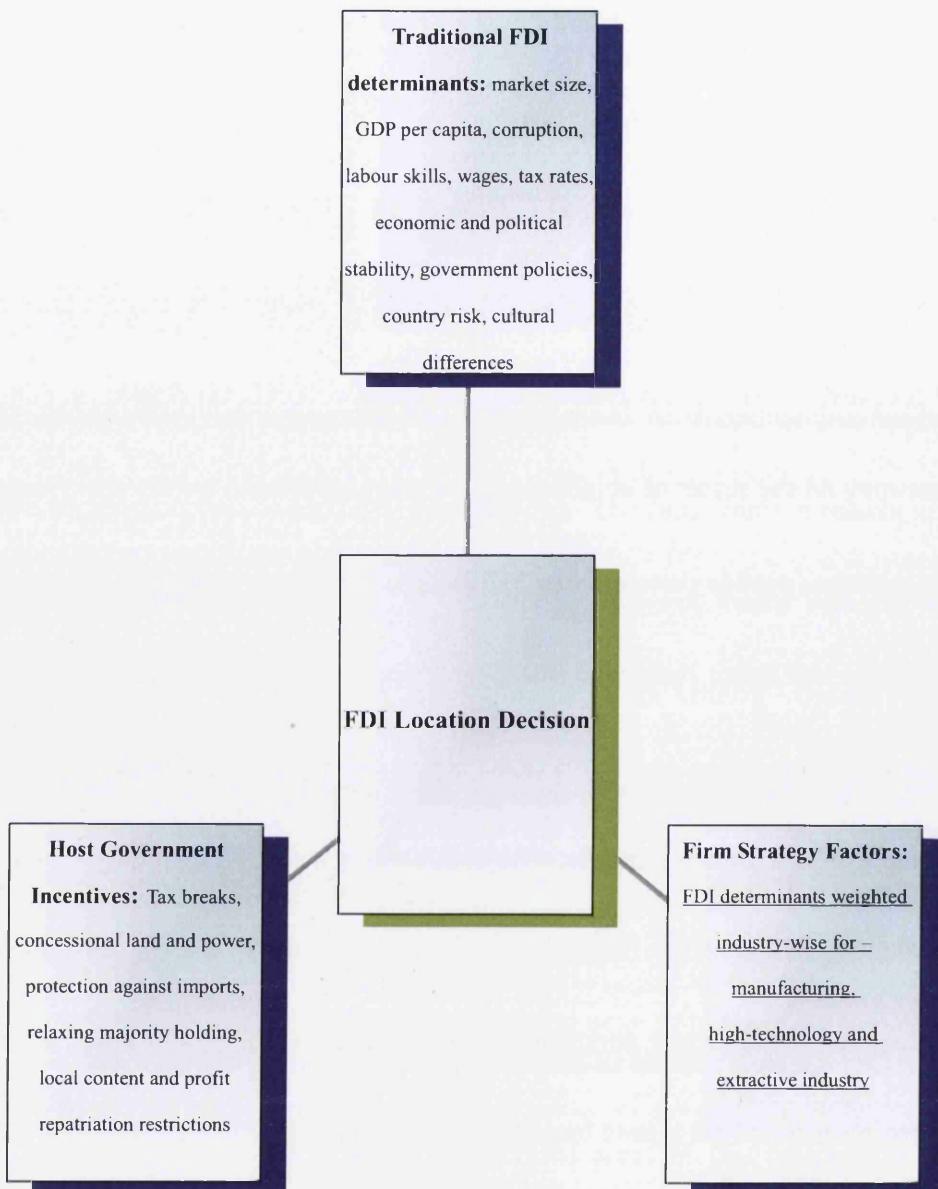
When it comes to the foreign-capital-concentrated areas of this thesis (case study regions), four SEZs were first created in the year 1980, three being in Guangdong and one in Fujian coastal area. The government gave them preferential tax treatment in order to attract foreign companies with more advanced technology and providing capital. This was followed by the creation of Hainan SEZs and the Pu-Dong New

Area in Shanghai and the designation of fourteen open coastal cities<sup>2</sup>. “The pattern of FDI in China is highly geographically concentrated. Of the total amount of FDI that China has received since 1989, the coastal areas’ share has been over 90 percent. In contrast, the inland provinces such as Gansu, Yunnan, Qinghai, Ningxia and Guizhou provinces, which are considerably less developed and poorer, and in greater need of capital investment, have not played host to FDI to any significant degree. In part, this outcome may be the result of an absence of incentives offered by the government to foreign investors outside certain areas.” (Broadman and Sun, 1997:339) Furthermore, Zhang (2005) and Sethi, Judge and Sun (2011) come up with a similar contention. In more detail, Sethi, Judge and Sun’s 2011 article explains intra-country FDI inflow variations within a broader region. They argue that neither “location advantages” (infrastructure, labour skills, market size, political stability, wages, corruption etc when weighted by industry) nor “government incentives”, by themselves, correctly reflect province-wise FDI inflow variations. Only the scale of interaction between the two closely mirrors those variations and therefore can be used for FDI prediction.

Table 5.1 shows a refined FDI location decision framework in China.

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<sup>2</sup> Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai.

**Table 5.1 FDI location decision framework**

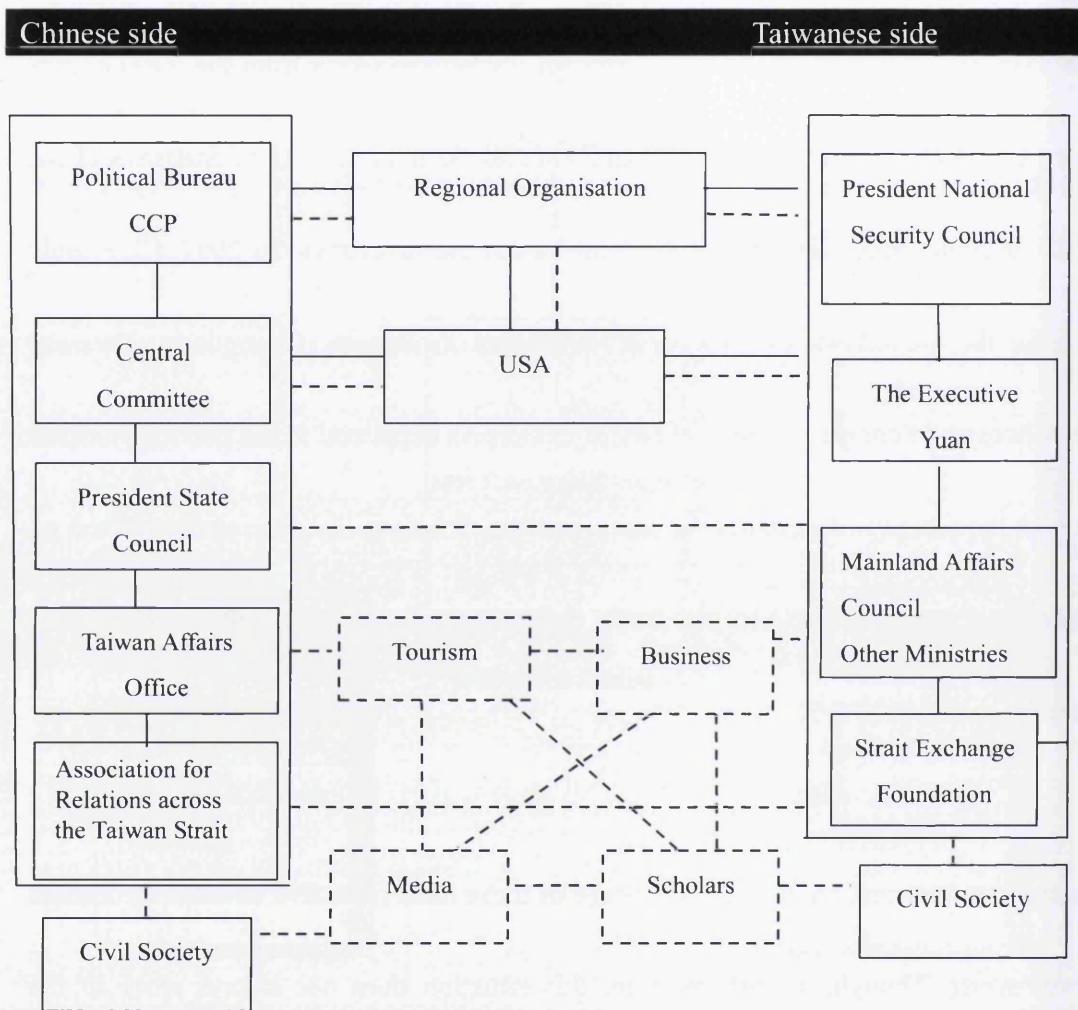
Source: Adapted from Sethi, Judge and Sun (2011; 329)

The last five years have seen a change in policy by Chinese central government which is now seeing a need to provide greater encouragement to investment in inland regions, the initially favoured coastal regions having experienced a considerable growth in economy and population of which the YRD and the PRD already account for over 66.5% of the country's total foreign investment (49% from the YRD 17.5% from the PRD according to HKTDC in 2008 and National Bureau of Statistics of the PRC in 2008), and over 80% of the total Taiwanese investment in 2007. (See Table 6.4 for the breakdown of Taiwanese investment in Jiangsu, Guangdong, Zhejiang provinces and Shanghai municipal city of China) As explained in the previous chapter, due to the paucity of comparable data, time and funding, the case studies based on interviews and documents in this thesis only concentrate on the YRD and the PRD regions.

Taiwanese investors have taken advantage of these local incentive policies for foreign investments. Though, as will be seen, this situation does not always work to the advantage of Taiwanese business, and in certain cases, they can be treated less favourably than other foreign businesses. This is given a special flavour because of the peculiar relationship between the mainland and Taipei government authorities. The methods of instituting and fostering investment have established various patterns

of communication and interaction. These are summarized in Table 5.2. Playing an important part in this process is the role of Taiwanese business people (*Taishang*).

**Table 5.2 Formal and informal interaction among government, civil society and Taiwanese business people**



*Source: Author's research and compilation*

Note: Regional organizations are APEC, CSCAP, Boao Forum, etc. However, Taiwan does not participate in the ASEAN or the ARF. Civil society here means social groups such as tourism or business (some more structured and the others more spontaneous). Dotted lines (----) mean informal and unofficial interactions and the solid lines (-) mean official linkage and governmental diplomacy. Tourism, media, business and scholars can be in either two of the civil societies. Taishang (Taiwanese business investors) are in the box of business and Taiwanese civil society.

Table 5.2 is based on a Multi-track Diplomacy (MTD) framework as proposed by Louise Diamond and John McDonald in 1992. This involves many sectors of civil society and also influences or is influenced by business dynamics. Diamond and McDonald in 1992 argue that eight channels can help resolve conflicts which include: conflict resolution professionals, business, private citizens, the media, religion, activism, research/training/and education; and philanthropy/or the funding community. In addition, they view no one agency as more important than the other, and no one agency is independent from the others. In other words, they operate together as a system. Each track has its own approaches, resources and values, but since they are all linked, they can operate more powerfully when they are coordinated. (Diamond and Notter, 1996)

This kind of interaction is common in East Asia, especially in Taiwan-China relations. On the left side of the table, the hierarchy of the Chinese political system and how they relate to each other are shown. On the right side of the table, it presents the political hierarchy/structure of Taiwan in comparison with the Chinese political hierarchy/structure. The multiple interactions in this table demonstrate how Taiwanese business people (*Taishang*) connect with both Chinese and Taiwanese government in

these dynamics. Table 5.2 also helps to understand the importance of *Taishang* in reality as middlemen through various channels to moderate Taiwan-China conflict as well as improving cross-strait political interaction.

### **5.2 The role of Taiwanese business people (*Taishang*)**

The importance of *Taishang* in cross-strait relationships may affect how Chinese local government authorities perceive and implement their preferential policies. *Taishang* have played a decisive part in easing their dealings by setting a more relaxed climate in two ways: their influence or involvement with both the Chinese and Taiwanese political elites, and the spontaneous, general or natural economic activity in the Taiwan Strait.

Stability is one of the most precious assets to entrepreneurs, and they need continuously to interact with government authorities, engage in social activities, workshops, conferences and strengthen commercial links with the mainland in order to give the region where they are based a more peaceful and prosperous future, and to reduce obstacles which they might face.

With Hu Jintao's policy of "counting on the Taiwanese people" (Keng and Schubert, 2010), the importance of their political role has been noted by many. Keng and

Shubert and others fear that they could be hostages to any moves by China to pursue reunification but the present feeling is that China would not succeed in trying to use them to gain political leverage. Keng and Schubert argue that *Taishang*'s political roles can be classified as "China's hostage (passive role)"<sup>3</sup>, "China's agents (active role)"<sup>4</sup>, "Taiwan's buffer (passive role)"<sup>5</sup>, "Taiwan's lobbyist (active role)"<sup>6</sup>. In their view, China will not take any action against Taiwan with reference to *Taishang* because: 1. China's need for coordination and its complicated political history with Taiwan; 2. in the psychological game-play, the threat of economic sanction is diminished because of the background presence of the USA, likely military support should China embark on military foray; 3. targeting the *Taishang* with selective sanctions, though used in a few cases such as Xu Wen-Long<sup>7</sup>, is risky economically for China because of the consequences internationally for the efforts to attract FDIs; 4.

<sup>3</sup> If China threatens to cut off cross-strait economic ties, putting *Taishang* business interests and assets in jeopardy and holding them as economic hostages, they may be used to force the Taiwan government into line.

<sup>4</sup> In order to counter China's pressure and to secure their own economic interests, the *Taishang* actively support and promote China's Taiwan policy, thus acting as Beijing's agents.

<sup>5</sup> If the *Taishang* are recognised by Beijing to be indispensable for the growth of China's export economy, they may become a political buffer for Taiwan, thus helping the Taiwan government.

<sup>6</sup> If the *Taishang* can effectively use their own institutional channels – most notably the Taiwanese merchants associations (TMAs) to influence the Chinese government, they may become lobbyists for Taiwan.

<sup>7</sup> Xu Wen-Long is a previous CEO of Chimei enterprise who has the significant investment in China. He supported the DPP, the party in power from 2000-2008, which has traditionally had a pro-independent inclination. He was regarded by the Chinese government as a pro-Taiwan-independent businessman; therefore he was restricted by China for his business in China.

Chinese central government needs to be transparent because of the WTO entry. As a result, there is less room for individual economic sanctions to achieve central political objectives. Furthermore, local officials who play the predominant part dealing with *Taishang* in fact have their policy agendas (Keng and Schubert, 2010: 299-300).

### **5.3 The role of the Taiwanese Merchant Association (TMA)**

The relationship between the Chinese local officials and *Taishang* is by way of government to business individual contacts and also government to business groups. These business groups are the so called Taiwanese Merchant Associations which are set up by Taiwanese business people in China.

TMAs are most important in bringing together Taiwanese businesses operating in mainland China and securing Chinese government authorities' cooperation. (Lee, 2008) The need for businesses to have their views effectively considered by local government authorities prompted them to organise associations to provide a strong and concerted voice. The first Taiwanese Business Association was established in 1990 in Beijing. There are now over 100 TBAs. The Chinese for their part appoint staff from the local Taiwanese Affairs Office<sup>8</sup> (TAO) to each TMA and in fact it is the

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<sup>8</sup> The Taiwanese Affairs Office is the highest Chinese government department dealing with any matters

practice for one of their staff to be designated deputy chairman or general secretary in each TMA. As can be expected, there are differing views as to whether these appointments are to be seen as positive; though they provide for more expeditious contacts for the promotion of company affairs, their activities are under constant supervision by the Chinese central government. This was more marked at the outset when the government was unsure how to view these associations. Nevertheless, the real effectiveness is at the local level, particularly for the Taiwanese small and medium businesses which predominate in Southern coastal China (Keng and Schubert, 2010). The larger Taiwanese enterprises tend to have more direct access to Chinese local officials.

*Guanxi* operates at all levels of the Chinese bureaucratic system. It is traditional in Chinese relationships and it is necessary to be aware of its role in facilitating dealing with Chinese officials and establishing a good rapport with them. These officials are constantly changing, so it is an on-going process (Lee, 2006). Because of a common language, longer established business investment in China, and a larger presence than other foreign investors, generally speaking, Taiwanese businesses have more effective direct contact with local officials – foreign businesses seeing the need to employ relating to Taiwan.

locals to have necessary *guanxi*. A more detailed explanation is given later in this chapter.

The *Taishang*'s close relationships with local authorities allow the Taiwanese to build well-functioning interest networks that give them substantial influence in Chinese local politics. On the whole, the TMAs keep a low profile, restrict themselves to providing a service platform for their members, and most importantly, focus on perpetuating smooth relations between the *Taishang* and the mainland authorities (Keng and Schubert, 2010:307). The function of TMAs is described as helping to ease potential tensions in the Taiwan Strait, providing a platform for their members, sustaining positive relations between *Taishang* and the Chinese authorities.

The author's interviews with TMA secretaries indicate that:

1. TMAs are unlikely to influence the government's official policies. According to Mr. Chang of TMA Shenzhen, TMA is not a governmental agency and it does not carry a great deal of weight in political negotiation with China. It is also not to replace the role of Taiwanese government and act on its behalf. Even so, TBAs still play an important role in maintaining informal networking, mutual understanding and interaction.

2. TMAs are significant to small and medium enterprises, especially in labour intensive industries, which struggle to resolve problems posed by customs authorities and an ever-changing legal environment. TMAs mainly consist of Taiwanese small and medium enterprises, though some large enterprises are also inclined to join TMAs. The interviewee, Mr. Zhou-Yuan Chang felt the need for smaller companies to have collective and concerted voices to communicate with Chinese government authorities as the strength of bargaining depends on the significance of contribution companies can make and their size or scale.

3. TMAs are rather irrelevant to large Taiwanese companies with their own access to powerful political decision-makers in their locality, or to those enterprises in the service sector with solid economic positions that usually do not need a TMA at all.

TMA is, by and large, a facilitating bridge between the Chinese officials and individual Taiwanese entrepreneurs. As well as the Chinese local government, the Taiwanese Affairs Office (TAO) is one of the key Chinese political units which Taiwanese business people need to engage with and make connections with. Especially when it comes to Taiwanese preferential treatment, TAO plays a role in monitoring such a treatment, assuring its implementation and helping resolve any unfair incidents. The next section discusses TAO in more detail.

#### **5.4 The role of the Taiwan Affairs Office (TAO)**

The Taiwan Affairs Office of the State Council is an administrative agency of the State Council of the PRC. It issues and implements guidelines and policies related to Taiwan, stipulated by the Communist Party of China Central Committee and the State Council.

Members of the Taiwan Affairs Office are also members of the Communist Party of China Central Committee Taiwan Task Office. The structure of the office is divided into ten departments including the department of Secretary (inclusive of Personnel affairs), Integration, Research, Information, Economy, Hong Kong and Macao Affairs Related to Taiwan, Exchange, Liaison, Law and Regulation and Complaints and Coordination. It is responsible for preparation and conduct of negotiations and agreements with the 'Taiwan authorities'. It also administers and coordinates direct links in mail, transport and trade across the Taiwan Straits, has charge of the media and publicity work related to Taiwan, releases news and information concerning Taiwan affairs, and handles major incidents related to Taiwan<sup>9</sup>.

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<sup>9</sup> The detailed main functions of the Taiwan Affairs Office can be seen at [http://www.gwytb.gov.cn:8088/detail.asp?table=Introduction&title=Introduction&m\\_id=3](http://www.gwytb.gov.cn:8088/detail.asp?table=Introduction&title=Introduction&m_id=3).

The Taiwan Affairs Council is also responsible for coordinating and overall planning of economic and trade relations concerning Taiwan and exchanges and cooperation in such areas as finance, culture, academic research, sports, science and technology, and health, with the departments concerned. It also manages matters relating to personnel of both sides and relevant work on international conferences involving Taiwan.

In his introduction to be found on the Taiwan Affairs Office website, the minister gives his general description of the purposes of the office. While he strikes an encouraging note for Taiwan-China relations, he is careful to preserve the party line about Taiwan as a part of China by referring to “Taiwan compatriots” and China’s aspiration for the “reunification of our motherland”. The TAO plays an important and facilitating role in Taiwanese investment throughout all mainland China, particularly in the provinces and cities where most Taiwanese people settle, especially in the YRD and PRD.

As mentioned in previous chapters, case studies in this thesis focus on the YRD and the PRD since these two deltas are the top two areas for Taiwanese and

non-Taiwanese foreign investment. In 2009, according to the Taiwan MOEA<sup>10</sup>, these two deltas made up 68.5% of China's FDI and the amount of investment is approximately over 900 billion US dollars. The top ten countries to invest in China are the following: Hong Kong<sup>11</sup>, Taiwan, Japan, Singapore, USA, South Korea, United Kingdom, Germany, Macau<sup>12</sup> and Canada. Capital from these ten states contributes to 88.3% of China's FDI<sup>13</sup>. As discussed earlier, in 2007, over 80% of total Taiwanese investment is in the areas of the YRD and the PRD (See Table 6.4). Hsing (1997:150-151) suggests the main reasons as being: (1) Cluster effect; (2) cultural and linguistic affinity; (3) close geographic proximity; (4) preferential policies provided by local government, mainly relating to tax relief; (5) direct negotiation with local government authorities without Beijing's involvement and (6) the Taiwanese SME have less curbs imposed by Taiwanese government such as maximum capital they can invest. The next two sections discuss the overview and importance of the YRD and the PRD respectively.

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<sup>10</sup> The Taiwan Ministry of Economic Affairs, Please refer to <http://twbusiness.nat.gov.tw/countryPage.do?id=10&country=CN> for details

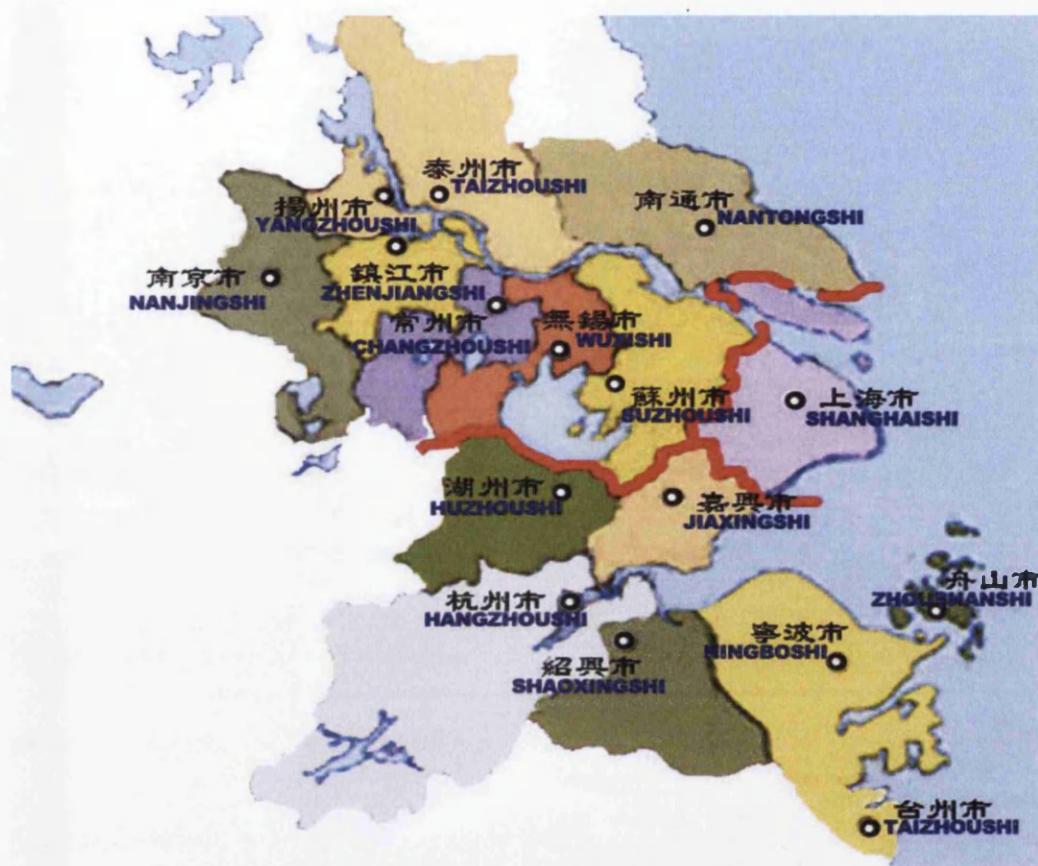
<sup>11</sup> Hong Kong is a Special Administration Region of the PRC and is a separate custom territory from China. For the researcher's case studies, foreign investors do not include Hong Kong and Macau for this reason.

<sup>12</sup> Macau is also a Special Administration Region of the PRC and has its own customs requirements. Macau is not included in author's case studies.

<sup>13</sup> The investment figure also includes capital coming from third areas such as British Virgin Islands, Cayman Islands, Mauritius, and Samoa etc on behalf of those ten countries and economic entities.

### 5.5 The Yangtze River Delta (YRD)

Table 5.3 Map and Cities/Prefectures/Counties of the YRD



<i>City Administration Level</i>	<i>City</i>
Provincial-level municipality	Shanghai
Sub-provincial-level city	Nanjing, Hangzhou, Ningbo
Prefecture-level city	Jiangsu Province : Yangzhou, Taizhou, Nantong, Zhenjiang, Changzhou, Wuxi, Suzhou  Zhejiang Province : Huzhou, Jiaxing, Shaoxing, Zhoushan, Taizhou

Source: Adapted from Pearl River Delta and Yangtze River Delta Collection online resource, Run Run

The Yangtze River Delta (the YRD or *Chang Jiang Sanjiaozhou* in Chinese) generally comprises the triangular-shaped territory of Shanghai, southern Jiangsu province and northern Zhejiang province of China. The Yangtze River drains into the East China Sea of the Pacific Ocean. The region includes some of the fastest-growing economies in China in recent years, and as of 2007 accounted for over 18% of China's total gross GDP according to HKTDC figures (Hong Kong Trade Development Council). This area produced a GDP of approximately \$2 trillion US dollars in 2007 according to the International Monetary Fund. It covers 99600 square kilometres and is home to over 105 million people as of 2007 (80 million living in urban areas) according to UN data whereas the population is over 147 million in 2008 based on the Chinese census of 2008 and the data provided by the Chinese national news agency *Xinhua News*<sup>14</sup>. It is also one of the most densely populated regions in the world. Key cities of this region include Suzhou, Shanghai, Hangzhou, Wuxi and Nanjing. It incorporates sixteen municipalities in three provinces. It, like the Pearl River Delta area, has become a model of economic development for other provinces in China to follow. While the Pearl River Delta was the pioneer in attracting Taiwanese investment, the

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<sup>14</sup> The data can be accessed from [http://news.xinhuanet.com/ziliao/2009-06/16/content\\_11552079.htm](http://news.xinhuanet.com/ziliao/2009-06/16/content_11552079.htm). The census also included foreign expatriates working in China.

YRD has over the years succeeded in drawing an even greater number of Taiwanese businesses. (Also see Table 6.4)

### **5.5.1 Economic Performance and Policy**

The success of the China's policy of promoting development in the YRD is shown in the following areas and this has naturally resulted in attracting foreign investors and Taiwanese in particular. In percentage terms, the proportions attributable to this region are indicated<sup>15</sup>.

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<sup>15</sup> The YRD's economic performance in 2007: GDP amounted to RMB4, 686 billion or 18.8% of China's overall economy. GDP growth reached 15.3% in real terms. GDP per capita was RMB47, 513, compared to about RMB18, 934 for China as a whole. Retail sales amounted to RMB1, 443 billion, 16.2% of China's total. Industrial output reached RMB9, 837 billion, 24.3% of China's total. Exports amounted to US\$451 billion, 36.9% of China's total. Actual foreign investment amounted to US\$36.9 billion, 49.3% of China's total.

Table 5.4 Major Economic Indicators of YRD (2007)

Cities	Land Area (sq. km)	Population (mn)	GDP (RMB bn)	GDP Growth (%)	Per Capita GDP (RMB)	Retail Sales (RMB bn)	Exports(US\$ bn)	Actual FDI (US\$ bn)
<b>YRD Total</b>	<b>110,115</b>	<b>93.9</b>	<b>4,686.3</b>	<b>15.3</b>	<b>47,513</b>	<b>1442.6</b>	<b>450.7</b>	<b>36.9</b>
Shanghai	6,341	18.6	1,218.9	14.3	66,367	384.8	143.9	7.9
Hangzhou	16,596	6.7	410.0	14.6	52,590	129.6	30.0	2.8
Ningbo	9,816	5.6	343.5	14.8	50,474	103.5	38.2	2.5
Jiaxing	3,915	3.4	158.5	14.4	38,357	50.1	11.7	1.7
Huzhou	5,818	2.6	89.2	15.0	32,047	31.9	3.7	0.8
Shaoxing	8,256	4.4	197.2	14.3	43,442	51.5	13.8	1.1
Zhoushan	1,440	1.0	40.9	17.0	39,605	13.2	2.4	0.1
Taizhou	9,411	5.7	172.3	14.5	30,105	59.6	9.4	0.3
Nanjing	6,582	7.4	328.4	15.7	53,638	138.0	20.6	2.0
Wuxi	4,788	6.0	385.9	15.3	83,923	113.5	29.3	2.8
Changzhou	4,385	4.4	188.1	15.6	52,841	61.1	9.8	1.8
Suzhou	8,488	8.8	570.1	16.0	91,911	125.0	118.9	7.2
Nantong	8,001	7.2	211.2	16.2	27,500	73.7	9.0	3.1
Yangzhou	6,634	4.5	131.2	15.7	28,585	41.9	3.3	0.9
Zhenjiang	3,847	3.0	120.7	15.5	44,894	33.1	3.7	1.1
Taizhou	5,797	4.6	120.2	15.7	23,933	32.1	3.0	0.8

*Note: a) GDP per capita of the YRD is calculated based on the GDP and population figures in this table.*

*b) Industrial output of industrial enterprises with an annual sales income of over RMB 5 million.*

*Source: Statistical Yearbooks of Shanghai, Jiangsu and Zhejiang, 2008*

### 5.5.2 Industries

The YRD's manufacturing industries are developing rapidly, partly as a result of the influx of foreign investment. Cities that have a relatively large industrial production include Shanghai, Suzhou, Wuxi, Hangzhou, Ningbo and Nanjing. The YRD's total industrial output amounted to RMB 9,837 billion in 2007, accounting for about 24.3% of China's total.

While the Pearl River Delta excels in the assembly of light consumer goods, the YRD is more focused on heavy industries such as machinery, chemicals and other upstream industries, i.e. the production of raw materials, intermediate goods and capital goods including electronic parts, textile and chemical fiber. For example, in terms of volume, Shanghai and Jiangsu together accounted for more than 70% of the national total output of micro-computers; Jiangsu and Zhejiang together accounted for 69% of China's total output of chemical fiber in 2007. Within the YRD region, while Jiangsu and Zhejiang are major producers of garments, textiles, chemical fibers, and machinery, Shanghai also produces a relatively large share of chemicals, machinery and motor vehicles. Shanghai alone produced 17% of China's total output of cars in 2007.

**Table 5.5 Major industries of the YRD and their shares in China's industrial output (2007) (%)**

Industries	Shanghai	Jiangsu	Zhejiang
Textile industry	1.9	23.0	22.4
Garments & other fibre products	5.7	22.5	17.3
Raw chemical materials and chemical products	6.1	19.3	8.0
Chemical fibre	2.6	31.4	37.2
Smelting and pressing of ferrous metals	4.8	15.3	3.4
General purpose machinery	10.3	18.0	14.0
Special purpose equipment	5.7	13.5	8.3
Transport equipment	8.7	9.0	7.9
Electrical machinery & equipment	6.5	16.7	12.8
Telecommunication equipment, computers and other electronic equipment	12.7	20.9	4.6

Source: *Statistical Yearbooks of China, Shanghai, Jiangsu and Zhejiang 2008*

### 5.5.3 Foreign Trade

The YRD is an important export base in China. From 2001 to 2007, YRD's exports rose

by an average of 38.7% per annum to US\$451 billion in 2007, which accounted for

36.9% of China's total exports. Major export items included machinery, transportation

equipment, electrical equipment and parts, garments, textile and raw materials. Major

export markets included US, EU, Japan, Hong Kong and South Korea. Apart from

some products such as precious metals, raw materials, electrical parts, cements, Taiwan

does not feature prominently in China's export market (ranking as the 9<sup>th</sup> biggest

market for China's export based on the figure of National Bureau of Statistics of

China<sup>16</sup>). In contrast Taiwan has a phenomenal trade surplus<sup>17</sup> through its exports to China of such products as mechanical parts, plastics, steel, polyester, chemicals etc. According to the Ministry of Economic Affairs of Taiwan and the National Policy Foundation (13/06/2002), export to China accounts for over 25% of Taiwan's total exports and from November 2001, China replaced the United States as the top market for Taiwan's exports.

From 2001 to 2007, YRD's imports grew by an average of 29% per annum to US\$327 billion in 2007. As a manufacturing base, major imports of the YRD included raw materials, chemical products, electrical equipment, and parts and components. Major import sources included EU, Japan, US, Taiwan, South Korea, and Hong Kong.

### **5.3.4 Foreign Investment**

FDI inflow amounted to US\$36.9 billion in 2007, over 49% of China's total. Hong Kong is the leading source of FDI in the YRD (HKTDC, 2008). Other major investors include Taiwan, Japan, Singapore, US and South Korea.

Over 80,000 foreign companies have invested in Shanghai, Zhejiang and Jiangsu. Major foreign companies include General Motors, Shell, Matsushita, Exxon, Siemens,

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<sup>16</sup> Please refer to <http://www.stats.gov.cn/english/statisticaldata/> for details.

<sup>17</sup> According to the Ministry of Economic Affairs of Taiwan, the trade surplus is close to 500 million US dollars in 2010. Please refer to <http://www.moea.gov.tw>

Sony, Volvo, TSM Taiwan, ASUS and LG. Such investment is more concentrated in Shanghai, Suzhou, Wuxi, Nantong, Ningbo and Hangzhou. In 2007, these six cities accounted for over 71.3% of the region's FDI.

Foreign investment in the YRD concentrates on the manufacturing sector, such as the manufacture of computers, mechanical and electrical products, hardware and chemical products. Relocation of high-tech industries to the YRD is significant. In particular, many Taiwan businesses have shifted their high-tech products manufacturing to the YRD region in recent years. Taiwan's high-tech investment has focused on Kunshan, Suzhou, and Wuxi, of which many of these companies are engaged in IT products and high-tech electronics such as PCs, semiconductors, integrated circuits, digital cameras and LCD monitors.

#### **5.5.5 Consumer Market**

The YRD is one of China's largest and most sophisticated consumer markets. The relatively high income level in the YRD, combined with a large inflow of tourists, resulted in strong consumer demand. Its combined population of 93.9 million contributed to total retail sales of RMB1, 443 billion in 2007, which was about 16.2% of China's total.

The consumption pattern in the YRD is also moving towards services. There is also a trend of rising expenditure on new types of durable goods, such as cars and computers.

Besides a huge consumer market, the YRD also has major distribution hubs. The retail sector is highly developed with major foreign enterprises represented, of which Taiwan's Trust-Mart features. (Others include Carrefour from France, Metro from Germany, and Yaohan from Japan). In common with other countries reaching a sophisticated level of consumer development, China, especially the YRD, has embarked on the most modern forms of retail development such as chain stores, supermarkets, hypermarkets, warehouse type markets and shopping malls.

For Taiwanese investors wishing to gain access to China as a whole, the YRD is therefore a significant point of entry. This has been one of the main drivers for Taiwanese companies' selection of this delta for investment.

However, one should be aware that the picture is getting more competitive for Taiwanese as well as other foreign investors. China's growing economic power and success in trade and investment has reached the point where they compete in what they have to offer in the world market with advanced industries such as those from Germany. The rapid growth in China's GDP is having an effect on the labour market

with an impact on the level of wages and the government is conscious of the need to curb wage inflation. China is coming to the point where investors are not encouraged to the same extent as before in the YRD and in certain cases they are even advised to look elsewhere, e.g. Vietnam. Interviewee GY3<sup>18</sup> said: “saturation of foreign investment in the high-tech park in Shanghai and other coastal provinces of China makes it more difficult for us to give preferential treatment specifically to Taiwanese investors. Also more and more Chinese companies are able to accumulate their capitals to compete with foreign companies and Taiwanese ones for bidding and proposals. Various factors force some foreign companies to have to make a decision to move their investment into less developed Chinese provinces or countries with even cheaper labour cost such as Vietnam and Indonesia.” China itself is now engaged in moving into other countries (in the same way as some other BRIC companies e.g. Tata of India) and indeed is on the acquisition trail for even the largest companies.

#### **5.4 The Pearl River Delta (PRD)**

**Table 5.6 Map and Cities/Prefectures/Counties of the PRD**

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<sup>18</sup> Please refer to Appendix 5.A for the coding.



City Administration Level	City
Provincial-level municipality	Guangzhou City; HK SAR and Macau SAR
Sub-provincial-level city	Shenzhen, Zhuhai, Foshan, Jiangmen, Dongguan, Zhongshan
Prefecture-level city	Guangdong Province : Huizhou Urban District, Huiyang County, Huidong County, Boluo County, Zhaoqing Urban District, Gaoyao City and Sihui City

Source: Adapted from Pearl River Delta and Yangtze River Delta Collection online resource, Run Run

Shaw Library, City University of Hong Kong, 2006

This delta is formed where the Pearl River flows into the South China Sea. The Pearl River Delta (the PRD or *Zhusanjiao* in Chinese) is mainly situated in Guangdong province of the PRC and is the second most populous area in China and one of the most densely populated in the world. It is a focal region for China's economy. Like

the Yangtze River Delta, it includes highly developed metropolitan cities.

Metropolitan areas include : Guangfo Metropolis (Guangzhou, Foshan, and Zhaoqing),

Greater Hong Kong<sup>19</sup>, Shenzhen, Dongguan-Huizhou Metropolitan Area (Dongguan

and Huizhou), Greater Macau<sup>20</sup>, Zhuhai, Jiangmen-Zhongshan Metropolitan Area

(Jiangmen and Zhongshan), Huiyang County, Huidong County, Boluo County,

Gaoyao and Sihui. According to the 2010/2011 State of the World Cities report,

published by the United Nations Human Settlements Programme, the population of the

PRD is estimated at 120 million people while *Zhongguo quyu jingji tongji nianjian*

2010 (Chinese Regional Economic Statistics Yearbook, in English) gives a figure of

25.5 million registered inhabitants. The disproportionately low number of migrants in

the PRD is mainly caused by the fact that many migrants coming from rural areas

outside the PRD in Guangdong or from other provinces, and do not register themselves

in the PRD as their household addresses are still registered at their hometowns. Many of

the migrants move frequently because they work part-time or have short-term contracts,

resulting in a discrepancy in the population numbers in the census. In addition, the

census does not include foreign business people who are on short-term contracts

working in China. The region is fast becoming the world's first Mega-region, which

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<sup>19</sup> The PRD that the author refers to does not include Hong Kong as it is considered as a separate custom territory.

<sup>20</sup> Macau is not considered in the author's PRD cases of this thesis as it is a special administrative zone of China.

encompasses large agglomerations of urban conglomerations with over 100 million people. (Vidal, 2010) One thing worth noting is that official Chinese data sources are often inconsistent, as Bajpai and Dasgupta (2003) and Sethi, Judge and Sun (2011) state.

The economic reform of the late 1970s has transformed the region from an area consisting mainly of small rural villages and farms into China's economic powerhouse. The PRD has become one of the leading economic regions and a major manufacturing centre of China and the world. Since 1980s, when the economic reform became more established, foreign investment has poured into this region. The PRD like the YRD was one of the first few developed economic zones, becoming a role model for other areas in China to learn from for economic growth and social stability. Its internationally favourable aspect, with Hong Kong established as eminent in world finance and service industry and with manufacturing strength of Guangdong, has provided an economic gateway for foreign capital and investment in greater China, a process encouraged by the Beijing government. The eastern side of the PRD (Shenzhen, Dongguan), relying largely on foreign capital, is the most developed economically. Because of the long history of Taiwanese investment and the local government authorities' welcoming incentives, a large amount of Taiwanese

investment (mainly small and medium enterprises) is based there. While the western areas of Foshan, Zhuhai, Zhongshan and Jiangmen, mainly served by local private capital, are open for development and other foreign investment opportunity, they have attracted a lesser amount of Taiwanese investment.

The Pearl River Delta has become the world's major manufacturing base for products such as electronics, shoes, textiles and garments industries, leather and plastic products, and toys. A large part of the industries' focus is on exports, with substantial investment from foreign sources, these being attracted particularly by tax and other privileges from the local government for export-only goods. Private enterprises are developing rapidly particularly since 2000 when they have had a much easier development environment.

The Pearl River Delta Economic Zone accounts for approximately 29.1% of China's total export and 10.2% of China's GDP.

Table 5.7 Major Economic Indicators of PRD (2007)

Cities	Land area (sq.km)	Population (mn)	GDP (RMB bn)	GDP growth (%)	Per Capita GDP (RMB)	Added value of industry (RMB bn)	Retail Sales (RMB bn)	Export (US\$bn)	Actual FDI (US\$bn)
Guangzhou	7,434	10.0	710.9	14.9	71,808	241.1	259.5	37.9	3.3
Shenzhen	1,953	8.6	680.2	14.8	79,645	329.9	191.5	168.5	3.7
Zhuhai	1,688	1.5	89.6	16.7	61,693	47.5	30.1	18.5	1.0
Foshan	3,848	5.9	360.5	19.2	61,199	233.2	94.7	26.2	1.6
Huizhou	11,158	3.9	110.5	17.4	41,044	50.3	35.4	14.6	1.2
Dongguan	2,465	6.9	315.2	18.2	46,027	143.1	69.6	60.2	2.1
Zhongshan	1,800	2.5	123.8	15.7	49,488	82.5	39.6	17.3	0.7
Jiangmen	9,541	4.1	110.7	15.1	37,779	57.6	40.9	8.7	0.8
Zhaoqing	14,856	3.8	59.3	15.3	35,695	16.8	19.7	2.2	0.8

Note: a) figures in value terms are calculated at current prices;

b) statistics of value-added of industry cover all state-owned and non-state-owned enterprises with an annual sales revenue over 5 million yuan (RMB)

c) Panyu is a district of Guangzhou. Chencun, Nanhui and Shunde are districts of Foshan. Those cities are not separately listed here;

d) Hong Kong and Macau are not listed here because they are not in the scope of this thesis when referring to the PRD. Politically they are Special Administrative Regions.

Source: Guangdong Statistical Yearbook 2008, and HKTDC 2008 index

The following table shows the dramatic change in the composition of the PRD's industries since 1980s. As can be seen, primary industry now plays a minimal part in the PRD economy and the interviews of the researcher in China accordingly focus on the secondary and tertiary industries in the PRD and the YRD, these being conducted with those Taiwanese and non-Taiwanese companies and government officials.

**Table 5.8 PRD Composition of GDP (%)**

	1980	2007
Primary Industry (%)	25.8	2.4
Secondary Industry (%)	45.3	51.0
Tertiary Industry (%)	28.9	46.6

*Source: Guangdong Statistical Yearbook 2008*

### **5.6.1 PRD as a Manufacturing Base**

The beginning of the 1980s saw the commencement of whole-scale manufacturing with the labour intensive production of consumer items including toys, clothes and food and beverages. This prompted the relocation of industry from other regions, principally from Hong Kong, with light industry forming an increasingly thriving part of the PRD economy. This was followed in the 1990s by heavy industry which then played a leading role in the industrial output of the PRD, providing a flourishing export market.

Prominent in this has been the manufacture of high-tech electronic equipment and machinery, automobiles and chemical products. The PRD provides a majority share of world production of toys, Shenzhen itself accounting for one fifth of world mobile phones. The following table gives details of the varied industrial profile of Guangdong province.

**Table 5.9 Performance of the 9 Pillar Industries of Guangdong in 2007**

Industrial Output Value of 9 Industries	Gross Output (RMB bn)	Proportion (%) in the Gross Industrial Output above Designated Size
<b>Nine Industries</b>	<b>3,887.9</b>	<b>71.6</b>
<b>Three Fresh Industries</b>	<b>2,692.9</b>	<b>48.7</b>
Electronic Information	1,337.7	24.2
Electric Equipment and Special Purposes Equipment	850.2	15.4
Petroleum and Chemistry	505.0	9.1
<b>Three Traditional Industries</b>	<b>763.3</b>	<b>13.8</b>
Textile and Garments	304.4	5.5
Food and Beverage	237.5	4.3
Building Materials	221.4	4.0
<b>Three Potential Industries</b>	<b>431.7</b>	<b>7.8</b>
Logging and Papermaking	131.1	2.4
Medicine	43.2	0.8
Motor Vehicle	257.4	4.7

*Note:*

a) the figures in value terms are calculated at current prices

b) statistical coverage includes all state-owned and non-state-owned enterprises with an annual sales revenue over 5 million yuan

Source: *Guangdong Statistical Yearbook 2008*

Foreign investors have been large players in the region's industrial progress. Foreign capital plays a major role in PRD's industrial development. In 2007, the region's utilized FDI reached US\$13.1 billion, 17.5% of the national total. Foreign enterprises, most of which are from Hong Kong and Taiwan, accounted for 62.9% of Guangdong's total exports. Shenzhen, Dongguan and Guangzhou, thanks to their proximity to Hong Kong, are the 3 cities in PRD that attracted the most FDI. An estimated 57,500 factories with Hong Kong interest are operating in PRD (Guangdong Statistical Yearbook 2008).

With the lifting of restrictions on private enterprises and their formal recognition, the PRD in recent years has seen a rapid growth of such companies from 2000 till the present. In the whole of Guangdong, the value of exports from private enterprises ballooned from US\$614 million to US\$65.2 billion.

### **5.6.2 Industrial Agglomeration**

The success of China in manufacturing has been attributed to the “cluster effect”<sup>21</sup> (Porter, 2000): industries benefit against their competitors by geographical concentration. The supply chain is located within a certain area, where the sourcing of

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<sup>21</sup> A business cluster effect is a geographic concentration of interconnected businesses, suppliers, and associated institutions. This effect is thought to increase, nationally and internationally, the productivity with which companies can compete.

all parts of the production process takes place and thereby enables the rapid fulfillment of orders. Greater efficiency in the use and production of resources is achieved, costs are reduced and there can be a greater degree of specialization. The east bank specializes in the production of electronics and IT and the west bank in household appliances. PRD has established various special purpose zones in order to be a magnet to foreign enterprises with tax deductions and exemptions. At the present day, there are 4 Economic and Technological Development Zones, 6 New- and High-tech Development Zones, 6 Tariff Free Zones and 2 Export Processing Zones which exist in this area (Taiwan Economic and Trade Monthly, 2010).

### **5.6.3 Services Industry**

In this period, the tertiary industry has increased in importance with residents' growing prosperity, resulting in an increased demand for such services as education, telecom services, travel and recreation. The expansion of manufacturing has led to a concomitant growth of business service in the PRD.

### **5.7 Analysis of personal interviews**

The author conducted interviews with key Taiwanese and non-Taiwanese companies' personnel, local and central Chinese and Taiwanese officials and academics, against

the backdrop of the shifting and constantly evolving economic and political scene.

Several themes highlight the interaction between government authorities and investors

and the preferential treatment available to investors.

For reasons of confidentiality, the interviewees are coded as follows, their details

being shown in a special appendix. They come from the manufacturing and tertiary

sectors and they and their companies are Taiwanese, European, Japanese and

American by nationality. They occupy positions at or above managerial level. In the

case of the Chinese government authorities' agencies and departments, interviewees

were selected for their direct connection and association with the FDI in its various

aspects. As to academics, the interviewees specialise in East Asian Studies with a

focus on Taiwan-China relations. With a variety of sources, a more balanced picture

can be gleaned, providing a more reliable analysis. In total, the analysis is based on

over 25 personal interviews in China and Taiwan. Some of the interviewees

mentioned in this chapter and Chapter Six are coded because they chose not to have

their names revealed in this thesis (the list of coding is on Appendix 5.A).

Yeung in his paper of 1999 entitled *the Political Economy of Singaporean Investments*

*in China* commented that "the re-articulation of China into the global economy since

December 1978 has led to a tremendous influx of foreign capital during the past two decades". Singaporean companies have felt a need to look outside the country's boundary (i.e. Singapore) in view of a limited domestic market. As a consequence, a great deal of investment has gone to China and Yeung was able to conduct interviews with over 200 Singaporean companies and 50 of their subsidiaries and/or affiliates in Hong Kong and China. His interviews demonstrated the success of transnational operations as relying on well-established networks of social and political relationships, providing vital political leverage and useful strategic resources. As with the researcher's own interviewees, his research pointed to the importance of a firm rapport with local politicians and the need for awareness of the role of China's and the foreign countries' politics in the international business operations of foreign investors.

### **5.7.1 Negotiation/Communication with Chinese Government**

Lucy Kellaway in her article in the Financial Times (2011) comments that the Chinese workplace "is riddled with office politics – promotions on merit are almost unheard of; the rules that govern relationships and status are all important – and impossible for any westerner to grasp".

Yeung (1999) like my interviewees saw no evidence of the waning of *Guanxi* as a

result of the growth of market socialism but on the contrary, because of less central control, there are more opportunities for a variety of influences notably *Guanxi* relationship and local politics. He concludes that *Guanxi* will be even more phenomenal in politics than at the times of Mao and Deng because the current Chinese society is less authoritarian and has more private companies. Therefore, *Guanxi* stands out. (See also Wank, 1996:836 and Tsang 1998) His study leads him to advocate companies embracing these features on pain of business “suicide”. He also referred to Hsing’s (1998:141) study of Taiwanese investors’ experiences in southern China showing that public criticism of foreign officials would make them “so embarrassed that they would neither admit their mistakes nor make efforts to improve the situation”.

Purves (1992) points to the importance of relationship in Chinese society, *Guanxi* being a means of cementing relationships. Formal obstacles may thereby be overcome and principles of impartial government treatment may sometimes be ignored. Luo (2007:2) refers to *Guanxi* as a concept of drawing on connections in order to “secure reciprocal exchange of favours in personal relationships...It contains implicit mutual obligations, assurances, and understanding and only socially binding without time specifications.” It also means more than a simple interpersonal relationship and the

inter-firm networking in the West. *Guanxi* in China is omnipresent and “plays a fundamental role in daily life... Constructing and maintaining *Guanxi* is a common preoccupation for entrepreneurs, managers and officials.” Amber, Witzel and Xi (2009: 101) argue that today “*Guanxi* with government remains of primary importance for any businessperson, Western or Chinese. Observers are unanimous on this point: *Guanxi* with [Chinese] government officials plays a much more critical role in business growth and profitability than does *Guanxi* with other managers.” This is echoed elsewhere in the literature and the interviews being conducted also underline the crucial role of *Guanxi* in business-government relationships.

Turning to the field interview, Taiwanese interviewee Mr. Tseng points out that for Taiwanese, “linguistic commonality with China as a communication tool between gift givers and receivers, especially the understanding of the hidden messages underneath the spoken words (such as the timing and type of gifts), plays a crucial role in the establishment of *Guanxi* through gift exchanges.” As for the non-Taiwanese investors, Interviewee Mr. Naert refers to a Chinese proverb saying: “*one cannot make a decision on one's own: It is safer to act with others.* Contacts must be maintained with government officials at every level to ensure they understand the situation and recognize your professionalism. Different levels of government are more or less connected.”

Corruption in China is an issue that foreign investors in China need to face. According to Transparency International's Corruption Perception Index in 2010<sup>22</sup>, China is ranked 78<sup>th</sup> among 178 countries. Furthermore, to many foreign investors in China, the definition and difference between the normal relationship and corruption are different from the Chinese. For example, offering gifts and inviting clients for dinner or drinks are considered Chinese traditional business culture. In Chinese domestic companies, it is common for the employers to hire relatives or friends through nepotism. In China, the boundary of a personal relation and business relation is blurred at times; therefore, employees need to be trained about how they should deal with company regulations. In Chapter 6 (product market), testimonies from the interviews emphasize this situation in the PRD region.

In addition, *Guanxi* sometimes becomes a 'weapon' for a company to attack its competitors - i.e. foreign companies. This is more obvious when that foreign company's networking is not as strong as its domestic competitor. Many foreign companies including Taiwanese ones try to prevent bribery and corruption; however, they also try to adopt Chinese local customs. For example, during three festivals

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<sup>22</sup> The full list can be seen at [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2010](http://www.transparency.org/policy_research/surveys_indices/cpi/2010). Data accessed on 2011/05/03

(Chinese New Year, Mid-Autumn Festival and Dragon boat festival), companies have budgets for presents to government agencies/or persons, donate money to charities or provide workshops for government officials such as in international business training. Mr. Telek's company is a company providing this kind of workshop.

Out of all company interviewees, none said that corruption does not exist in China. Many of them said that their companies avoid bribery, receiving commissions, and exchange of favours, when possible. The ideology and fundamental mindsets of Chinese government senior officials are, in many cases, very different from those of Taiwanese and non-Taiwanese investors. Many over-forty-years-old officials have been brought up during the Chinese Cultural Revolution. They have climbed the ladder to their current high positions under the influence of Communism. Though they may appear internationally minded and energetic, their approaches may conflict with foreign investors' approaches. In the case of those who have been able to receive a Western education, there is a greater understanding of foreign investors' attitudes and ways of conducting business.

Interviewee Mr. Chang referred to the transition of the Chinese economy from a planned economy to a market economy and to several grey policy areas. So that

investment and business practice in China cannot simply rely on the normal business planning model which takes account of cost, business opportunities, capital and expenses, some factors affecting investment not being tangible and predictable.

Interviewee Mr. McLeod also referred to the uncertainty of doing business in China. His discussions with the Chinese government authorities could be long and exhausting but at other times they could be simple or straightforward, no two procedures being the same.

While Mr. Knight acknowledged the benefits of special relationships with Chinese government authorities to his company's performance and competitiveness, it is no longer a prime consideration for his company. For the past 15-20 years, Chinese economic development has taken account of the importance of learning from mistakes. He estimated that his company spends about 65% of the time to interact with government agencies. The majority of the interaction relates to the business deal and negotiation, but at least 10% of the time is spent to consolidate their traditional relationship with the government to establish a foundation of mutual understanding and trust.

Similarly, interviewee Mr. Chiu felt that interaction with the Chinese government is

inevitable. This traditional form of government-business interaction applies to all investors in China, the degree varying from place to place. For example, the Shanghai area differs from the special zone of Dongguan in Guangdong province.

According to Mr. Telek, doing business in China needs patience, and "having good communication with the employees and customers is important. You must show respect to Chinese people and receive the same from them. You need time to understand the nature of business in China. It takes at least two years for this. You should understand the Chinese way of thinking... Being consistent and trustworthy is another issue in doing business in China. Chinese customers would like to see your company operating for at least three years before starting to cooperate with you". This is a two-way process which requires time and patience on the part of the investors before they are fully accepted by the Chinese. Other interviewees such as Mr. Tseng, Mr. Lin and Mr. Shaw also emphasize *Guanxi* takes time in China.

In short, as mentioned in Chapters Two and Three, common problems in the interaction between investors and local government include China's inconsistency of implementing laws, the gap in China's legal system, uncertainty in the interpretation of laws, and slowness in dealing with application and negotiation. They are seen as impediments in business-politics relationship.

Mr. Chen and Mr. Lin consider it to be crucial to build a relationship with every level of Chinese government authorities from the central to the local. “It is best to get their complete support from everyone in the government for your business proposal and try to persuade [them]”. In other words, the key to the success of negotiating with the government is that you should get the complete support. Interviewee Dr. Tao also thinks that, “foreign investors including Taiwanese business people need to possibly establish an amicable relationship with any level of the Chinese government, from the National Development and Reform Commission of People’s Republic of China (NDRC)<sup>23</sup> to the minister of foreign affairs and the vice-minister of NDRC who actually influence the decision”. Mr. Chang mentions the importance of companies fully understanding the thinking of all major officials who affect companies’ business policies and functions. For his company, “in order to get the permission from government officials, we have to communicate and negotiate with all related governmental departments/agencies (such as tax bureau, the custom service, the public security bureau, the public health department and the like) and even indirectly relevant departments/agencies such as local banks and water companies”. Seemingly irrelevant officials, while not necessarily helping, may prove a hindrance to investors. To Mr. Tang, these kinds of interaction seem to be too complicated for

<sup>23</sup> Their website can be viewed at <http://www.ndrc.gov.cn/>

non-Taiwanese investors because they are not used to such. This situation being unique in China, it is difficult for them easily to achieve a wholly comprehensive relationship. Taiwanese investors generally do better in managing this complex and cumbersome relationship. GY1 and PG1 both say that “we know the investors’ intention in mingling with us. As long as we feel respected by them and they follow the rules, we will try everything to help in their application process and business development. Even if they encounter problems, we are willing to resolve them within our authority”. Furthermore, Hsing (1997:159) argues that “the cultural and linguistic affinity between Taiwanese investors and local officials might be necessary in establishing the social networks, yet it is not sufficient to guarantee a successful business operation in China...Cultural affinity does not always come naturally simply because both Chinese and Taiwanese are” ethnically Chinese.

It can be seen that there is no universal principle governing how to interact and communicate between foreign investors and Chinese local government. The ability to build up good *Guanxi* with Chinese government is advantageous for a company from whatever country. The view of local official GY2 echoes the sentiments expressed by others that *Guanxi* along with good local political relationships is a *sine qua non* for foreign investors as for native businesses to prosper.

### 5.7.2 Nationality of a Company

As compared with other foreign investors, Taiwanese businesses in general do get slightly favourable treatment from local officials by reason of their appreciation of the application of *guanxi*. That is mainly because of a shared culture and language. Their early presence in the Chinese investment market also gave them a head-start which they have built upon, establishing close contact and understanding of Chinese officials' mentality and ways of doing things (Interviewee Mr. Tang, Mr. Chen and Mr. Pon). Nevertheless, Mr. Chiu, Mr. Wang and Mr. Lin observed that the advantage of being Taiwanese is not great against non-Taiwanese investors. They also think this advantage is gradually decreasing for a variety of reasons. Moreover, they think there are occasionally distrust, legal disputes over business arrangements and tension between *Taishang* and their local Chinese business partners or employees. As Hsing (1997, 159) puts it, "cultural affinity does not always produce positive results in business operations".

In addition, depending on the view taken by the Chinese authorities of their political relationships with a country, nationality can affect the way that a company from that country is treated. One instance was "when the US imposed trade sanctions on China as a result of the transfer of military technology to Pakistan, the Chinese aviation

authorities switched from purchasing Boeing jets to the European Airbus...” (Breslin, 2007: 141)

If this is true about externally invested (foreign owned) enterprises, it is even more pronounced in the case of Taiwanese given that cross-strait relations are much more contentious and salient in China’s domestic politics.

The interviews with Mr. Naert, Mr. Chang, Mr. Hunter and Mr. McLeod underscore the importance of China’s political relationships with particular countries including Taiwan in the dealings of the YRD and the PRD local government authorities with businesses. However, this does not necessarily mean that the Chinese state’s relations with other countries is the determining factor in the treatment of applications by the two regions’ local government authorities. With the decentralization of the process, local government authorities are given a certain degree of autonomy in economic affairs. Local officials apply the same policies to Taiwanese companies as to other foreign investors; they do not discriminate for or against Taiwanese investors according to the state of the China-Taiwan political climate at any point in time.

All Taiwanese interviewees say that, when it comes to commercial relationships with

Taiwanese companies, the One-China policy is ignored and they are treated as occupying a space neither equivalent to that of Chinese companies nor of wholly foreign companies. In other words, they are viewed as being mid-way between the two categories. Mr. Chen and Mr. Pon indicated that in the early years of their investment in China (the 1990s), the nationality of companies was an important factor for foreign investment. There was less competition then compared with the late 1990s and 2000s, so that a famous brand name of a company or a company of a financially powerful and influential country would be favoured by the local officials. Mr. Wang said, in some cities of the YRD (such as Nanjing), Japanese investors were not viewed with favour because of China's antipathy to Japan resulting from World War Two.

Interviews with GY1 and GY3 show that the negative sentiments of Chinese towards Japan still persist. However, this does not affect how Chinese central or local government view or treat Japanese investment in China. "The ordinary person mostly cares about where they can get employment and the amount of their salary. The nationality of the company they work for does not really matter." (GY1) In addition, GY3 further commented that, "holding grudges against Japanese does not help economic growth, at least from the government's point of view." In other words, though some remnants of anti-Japanese feelings still persist among some sections of

population some time after the bitter experiences suffered during the Japanese occupation, officials are keen not to discriminate against Japanese as they see this to be against the Chinese economic interests.

As for Taiwanese business people, Mr. Chen, Mr. Pon, Mr. Tseng and Mr. Lin confirmed that Taiwanese investors benefit from their "ambiguous" status with the same privileges accorded to foreign investors. But that special status can be a double-edged sword for Taiwanese. The interviewee Mr. Lin's downstream company, a smaller enterprise, experienced difficulties from the local government inspection of its factory. As a consequence, the company had to forfeit some of its equipments as a penalty, though there was no *true* liability on the part of the company. In this type of case, the common language might in fact have been a negative factor; the manager concluded from his previous experience that the advantage of communication in Mandarin Chinese sometimes made it easier to discriminate against Taiwanese. Mr. Lin said that other non-Taiwanese investors in their area did not experience the same problem from local officials as his downstream company faced. Sharing a common language may not necessarily be a guarantee of being attuned to local sensibilities. Even investors such as the Taiwanese who share the Mandarin Chinese language can miss the subtleness of the local language and culture. According to

interviewees Mr. Chiu and PG1 and PG2, discrimination caused by the investors' ability to communicate in Mandarin Chinese is rare. This was a feature in the late 1980s and early 1990s when local officials were not familiar with standard international business practice and had bigger language barriers. As a result of their lack of fluency in foreign languages, local officials tended to have reservations coupled with a cautious attitude (often polite) towards non-Taiwanese foreign investors. On the other hand, Chinese officials expected *Taishang* to grasp the hidden meaning of their words and expected them react accordingly. As a consequence, the Chinese authorities gained a reputation for being at times intimidatory.

Multiple factors have led Taiwanese investors to migrate to China such as cheaper labour cost, tax benefits and business cluster. An important part of the migration has been in the semi-conductor sector which has been one of the crucial industries upholding the Taiwanese economy in the past 20 years. It is also of special concern to both Chinese and Taiwanese government authorities since it affects three aspects of a broadly defined notion of security: economic<sup>24</sup>, technological<sup>25</sup> and defence<sup>26</sup>. The

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<sup>24</sup> Economics competitiveness, economic independence, and a direct contribution to the exercise of power

<sup>25</sup> A concept dealing with the perception of a nation or a firm which presumes that technology is a key element in national security.

<sup>26</sup> State's territorial integrity is chiefly maintained through its military capability

interviewees Mr. Tseng and Mr. Wang saw that Chinese local officials were favourably disposed because of Taiwanese managerial know-how, talent flow, technology transfer, local employment and China's thirst for a much-needed semiconductor human resource. On the other hand, the Taiwanese government saw this as a sensitive industry and companies should refrain from business dealings with the Chinese military, according to the interviewee Mr. Yin-Long Yu. However, business is business. Both Chinese and Taiwanese government authorities may bend the rules or turn blind eyes for convenience or commercial reasons. Mr. Yu confirmed this practice of the Taiwanese government and mentioned that this practice normally relates to grey areas of laws. Mr. Hunter and Mr. Chang both confirmed that the Chinese government would turn a blind eye to cases where they believe they can control the situations or where the company's problem is not too complicated. Mr. Chang also mentioned that in normal circumstances, "the company may need someone to talk to in the government to 'oil the wheels'".

Interviewees GY1 and PG1 claim that Chinese government officials at all levels show a greater or lesser willingness to apply central policy (1988 and 1994 regulations mentioned in Chapter Two) promoting special treatment of Taiwanese companies. He

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views the position and direction of the Taiwan Affairs Office with reference to Taiwanese investment in mainland China as clear and positive. "We, as a government body, are here to help Taiwanese compatriots to establish investment and other economic activities in China. We will attempt to resolve any inconvenience caused to Taiwanese people. We believe that Taiwanese investors have benefited from this either in the Yangtze River Delta or the Pearl River Delta, during the past 20, 30 years."

While anxious to appear neutral, he warned that, "with the competition from other foreign investors and even Chinese domestic companies, the amount of preferential treatment given to Taiwan will inevitably decrease over the years. As having said that, we will still try our best to ensure the interests of Taiwanese people in China." The preferential treatment here is in the form of expedition of business application, taxation benefit, miscellaneous charges, water and electricity charges, rent etc. GY3 also echoed this statement. She points out the different stage of development which the coastal regions have reached as referred to earlier in this chapter.

There is no clear set of rules for Chinese officials to give preferential treatment to a particular country. According to GY1 and PG2 and PG3, "this all depends on the

circumstances including orders from the central government, China's five-year plan(s), local economic concerns and relationship between the company and the government".

Official statements of the Chinese local government in the YRD and the PRD all say that Taiwanese and the people of Hong Kong and Macau are all Chinese compatriots so that China has a responsibility to take care of them and create prosperity for all.

From the interviews and literature, it seems that this statement does not fully reflect the actual situation.

### **5.7.3 New/Old Chinese Bureaucracy**

The Communist party/government has been gradually developing its policies as shown over the years since the first 5-year plan of 1953 (it ran from 1953 to 1957) in line with the increasing openness to outside influences. The apparatus has developed from a less centrally directed bureaucracy to a greater devolution of functions to the lower levels. FDI initiatives are a response of central government to the drive to economic development, and this together with the increased role given to local government authorities mean that initiatives which are set in the 5-year plan are allowed to be largely implemented by the local authorities. This section looks at the way these local government authorities operate in different parts of the PRD and the YRD at the local levels.

Some higher-ranked local officials are from a younger generation who have or have not received education overseas and the others are from older generations having experienced a stricter Communist regime and the Cultural Revolution. Their past experiences and background have led to their different ways of thinking, which affect how they deal with preferential policies and government/business relationship.

“China’s economic reform is still rooted in its socialist past although it is influenced by capitalism. When the ideology of capitalism of foreign investors meets with the ideology of Chinese officials, it can cause misunderstanding and sometimes a clash”, said Mr. Li (AC1 in Appendix 5.A). However, most interviewees feel that this adverse effect of Chinese officials’ ideological approach has reduced over the years.

It is worth noting that, although Chinese economic reform has achieved much, some of the old practices still persist, for example nepotism. “In Shanghai for instance, local government authorities choose officials by their merits and capability; however, in other parts of China, the selection of officials is often based on politics rather than their qualification.” (GY3) This shows that officials in charge in the YRD and the PRD do not always follow the standard guidelines when they have to make decisions

and judgement on the matters such as the appointment of local officials, dispute and business application of FDIs.

Applications for license/permits for foreign investors need to be processed via the central government, provincial government and local government. In each investment case, these three levels of Chinese government must be dealt with simultaneously to be successful. But as Mr. McLeod mentioned, different government levels operate according to their own priorities; and it is a big challenge to meet all government's requirements. He said: "these various governmental departments have different interest considerations to investment cases, timing and participants etc. These situations have not changed much compared to the past". While Taiwanese investors face the same procedures, most operating in the Pearl River Delta, being small and medium enterprises, came to China earlier than most non-Taiwanese companies; they have found ways of working through the Chinese bureaucratic political system. Mr. Pon confirmed that, "Taiwanese companies exchange information with each other and get to know what different levels of Chinese government authorities really ask for from foreign investors. Thus, we can try to avoid the uncertainty caused by the Chinese government as much as possible."

With regard to business risk, there is a difference in attitude between the Chinese officials and foreign enterprises. (Mr. Hunter) "In the west, the business risk management and proactive initiatives are valued and emphasized. But in China, everything is under control and scrutiny", said Mr. Knight. China with its Communist regime sees it as important, while encouraging the growth of a market oriented economy, to maintain political control and a balanced social system. According to Mr. Chang, "on average, officials are often afraid of making mistakes, therefore they are cautious in making decisions. These officials said to me that we live in a society where doing a job is considered normal but making a mistake might result in losing one's job. In this sense, many officials prefer to pass on the decision-making and responsibility to their superiors". In other words, investors are hampered by the ultra-cautious decision-making because of the continuing fear of being held to account by superiors for misjudgement of the viability of a case.

Chinese local government authorities on the whole have been embracing the national policies for economic reform in recent years, and have tended to test the waters first in a particular area to determine whether such initiative works and whether it should lead to more general adoption. Mr. Chen confirms that, "you might realise that central government encourage local departments to carry out certain regulations and observe

their practicality. If they work well, then those regulations will be implemented all over China". In general, except in some cases, "the main influence of the central government is in my opinion the fact that it leaves the local government relatively free in setting up preferential policies to attract investment", said Mr. Naert.

Although the difference in the thinking of Chinese government officials and foreign investors has been a challenge for foreigners, this difference is getting smaller. Most interviewees agree. Mr. Shaw describes the Chinese economic reform as being "gradual from a planned economy to the present market oriented economic model. In the past, the government controlled everything from trivial affair to important policy. For example, they would interfere how much you produced in your factory and how many employees you should hire". Now the situation has changed dramatically. "The officials I have met understand macroeconomics and how to facilitate job opportunities and the importance of profits. In the past, they thought that wealth should be divided for people and companies should not make huge profits. However, nowadays their way of thinking has shifted mainly because they have the eagerness to improve the quality of life. Therefore, some government officials would spend a great deal of time discussing profits of business with you, which did not often exist in the past". The newer generation seems to have a greater understanding of businesses and

cases presented to them. It makes for easier communication and facilitates the implementation of preferential policies.

Mr. Chen also thinks that Chinese officials have a more international perspective which provides a catalyst for business development in China, and that the Chinese government is generally active in tackling economic challenges. Mr. Tseng considers that, "Chinese officials who have a business degree, foreign educational qualification or long-term experiences with interacting with FDIs tend to understand what foreign investors really need. In addition, they seem to be more proactive and ambitious to have economic achievements in their own regions." Mr. Mcleod thinks that Chinese leaders understand what the challenges are and willing and capable of resolving the problems of banking structure and financial stability, development of national enterprises, financial competence, unemployment and social welfare.

The researcher's focus has been on the local government, while they now have a primary role in the relationships with businesses. They are still to be seen as working in accordance with the 5-year plan. The FDI policy affected and guided by this plan and the central government themselves are a response to outside factors. Neither the

central government nor local government operates in a vacuum, and it is of interest to note the way the party reacts to general development as a guide to a future direction of policies, both local and national. Inevitably FDIs come into consideration. From a concentration wholly on economic development, there has been a greater awareness of China's other structural problems which is reflected in China's 12<sup>th</sup> 5-year plan presented to National People's Congress annual meeting in March 2011. The 2011 China's 12<sup>th</sup> 5-year plan focuses on distribution of wealth and domestic economic issues including its urbanization rate (reaching 51.5 percent) and the building of 36 million affordable apartments for persons with low-income<sup>27</sup>. Premier Wen Jiabao said that China will not only address the implications of economic growth but will: "have to shift its measure of economic success away from GDP-focused criteria towards a broader set of sustainability metrics if the country is to meet new goals designed to save energy and reduce reliance on fossil fuels". The plan aims to improve Chinese livelihoods, social infrastructure and safety nets, and to tackle its rising inequality. "Expanding domestic consumption is seen by many as a key part of China's economic structural adjustment and achieving more balanced growth" (Sara Wang, BBC, March 3<sup>rd</sup> 2011). This new direction will naturally have an impact on the

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<sup>27</sup> For details and analysis, please see [http://graphics.eiu.com/upload/eb/china\\_five\\_year\\_plan\\_jan2011\\_public.pdf](http://graphics.eiu.com/upload/eb/china_five_year_plan_jan2011_public.pdf) and <http://www.bbc.co.uk/news/world-asia-pacific-12639898>

relationship between Chinese local government and foreign investors in the coming years.

The 5-year plan reflects the changed dynamics of China's expanding economy and transforming society. The biggest problems include the rate of inflation, the effect on wage demand, availability of labour, redirection of targets for investment and the need to achieve a greater trade balance by reducing the emphasis on exports and encouraging internal consumption. Chinese domestic consumption has rapidly grown in the last 10 years by an average of 15 per cent; China is now the second largest importer according to *MoneyMorning* (March 25<sup>th</sup> 2011). If the state forecast of a rise of 20 per cent in imports and increase of 16 per cent in exports is correct, the trade surplus would reduce by 13.2 per cent.

The new emphasis on consumption is significant for foreign investors with a large manufacturing base in China and other such investors as they will naturally need to direct their appeal to China's consumers.

At the forefront of the central government's mind are also the problems of the present wage tendencies: while wishing to increase wages in line with economic growth by

between 16-26%, they need to combat inflation and adjust the GDP growth rate from 10% down to 7-8%. This measure would also reduce pressure from the USA to appreciate China's RMB currency. China is learning from Japan's experience in the 1960s, which saw the creation of the world's second largest economy for a period of 42 years with a marked increase in wage levels and living standards.

Wage increases will have an immediate impact on foreign-invested factories in China because one of the reasons that FDI come to China is its abundant human resource and comparably low wages which are controlled by Chinese central government. The local government authorities need to think of ways to keep the FDI in their regions, and the local officials will have to adjust their existing preferential treatment or investment recruitment strategy to even more appealing ones. Otherwise, a few of the FDI have inevitably been moving to emerging manufacturing bases such as Sichuan province (notably the municipal city of Chongqing and the capital city of Sichuan- Chengdu) or in the less developed inner regions of China (such as Qinghai, Gansu provinces etc) or even out of the country to places like Vietnam, Mexico and India. Although the Chinese CPC government's 12<sup>th</sup> 5-year plan has embarked on this target of balancing economic growth of different regions of China, local government officials in the PRD

and the YRD have not only had to follow superiors' aims but also had to sustain their own areas' economic prosperity and safeguard the areas' capital flow.

The plan also promises a drive against corruption. That will re-shape some of the informal relationships that currently exist in China's politics-business relations.

Dong Tao, managing director of non-Japan Asia and chief regional economist for the Asia Regional Economy of Credit Suisse remarked: "China is fast approaching the so-called "Lewisian turning point"<sup>28</sup> - a critical moment in a developing economy when its surplus labour supply dries up, prompting hikes in wages, prices, and inflation.

In China, demand for workers will outstrip supply by 2014" (Sophie Leung and Simon Kennedy, Business Week, March 3<sup>rd</sup> 2011). This lack of young labour in the future and aging society are the consequences of China's one-child policy. Tao (interviewee) added "when historians go back and describe 2010, the big story will be the massive increase in salaries that will redefine the global manufacturing model and redefine the inflation outlook for the next 10 years".

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<sup>28</sup> According to Arthur Lewis, developing countries' industrial wages begin to rise quickly at the point when the supply of surplus labour from the countryside tapers off. The Lewisian turning point, named after him, has recently gained wide circulation in the context of economic development in China.

Rising wages make for rising quality of living for substantial parts of the population but while being a goal of the Chinese central government, the authorities are conscious of the associated problems of domestic and global inflation. This will affect the future interaction between Chinese central (including local) government authorities and foreign investors. There will be increased competition to attract skilled workers and know-how between China and other countries. As with central government, local government authorities with their increased functions must take account of all outside factors – economy, the political climate, population pressures, employment, and social factors. The research indicates how different areas react differently to changes in policies with some such as the YRD and PRD being more cooperative in interviewees' experiences.

#### **5.7.4 Decentralisation of Chinese Government**

Chien (2010:69) claims that the trend of Chinese power distribution is one of “economic decentralisation to the local” government and “political centralisation under the Party”. In addition, Hsing (1997) describes the current Chinese local economy autonomy and authority. He noted the argument from Naughton, Oi, Zweig and Solinger that “China’s current economic system is better understood as a decentralised command economy rather than a full-scale privatization or

marketisation process in the neoclassical sense." (Hsing, 1997:145) He further said that Chinese "local officials with newly gained economic authority have become the most important agents for Taiwanese investment in South China. They tend to be more flexible about regulations than provincial or central authorities and are more willing to cooperate with overseas investors." (Hsing, 1997: 147)

The decentralisation process of Chinese government mentioned in Chapter Two is commented on by the interviewee, Mr. Telek who says: "from the late 1990s, Chinese decentralisation is one of momentous occurrences in China. In the past, the applications normally needed to go through the Beijing government; however, now authority is given to the local authorities to make certain rules relating to their areas".

Only the largest investment cases now need approval from the central government. Mr. Knight also thinks this is a very positive change as it allows foreign enterprises to establish a closer relationship with the officials directly who supervise their local business operations. Taiwanese investor, Mr. Chiu said that "even large projects which require approval by provincial, municipal, or central government need full cooperation at the local level, where production is actually carried out." His company is one of these large projects.

Treisma and Cai (2006:505) comment: “many scholars attribute China’s remarkable economic performance since 1978 in part to the country’s political and fiscal decentralization. Political decentralisation is said to have stimulated local policy experiments. Fiscal decentralisation is thought to have motivated local officials to promote development and harden enterprises’ budget constraints. The locally diversified structure of the pre-reform economy is said to have facilitated liberalisation”. They find that there is no “convincing link between decentralisation and China’s successes” and suggest an alternative view of growth-enhancing policies emerging from competition between pro- and anti-market factions in Beijing. However, the interviews and other literature show that there is a link between the Chinese decentralisation process and Chinese economic success. This is mainly because decentralisation indirectly encourages local business recruitment and stimulates the business competition and development. As Hsing (1997:145) noted, new policies allow “local government authorities to retain a major portion of revenue for local use and to grant permission for the investment of foreign capital. Local Chinese officials compete with one another to attract foreign investment projects to their areas, offering more generous tax breaks and cheaper land and minimising bureaucratic holdups.”

Interviewees Mr. Chiu, Mr. Tang, Mr. Chen and Mr. Lin all think that the decentralisation process in China is making progress with the passage of time. Their government contacts who would previously have been almost entirely with central government officials have gradually shifted to the regional levels. This has given them

more room; for example, a more advantageous policy break can be tailor-made through individual arrangements with the local officials (Interviewee Mr. Tang) but with a certain drawback that agreement with local government is not as secure as that with the central government because either they do not completely comprehend all the rules relating to *Taishang* or various officials concerned can differ in their perception of the rules (Interviewees Mr. Chiu and Mr. Chen). One thing which has not changed much is the Chinese management ethos, such as -“*just do it because I say so*”. Generally speaking, the move to decentralisation has made *Taishang* feel that local government officials are slightly more welcoming and cooperative than they were when acting in a subordinate capacity in late 1980s and 1990s. The officials they encounter have “changed a bit of their bossy attitude to a more friendly approach” (Mr. Chen). In other words, when local officials have had more experiences dealing with the FDIs and have adopted newer business mindset, their attitudes towards FDIs have become more accommodating.

It is open to the local government to ensure economic development in their areas without being handicapped by bureaucratic delays previously experienced, occasioned by the need to get central government’s approval. It is a reason for them to encourage foreign investors by *inter alia* dealing with them in a more expeditious manner.

Decentralisation accordingly can provide a way of easing the path of investors, overcoming some of the uncertainty examined in the next section.

### **5.7.5 Uncertainty of regulations**

“Planning cannot beat a change and a change cannot win an order from the boss”. (Interviewee Mr. Tseng) This view is shared by other interviewees and indicates their perception of officials’ attitudes of unilateral decision-making still surviving to some extent from the old authoritarian days, and impartiality in the application of the laws is not always exercised. This hardly makes for predictability in the treatment investors can expect.

Consistency of Chinese laws, regulations and administrative rules is questionable. The PRC legal system is full of apparently mutually irreconcilable laws, and Corne argues that China lacks “an independently constituted body... with the authority to deal with this problem on an ongoing basis” (Corne, 1997:186). The system is not responding adequately to the constant changes in the domestic and world environment, proceeding more on a case to case basis than applying a consistent approach. This is inimical to the objectives of investors who want to be secure in the outlook for their investment. As Potter (1996:174) puts it, this uncertainty “poses particular problems

for the state's capacity to manage foreign investment in pursuit of national development goals." The problem holds good for Taiwanese as much as for others and affects how well the local government authorities implement the regulations relating to the preferential policies.

"China often drafts principles first, then worries about details later" (Lex column, *Financial Times*, March 4<sup>th</sup> 2011). Foreign investors are often concerned at the lack of clear guidance regarding the circumstances and thresholds that might trigger a review of their proposals. They are often left uncertain about the likely line that would be taken in their own cases, given the way China operates (in effect not as a market-led economy but still with strategic state objectives having a predominant influence).

On the other hand, some sensitive industries are deemed by the Chinese government vital to its economic security, though Taiwanese are more likely to encounter difficulties in entering these areas, they are more in tune with the Chinese government's policies and to that extent can have greater certainty than others. The industries include those relating to the military, resources, some important transport and infrastructure sectors, important agriculture, 'key technology' areas, and 'major equipment manufacturing'.

Given the uncertainty of Chinese central and local government authorities' regulations, policies and orders affecting both Taiwanese and non-Taiwanese investors, do the Taiwanese investors generally fare better by reason of their greater understanding of the political economic environment and do they benefit in their dealings with local officials? Interviewees Mr. Naert, Mr. Telek and Mr. Shaw draw attention to the particular importance of *Guanxi* when the regulations and policies are unclear and incomplete. This is especially so in the light of the laxity of some of the Chinese business laws which give room to officials to place their own interpretation of these laws.

Interviewees Mr. Pon, Mr. Tseng and Mr. Tang said that most Taiwanese are familiar with both written rules and unspoken or 'unofficial' rules and they share information with their compatriots on the best ways of operating. A good *Guanxi* with local officials enables them to ensure compliance with the legal requirements and to avoid penalties. If, however, a company does not have good *guanxi*, it can take six months to get a license; in contrast with some with good *Guanxi* able to get rapid authorization in as little as two weeks. Mr. Telek also refers to the uncertainty of the application of regulations and difficulty of timing when the result is unknown. But he

emphasizes that organized pre-agreement can facilitate success and said that his company was able to finalise the business license within 15 days from submission of necessary documents. He has not observed any discrimination and believed that both the central and local authorities are receptive to foreign investment: “getting a company licence is quite easy if you fulfil the required documents<sup>29</sup> and capital”.

As Lubman (1995) pointed out and was referred to on page 104 in Chapter Two, though there have been improvements in the objectives of the law since reform, the system still carries traces of previous tendencies to capriciousness and corruption. Interviewees observe that investors cannot fully rely on ‘gentlemen’s agreements’ from Chinese officials. Even formal contracts may be ignored in extreme cases. Connections are all important. The following cases can exemplify this point.

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<sup>29</sup> The required documents for filing application of business proposals in China include: notice for the examination and verification of corporate names, application form, list of board directors, CV and ID of board directors, business licence of investors, proofs of credit standing by the bank, proofs of working sites, ID duplicate of legal representative and the handling person, tax registration application sheet and seals, permit for opening bank accounts, seals, housing contract, original and duplicate of national and local tax registry, ‘enterprise register’ and ‘Listings of Enterprise Managing Personnel’ pre-registered by the Customs Office, Articles of Association (interview Mr. Telek, Shanghai municipal government office, Shanghai business recruitment centre)

The failure of Singaporean investment in the YRD's Suzhou industrial park in 1994-1999 and the complications and delays occasioned in 2001 in connection with French retail company Carrefour's development<sup>30</sup> are examples of the imperfections of Chinese laws and regulations. However, after China's admission to the WTO and adjustment over two decades, this situation is getting better as laws are becoming more transparent and settled. In undertaking that project, the Singapore government, not having worked in conjunction with the Chinese government on large scale development, were not able to adapt to the different approaches in style and aims of the Chinese so that there was an incomplete meeting of minds and a failure of complete cooperation. Moreover, Singapore did not have:

“the necessary knowledge about the existing economic climate and investment patterns within China and the Suzhou region to tailor programs and policies that were attractive and suitable for the foreign investors that they were targeting to recruit into the park.”(Han, 2008:2)

The upshot was Singapore's withdrawal in 1999.

Failure to give Chinese officials face was perhaps the biggest mistake made in connection with that project, according to Yeung (1999:25). CSSIP (the Singaporean

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<sup>30</sup> The detail of Carrefour case is mentioned in page 62.

company) was nervous about the know-how 'software' transfer whilst the Chinese counterpart placed an emphasis on fast profit return. Furthermore, CSSIP and the Singapore government publicly criticised their Chinese partners which embarrassed and upset them. This taboo of business operations in China was crucial in the failure of the Singaporean Suzhou project. It illustrates the need for 'communication with Chinese government' referred to previously and to take careful account of the Chinese regulation mechanism.

The case of the French retailer company, Carrefour, highlights the problems of compliance with regulations and the consequences previously discussed of 'decentralisation of Chinese government'. Under the '*Law on Chinese-Foreign Equity Joint Venture, 1993*' (*Zongwai Hezhi Jinying Chiye* in Chinese) and the '*Law on Foreign-Capital Enterprises, 1990*' (*Waizhi Chiye* in Chinese), foreign retail companies are limited in their operations in China: they can only enter the Chinese market by way of joint ventures with Chinese partner(s); their Chinese partner(s) must hold over 51 per cent of shares; and local government authorities have to obtain the consent of the central government. According to GY3, PG1 and PG2, so as to seize opportunities presented and to avoid the Chinese government's lengthy and time-consuming application procedure, some foreign retail companies in the late

1990s bypassed the central government and directly negotiated with provincial or municipal government officials. As a way of attracting new companies and gaining revenue in their areas, many local officials offered those foreign enterprises preferential land use rights, company shares proportion, quick approval of factory expansion plans, permission to sell a greater percentage of products in the domestic Chinese market, more favourable tax benefits and other advantageous conditions.

Carrefour was eager to expand its operation in the burgeoning Chinese domestic market. However, according to the *Financial Times* (February 20<sup>th</sup> 2011), the State Trade and Economic Commission (STEC) of the Chinese central government ordered Carrefour to stop setting up more branches in China and required it to re-apply for permission from them for all of its stores. It took Carrefour six months to settle with the central government to come to an agreement. The lesson from the Carrefour example is that regulations and laws in China can sometimes be wrongly interpreted even by local government authorities. Ignoring the need for a full appreciation of and compliance with current laws and regulations can make them single companies out for punishment, whatever their size, even such as Carrefour. The implication of the example of Carrefour is twofold: one is that preferential treatment (especially related to business operation and tax benefits) should be acquired through strict compliance

with regulations; the other is that foreign companies have to research carefully and analyse Chinese regulations in detail due to the volatile nature of Chinese laws and because local officials may not fully understand the regulations concerned with FDIs. Also, oral promises of Chinese local government may be cancelled without prior warning.

Another example of unpredictability of Chinese laws is the following; The Chinese government enacted a reformed labour contract law (*Lau-Don-He-Tong-Fa* in Chinese) in 2008 which aimed to overall strengthen the Chinese economy, regulations and job security, provide Chinese workers with guaranteed minimum wages, regulate foreign companies' responsibility toward employees, improve the working atmosphere, and avoid forced labour. Well in advance of the new<sup>31</sup> law going into effect on January 1, 2008, some larger and well-functioning organisations reformed their pay structures and compensation plans. By contrast, some smaller or less alert foreign enterprises have had to close down their China businesses and move elsewhere, their turnover being insufficient to pay all their employees. Their main problem was that the Chinese government's labour law was announced suddenly with little time for many small and medium enterprises to respond. The Chinese government's intention was benign, this

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<sup>31</sup> The old labour contract law of the People's Republic of China was issued in 1994.

law having resulted in an increase in general income level and conditions of the labour force, but some companies cannot afford to improve the wages and conditions of employees and have not got the alternatives of layoff of staff; many see the need to move production to other less-developed areas of China or outside China altogether. From the foreign investors' point of view, this new labour contract law has disadvantages, the short-term effect including redundancies and the creation of resentment by those affected against the government and the companies concerned, Chinese or foreign. Foreign investors could see this as detrimental to them over the short term, and refrain from or defer investment. The case of Taiwanese conglomerate Foxconn<sup>32</sup> (*Hon Hai* Precision Industry Co. in Chinese), a world largest OEM company in electronic products, exemplifies this situation. In order to offset the increase of labour cost, Foxconn decided to move some of its production to western China and overseas, to Brazil. (Reuters News, April 13<sup>th</sup> 2011, accessed on June 6<sup>th</sup> 2011). In addition, Foxconn has been criticised that their employees work overtime without proper compensation. (Daily Mail, August 18<sup>th</sup> 2006, accessed on February

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<sup>32</sup> Taiwanese enterprise, Foxconn, is the world's largest maker of electronic components with clients such as Apple, Acer, Motorola, Nokia and Sony. It is also the largest exporter and private employer in China. (Source: Foxconn website: <http://www.foxconn.com/CompanyIntro.html>, accessed on 2011/08/23)

13<sup>th</sup> 2011). But in the long run, the aim of the government is to increase the GDP and overall environment, to the benefit of workers; their working conditions will gradually improve and it is already apparent in the recent response of the workers employed by Taiwanese conglomerates to their bad working conditions. While companies which have relied on low levels of pay and conditions may lose from this law, many stand to gain from the effect of employment practices domestically and in more developed countries and to that extent the law would be supportive of better managed businesses and entrepreneurs. This also will tend to have a ripple effect with consequent improvement for employees in other sectors such as local government authorities and the professions. This development provides room for further research on the progress of the Chinese government's effort in this direction, in particular in FDIs and may allow for guidance about the future. The above three examples show that the uncertainty and unpredictability of Chinese laws not only affect the FDIs but also can have an impact on all Taiwanese firms.

Mr. Chen, Mr. Lin and Mr. Huang confirm that uncertainty and fast implementation of laws can be a detriment to business operation. From the past experiences, they have to learn how to quickly adapt to volatile Chinese regulations and cumbersome legal infrastructure when China is going through the continuous legal construction.

In relation to the local officials' implementation of 1988 and 1994 central government preferential regulations to *Taishang*, on the one hand, the majority of the interviewees (75%) think that the local officials do implement the central policies, these answers coming from both government officials and Taiwanese investors. On the other hand, a couple of the interviewees considered that not all the local government authorities implement central preferential policies, or implement them imperfectly. One of the interviewees, Mr. Lin said that, "some parts of those two laws are somewhat vague; therefore, it gives the local officials room to interpret the laws in their terms to suit their interests." Another interviewee Mr. Tang has a similar view: "local officials can implement these laws superficially so they can justify their actions if they are questioned by the central government officials or contacted by TMA representatives or *Taishang* themselves."

Most interviewees from local authorities claim that they try to favour *Taishang* and do follow their party leader and government superiors' orders, not to mention the "laws". Since the 1988 and 1994 central government laws focus more on encouragement and protection of Taiwanese investors, it is not easy to measure and judge to what extent they do "encourage" and "protect" Taiwanese investors with favourable treatments.

These two terms of the central government are rather ambiguous. Moreover, GY3 provided a different answer than those interviewees as to the implementation of central policies. She pointed out it is “difficult to choose between a superb business proposal from a famous non-Taiwanese company and an average Taiwanese firm. So, in that sense, we have to consider the economic side of the reality and cannot help discarding what the laws outline. As for my understanding, in the laws, it is not compulsory for the local authorities to always give business and convenience to *Taishang* as long as we ensure their rights are protected.”

To sum up, the uncertainty of Chinese laws and regulation is faced by all investors in China including foreign and domestic enterprises. As interview data show, Taiwanese investors, to some extent, have the advantage of being more familiar with changeable laws and regulations, than other foreign investors, this view being supported by the interviewees. The difference this advantage makes is, however, not apparent.

### **5.8 Conclusion**

This chapter provides an insight into the various political and economic influences on the relationships affecting FDI in China. They are the focus for empirical case studies through interviews and documents illustrating the practical implications and

comments made by the interviewees. They are situated in the most thriving FDI areas, namely, the YRD and the PRD regions. Further, the author highlights several themes governing the preferential treatments accorded to certain investors and examines to what extent Taiwanese investment specially benefits. These themes are analysed through existing literature and interview transcripts. The following factors are critical; the uncertainty of regulations and the present attitudes of Chinese bureaucracy, nationality of the company, and its ability to communicate and negotiate easily and effectively with Chinese government authorities. While Taiwanese investors have certain advantages relating to these factors, the differences in their performance are not great as compared with other foreign enterprises. The next chapter examines other themes developed by the author. A summary of the findings from Chapters Five and Six and discussion of findings therefrom will conclude the next chapter.

## CHAPTER SIX

## Results and Findings (2)

## 6.0 Introduction

The challenges of doing business in China, particularly for foreign investors, have been noted elsewhere in this thesis and are summarised by Sepehri and Pordeli (2009:19)<sup>1</sup>, who also summarise the key success factors<sup>2</sup>. (See also Friedl, 2003 and Forney, 2004 regarding the increase in corruption since Chinese economic reform.) Five criteria were considered in Chapter Five, and this chapter examines a further three criteria: location, industry and size of the FDIs.

In considering the impact of local government preferential treatment of FDIs in the PRD and YRD, three specific factors are of primary importance in the availability of competitive advantages for foreign firms. Both central and local governments have their parts to play in setting the policies. Local authorities being at the sharp end and being more directly concerned with the effect of policy operations, particularly in such areas as the YRD and the PRD, have more constant contact with businesses. The effects of policies are summarized in the following tabular Table by Yeung and Mok (2002) (the authors are dealing with Guangdong province but their Table 6.1 can also be mostly applied to YRD).

<sup>1</sup> Challenges: corruption, key economic freedom indexes, monetary policy (currency exchange rate), ease of doing business, intellectual property rights, production capacity, economic and financial policies, unemployment issues.

<sup>2</sup> Success factors: Economic growth and development, China and WTO, infrastructure development, market reform and economic power and other economic indicators.

A purpose of this chapter is to examine three criteria, additional to the five considered in Chapter Five, affecting Chinese local governments' preferential treatment of FDIs in the PRD and the YRD. These are: location of the investment (including the effect on labour, capital and product markets), the sector of industry and the size of the company. The last section of this chapter considers the materials obtained from this empirical study and discusses and analyses the findings to be gleaned therefrom. The order of importance of these criteria is also illustrated.

Interviewees reflect Sepehri and Pordeli's (2009:24) view that Zhejiang, Shanghai and other designated areas (YRD and PRD) are more receptive to businesses and investment than the greater part of China (with the exception of those under-developed regions for which the government is now keen to encourage investment). Opportunities for investors are found to outweigh the undoubted problems.

### **6.1 Location of Investment**

Location of investment has increasingly been influenced by a number of factors, which have tended to show greater regional differences: these include geographical location, the development of Chinese and external economies, and their growing trade relationships, as well as the local protectionism consequent on the decentralisation process begun in the 1980s. (De'Murger et al., 2002: 444-465) Chinese government policy incentives have been effective in attracting foreign firms, but the easing of restrictions has not been as straightforward as hoped. They find that the existence of bureaucracy is still providing obstacles and complications getting

in the way of effective competition – three sectors are of particular note, namely labour, capital and product markets. As with Yeung and Mok (2002) who were dealing with Guangdong, this section concentrates on the three sector policies<sup>3</sup> of central and local governments, which must be appreciated for a clear view of the changing scene for foreign firms operating in these areas.

As far as the labour market is concerned, of particular note are the treatments of employment permits<sup>4</sup>, the levying of miscellaneous fees, and the recruitment of factory managers. The purpose of the policy on employment permits is to provide a social safety net for workers, to implement birth control policies, and to regulate the control of migrant workers. In the case of the capital market, differences are perceived regarding the uniform rate of value-added, the 'estimated profits' approach of taxation, the export value-added tax (VAT) and the import deposit. The purpose of the estimated profits approach to taxation and the import deposit is to prevent transfer pricing by transnational companies, tax evasion, and the illegal re-selling of tariff-free imported raw materials by FDIs. As to the product market, the impact on the FDIs

<sup>3</sup> 'Sector-specific policies' are those Chinese (central and local) government policies specifically formulated to regulate the operation of labour, capital and product markets of foreign-financed manufacturing firms. This term is used to distinguish these strategies from other general government policies, such as policy incentives to attract the inflow of FDI, implemented in China.

<sup>4</sup> In Guangdong of PRD, every foreign-owned company has to apply for eight licenses for its operation and four permits on behalf of company employees: (1) Business registration permit, (2) National tax certificate, (3) Guangdong provincial tax certificate, (4) Certificate of Quality License for Export Commodities, (5) Certificate of Quarantine License for Export Commodities (zoological and plant quarantine permits), (6) Hygiene certificate, (7) Labour insurance certificate and (8) Health insurance certificate. Permits are: (1) Temporary residence permits issued by the local Public Security Bureau, renewable every three or six months to one year (this applies to migrant workers only); (2) Employment permit issued by the Labour Bureau (this applies to migrant workers only); (3) Single card or planned maternity card for married employees, issued by the Labour and Planned Maternity Bureaux; (4) Unemployment insurance, labour insurance, medical insurance and old age pension permits from the Social Insurance and Labour Bureaux.

manifests itself in the approaches to production contracts and verification rules on imports and exports. (Yeung and Mok, 2002: 6, 11 and 13) Please see Table 6.1 for details.

**Table 6.1 A Typology of the Effects of Chinese Government Policies on the Competitive Advantage of Foreign-Financed Firms in Southern China**

Policies	Aims	Policy Details	Effects on Foreign-Financed Firms
<b>Permits for employment</b>	To provide a social safety net for workers	Unemployment insurance, labour insurance, and old-age pension for every worker	Compulsory subscription to pension fund increases the production costs, for example up to 30 per cent of wage bills
	To implement birth control policies	Single card for unmarried employees and planned maternity card for married employees	FDI firms are subjected to fines or administrative sanctions if any employee does not possess all permits
	To regulate migrant workers	Temporary residence and employment permits for migrants	
<b>Miscellaneous fees</b>	To recoup the costs of services provided by various bureaux	The amount of miscellaneous fees tied in with the number of workers	In reality, the amount of payable miscellaneous fee is negotiable and varies geographically
		Some local governments backdated the newly introduced charge by several months, even before the formal approval date of the municipal government	Firms with better connections can get a 'discount' on the payable fee
<b>Uniform rate of value-added and the estimated profits approach of taxation</b>	To simplify the government's administrative duties	For FDI firms who conduct the 'value-added verification', the same rate of value-added tax is applied in the same industrial sector	Takes neither the productivity nor the special circumstances (eg US textile quotas) of an individual

			firm into consideration
	To regulate the transfer pricing of TNCs	The firm's profitability is equal to its output value multiplied by a predetermined and progressive percentage rate	Discontent among FDI firms, as there is no standardized procedure on the determination of estimated profits rate
<b>Export VAT</b>	To prevent tax evasion by FDI firms	From 1 January 1999 onwards, 8 per cent VAT is levied on the export value of import-processing P&A firms	The 2 year backdated period of VAT law has tremendous impact on import-processing P&A firms (imports and exports were VAT free before the new law)
<b>Import deposit</b>	To prevent the illegal reselling of tariff-free raw materials imported by FDI firms in the local market	FDI firms are classified into five classes (AA, A, B, C and D) since 1 October 1999	Favours firms in high-tech sectors and export-oriented large-scale firms, as they are automatically classified as class AA (import deposit is waived)
	To prevent tax evasion by FDI firms	Firms classified as class A and B have to pay the import deposit only for the import of restricted goods	A severe drain of operational capital for SMEs with low export value, due to the large amount of payable import deposit
		Firms classified as class C and D have to put down about 30 per cent of the value of imported raw materials as a deposit	
		Customs can confiscate the import deposit if the firm does not verify that the finished products have been exported within 3 months of the import of raw materials	Additional administrative duties to prepare the daily import-export records submitted to Customs
<b>Production contract</b>	To prevent the illegal reselling of tariff-free raw materials on the	The production contract outlines the strict definitions of the quantity and variety of raw materials	High transaction costs to justify the need to import more raw materials than allowed

	local market	that the FDI firm can import free of tariffs over a 6 month period	under the contract
		FDI firms have to renew their production contract every 6 months	Unable to facilitate market demand and removes the 'first mover' competitive advantage of sub-contracting firms
<b>Verification rules on imports and exports</b>	To prevent the illegal reselling of tariff-free raw materials in the local market	Under the 'gross-value verification', the foreign owner/buyer remits the total amount of foreign exchange to China to import/export the exact value of their raw materials/finished products	The 'gross-value verification' arrangement demands more working capital from the SMEs, while the 'value-added verification' arrangement favours those TNCs that are vertically integrated, from manufacturing to wholesaling
	To prevent tax evasion by FDI firms	Under the 'value-added verification', the foreign investor remits the amount of value-added to China, if the transaction is conducted within the enterprise	Unnecessary impounding of cargo
		Imported tariff-free raw materials have to be verified as processed and exported	Lack of a transparent legal channel for arbitration

Source: *Yeung and Mok (2002: 233-235)*

## Labour Market

The cost of labour in various locations is one of the principal factors governing FDI's investment decisions in China, as is explained in Chapter One. Preferential policies of local governments regarding labour benefits and the employment conditions in the PRD and the YRD, thus affect FDIs' operations and therefore their choice of investment location. Labour costs are particularly

marked in labour-intensive manufacturing industries. The research interviews show a greater emphasis on this factor by *Taishang* in the PRD than the YRD, there being a higher percentage of Taiwanese manufacturing in the PRD region.

In addition, interviewees refer to the fines and administrative sanctions (such as withholding of operational licenses) imposed by local governments on those firms employing workers without all the required permits. This causes particular problems relating to temporary workers who do not normally have formal contracts. "In fact, some migrant workers prefer to work on a temporary basis, as it allows them to job-hop." (Yeung and Mok, 2002:232)

Local authorities impose a miscellaneous charge calculated as a certain number of yuan (RMB) per worker; in 1997 the total miscellaneous fee for a foreign-financed firm could add up to over 100 yuan/worker/month, with the introduction of compulsory subscription to unemployment insurance, labour insurance, medical insurance and a pension fund. This has increased in the case of the PRD to as much as 150 yuan/worker/month in 2000, equal to approximately 50 percent of an unskilled worker's monthly wage. Many foreign financed firms had not taken account of such increases when they made their estimates. Additionally, they have suffered from concentration on them by the labour bureau inspectors, while certain local companies can escape such fees and benefit accordingly. (1996-97 and 2000 field survey of Yeung and Mok, 2002). Many Taiwanese interviewees point out that the compulsory adjustment for labour benefit has hit them in a big way, and can jeopardise their companies' cash flow. Mr. Pon and Mr. Lin indicate that they had to plead to local officials to "allow them more time to fulfil all the new labour requirements".

As noted elsewhere (in Chapter Five), local authorities tend to operate individually, so that there is a wide variation in their enforcement. Guangdong for example realises that the drawback of applying the legal measures in full could harm its economy. By imposing high fees without discrimination, they can drive foreign investors away. Much depends on *Guanxi* (personal connections), the “discount” on the fees payable varying with the connections (Yeung and Mok, 2002: 236). As a result, foreign enterprises make sure they select local people as factory managers who, as well as being *au fait* with changes in government policies, have the right connections. This was seen by one of the companies as the role of their joint-venture partner principally being “to do the public relations work with the bureaucracy” (1996-97 field survey of Yeung and Mok, 2002: 236). The researcher’s interviewees in the PRD and YRD, Mr. Chen, Mr. Pon and Mr. Chang mentioned that they hire experienced Chinese nationals to act as public relations managers or operational managers for their knowledge about fast changing Chinese government policies, who can more effectively communicate with local officials. In some cases, if their Chinese managers come from the same city or town as the Chinese local officials, this would be an additional advantage in communicating or negotiating on certain matters such as miscellaneous charges. Interviewee, Mr. Wang also said that when Taiwanese companies have a joint-venture with Chinese partners, more than half of the Taiwanese companies have their Chinese partners deal with the Chinese local bureaucrats. That ensures that preferential treatment is given and avoids unnecessary misunderstanding because of hidden meanings behind the spoken words. The interviewees Mr. Tang, Mr. Hunter and Mr. Knight said that they have similar practices in their companies in the YRD, and assign Chinese local employees to deal with local officials for smooth communication with local government. However, in certain cases they entrust the work to their expats (in this case, Taiwanese and British) to accompany their local

managers in meetings with local bureaucrats to ensure "these meetings are going well and there are no secret deals".

As mentioned above, the higher fees imposed by the governments' FDI policies have made some companies unwilling to cooperate with governments. For example, the result of higher fees and taxes levied on foreign firms led to under-reporting of the number of employees by 30-80 percent. In an extreme case, a FDI in Fenggang town of the PRD only reported 20% of their 200 workers; this company had to face dealing with 46 various fees (according to the survey of Yeung and Mok, 2002). Interviewees Mr. Chang, Mr. Chen, Mr. Pon and Mr. Tang also specifically complained about these charges. Objection is made to backdating by local government of charges which were unknown to the companies at the time and of fines for payment supposed to have been overdue. More recently, in recognition of the need to take action, the central government have taken steps to prevent the imposition of illegal charges (interview data). Local authorities must now obtain approval for charges on foreign financed and locally funded enterprises and receipts must be issued. In Dongguan of PRD, all fees must be paid directly into a designated bank account rather than to an official. These measures are imposed both in the PRD and the YRD. Mr. Chiu and Mr. Shaw said paying fees directly into a designated bank account "can avoid being accused of bribery of local officials. This is a part of the process of improvement in the Chinese legal system, though it is still not completely transparent."

High on the list of complaints by foreign investors in Guangdong are the ambiguity, variety of regulations and associated high transaction costs. (Yeung and Mok, 2002). Most Taiwanese

interviewees in both the PRD and YRD indicate that the operation cost is their first concern for initial investment and operation. The business incentives available in a particular city/area are the primary factor to reduce costs, but this has to be set against labour cost. Most non-Taiwanese foreign investors interviewed are above all concerned with ongoing costs in deciding on investment in China. They say that many methods of minimising expenditure and maximizing their capital has to be explored. In addition, most investors in the PRD and the YRD believe that they benefit from the central and local government's policies incentives but at the same time, due to the changing nature of the Chinese investment environment, they must be ready to adapt to associated costs of Chinese labour.

In looking at labour costs, foreign investors including Taiwanese have to be aware of local policies on wage levels. Local governments adjust the minimum wage level and need to take account of general inflation. The average wage level varies in different parts of the PRD and the YRD, so it is closely followed by FDIs in their choice of investment location.

### **Capital Market**

The State Bureau of Foreign Exchange uses a uniform rate of value-added, that is set according to the industry concern and which is calculated in relation to the value of a company's output and its profitability. (According to the industrial sector that the firm belongs to, the rate is set and will change depending on the value of a company's output and its profitability). In addition, the State Bureau of Taxation uses the 'estimated profits' approach to assess the profitability of every foreign-financed firm conducting 'value-added verification' in the same industrial sector. These measures aim at simplifying administrative duties and regulating transfer pricing by the transnational corporations. (Yeung and Mok, 2002 and see Table 6.1) As Yeung and Mok (2002:

237) noted, "these two general rules of thumb take neither the productivity nor the special circumstances of the individual firm into consideration." They recorded two US companies' experiences<sup>5</sup> affected by these two rules which have caused discontent among FDIs.

Many companies complained about unfair categorization for VAT. As interviewee Mr. Telek said, "the VAT is decided differently by the State Bureau of Foreign Exchange and the State Bureau of Taxation. Some of the rules are considered unfair practices because they use a predetermined percentage rate to estimate a company's output and profit... Even within the same industry, companies function differently, but this is not fully recognized by the government, the government not always taking a company's special circumstance into account." Mr. Hunter feels that it is confusing for FDIs to follow VAT rules for which different measurements are applied by the two different government agencies. Like Yeung and Mok's study (2002), interviewees Mr. Lin and Mr. Chiu commented that Taiwanese have the same procedure as other foreign investors. In spite of the rules' apparent inflexibility, there is still room for negotiation as long as companies can prove their estimated profits through their accountant/auditor's report. But the proposal still needs to be approved by officials. *Guanxi* in this case will kick in, especially in cases when a company's estimated profit looks dubious. When the researcher asked the

<sup>5</sup> For instance, the value-added of polo shirts manufactured by a US-based garment firm is very high, due to its successful marketing strategy and its allocated US quotas. However, the value-added of its two wholly foreign-owned ventures (WFVs) in Shenzhen is well below the industrial norm, since these only produce part of the polo shirt (eg buttons or collar) and use costly imported raw materials. Since the State Bureau of Foreign Exchange has granted no exemption for the firm, the firm's Asian headquarters has to remit more than 14 million yuan per month from Hong Kong to Shenzhen, even though the actual value-added of these two firms is about 10 million yuan per month. Consequently, the two WFVs have accumulated about 40 million yuan of idle cash within a year since the new policy was implemented. The State Bureau of Taxation generally assumes that profitable firms will produce more, but there is no standardized procedure for the Bureau to determine the rate of 'estimated profits'. (Yeung and Mok, 2002:237)

government officials GY1<sup>6</sup> and PG2, they confirmed that there is room for negotiating the VAT but would not confirm that personal connection will make a difference to this negotiation.

The import deposit applies to manufacturing companies both in the PRD and the YRD. No foreign investors can be favoured or get exempted (except the firms classified as class AA, A and B). According to interviewees Mr. Chen, Mr. Pon, Mr. McLeod, GY1 and Yeung and Mok (2002)<sup>7</sup>, these custom verification rules and import deposits were enforced after the end of 1999. The rules affect both large enterprises and SMEs in the manufacturing industry to whom sufficient cash flows are especially important. This has had a significant impact on both Taiwanese and other foreign SMEs as a great number of SMEs rely on bank loans. The change in the rules after 1999 is a driver for some Taiwanese and other FDIs to gradually move production out of the PRD and the YRD regions.

Apart from the factor mentioned above, other drivers promoted by the government include the incentives provided to relocate in central and western parts of China; the increased labour cost in the PRD and YRD; the reduction or cancelation in the scope of preferential policies in the PRD and YRD; and “inability of some older companies to adapt to changing conditions, for example,

<sup>6</sup> Whenever the coding is used in this thesis, it means interviewees chose to be anonymous.

<sup>7</sup> With the exception of firms classified as class AA, A or B, Customs regulations stipulate that, from 1 October 1999... foreign-financed firms have to put down about 30 per cent of the value of imported raw materials as a deposit, to guarantee that all of their finished products are for export. Customs inspectors have the authority to confiscate the deposit if the firm does not verify its production contract with export documents within 3 months of the import of raw materials. Moreover, foreign-financed firms also have to appoint designated auditors to prepare daily records of imports/exports for Customs...in late 1999, Customs verification rules have been enforced strictly, a situation that has profound implications for the cash flow of foreign-financed firms... For a large-scale firm with abundant capital, the strict enforcement of the Customs verification policy resulted in an immediate quadrupling of its cash flow. This obviously causes considerable disruption to the short-term operation of the firm. For a small and medium-sized enterprise (SME) with limited capital, the likely result is a severe drain of working capital, which in the worst scenario may push the firm to the edge of closing down” (in 1996-1997 and 2000 field surveys of Yeung and Mok, 2002: 238-239).

old-fashioned attitudes or management", according to interviewees Mr. Tang, Mr. Chiu and Mr. Tseng.

"The authoritarian nature of these policies (especially the uniform rate of the value-added and the 'estimated profits' approach to taxation) obviously counters some of the policy incentives, such as the tax-free holiday, designed to attract foreign investors. This is because the 'saving' on profit tax granted to foreign-financed firms at the time of their establishment is partially offset by the (possible) increase in the payment of the profit tax (due to the 'estimated profits' approach of taxation) after the expiration of their tax-free holiday in Guangdong." (Yeung and Mok, 2002: 239)

Interviewee Ms. Shen said, "in China, the business regulations, investment incentives and red tape never stay the same. The investment environment here is combined with opportunities and contradiction. This kind of situation does not vary with location." Taiwanese interviewee Mr. Chen also said, "the rules, policies and incentives in China on the whole as with most economies are constantly evolving but maybe this phenomenon is more marked in China compared to the western economies... We, as an investor, do not particularly feel that we are favoured in the PRD region now. Maybe in the past, we did enjoy that to some extent. That is mainly because there were not too many FDIs here in China when we arrived in the early 1990s... To combat this change and to survive, we need to focus on those parts of changing rules and policies which benefit our company... We just have to use all our resources to keep our established business here as we believe relocation of business is not always the best solution." Mr. Pon, a Taiwanese interviewee in the PRD also expressed the same view as Mr. Chen's comments: "the preferential

treatment in the PRD for *Taishang* was more obvious in the 1990s than in the 2000s... *Taishang* in this region generally try to adjust to the changes of Chinese laws and business environment first, before ultimately considering the relocation of their business.”

## Product Market

A “transferred goods arrangement” was introduced by Chinese Customs for foreign-financed firms, with Customs’ prior approval, in order to make easier operations by these firms and so as to help relieve transportation network pressures. Yeung and Mok give details<sup>8</sup> of this arrangement. (See footnote)

As interviewee Mr. Chang put it, “you scratch my back and I scratch yours...bribery with Customs is normally done quietly and strictly confidentially”. Although China has instituted a corruption eradication policy and the government officials said most customs inspectors do not accept bribes (PG1, PG2 and field survey by Yeung and Mok 2002), the reality of bribery still exists. “The extent of bribery has not been as rampant as before in comparison of the present and

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<sup>8</sup> A foreign-financed firm is allowed “to sell and transport directly its finished goods to another foreign or locally funded firm located in China, provided that the following three conditions are fulfilled: (1) all final products of the transferred goods are for export; (2) both companies have import licenses for the transferred goods; and (3) the quantity of transferred goods is less than the quantity of goods imported by the firm. However, the convenience of the transferred goods arrangement for foreign financed firms is offset by other Customs regulations, e.g., production contracts ...Foreign-financed firms have to apply every 6 months for a production contract from Customs to import raw materials into China free of tariffs... For every shipment of raw materials or finished products, foreign-financed firms have to apply to Customs for import or export declaration permits. To counter bureaucratic red tape, some foreign financed firms are either sharing their production contract to have the right to import tariff-free raw materials, or are smuggling part of their raw materials into China without proper documentation. In cases when cargo is impounded at the Shenzhen–Hong Kong border, foreign-financed firms normally pay off Customs inspectors to cover up their illegitimate activities. As the timely delivery of cargo is essential, and as it is too time-consuming to negotiate with Customs inspectors, foreign owners normally instruct their truck drivers to bribe the inspectors.” (Yeung and Mok, 2002: 239-240)

the past", according to Mr. Huang , Mr. Tang and Mr. Wang interviewed in 2008; "to some local officials, in places which do not have too many FDIs, bribery by giving gifts for them is considered normal practices...they call it *Zhiji Zhibi BaiZhen BaiSheng* (every success comes from mutual understanding)...therefore, the preferential treatment given to some companies including us results partly from the fact that we follow this practice...perhaps Taiwanese are generally doing better on this as most foreign expats do not like to socialize in the karaoke bars with local officials or people related to government...this individualist culture in the west is quite different from the collectivist mentality in the Chinese culture." (Interviewee Mr. Lin) But this change to a stricter approach on bribes has its downside.

The strict enforcement of regulations on production contracts<sup>9</sup> removes the 'first-mover' competitive advantage of FDI and affects the ability of FDI firms, especially sub-contractors, to compete. A production line needs to be able to be adapted to seasonal changes in the markets and to promote new products. The State Bureau of Foreign Exchange and Customs work together to prevent tax evasion and to combat re-selling of tariff-free raw materials imported by FDI firms in violation of the laws.

To verify<sup>10</sup> that their imported tariff-free raw materials are processed and exported to overseas markets, FDI firms must submit their production contracts to Chinese Customs, with daily records as to the importation of raw materials, the export of finished goods, and the amount of

<sup>9</sup> Production contracts contain strict definitions of the quantity and variety of raw materials that the firm is allowed to import tariff-free every 6 months. Such inflexibility does not make for an adequate response to dynamic market demand, firms being unable to increase production at short notice for an unexpectedly large order, or to introduce new products which demand raw materials not specified in the production contract.(Yeung and Mok, 2002:240)

<sup>10</sup> Two types of regulation on verification are: 'gross-value verification' (*cune hexiao*) and 'value-added verification' (*chae hexiao*)... *chae hexiao* requires much less operational capital from foreign-financed firms, and works in favour of vertically integrated transnational corporations from manufacturing to wholesaling. The *cune hexiao* is a big financial burden for SMEs. (Yeung and Mok, 2002)

raw materials in stock. These various regulations make for problems not only on FDI firms engaging in illegal trading but also for law-abiding firms. The extra costs of detailed documentation<sup>11</sup> provide Customs inspectors the opportunities to receive bribes.

There is no satisfactory method of legal arbitration as to the propriety of import and export dealings, and it is usual for customs inspectors to play safe and pass suspected cases to be dealt with by the Inspection Department even in the case of small irregularities<sup>12</sup>. (See Table 6.1 for more details)

From the researcher's field interviews, this situation happens in both the YRD and the PRD region, with improvement over the years. Interviewee Mr. Naert commented that "declaring production contracts and dealing with custom inspectors with import and export declaration forms can be a troublesome procedure for investors because custom inspectors are not always fair and they can sometimes deliberately delay releasing the goods for the company they do not like, even if the company does not make any mistakes in its forms and procedures." Mr. Chen and Mr. Pon said their companies encountered similar problems with customs when everything their companies did was legal. They both said customs inspectors did that because they were instructed to do so by their superiors. On a past occasion, interviewee Mr. Pon's company did

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<sup>11</sup> Whenever there is any discrepancy between the import and export declaration forms, Customs inspectors regard undeclared goods (the raw materials not declared for sale to other foreign-financed firms as finished products) as sales for the local market. In addition to imposing a fine, Customs inspectors impose a surcharge of 40 per cent of the value of undeclared raw materials... It is also not easy for Customs inspectors to decide which cargo is deliberately under- or over-reported in the import or export documents. (Yeung and Mok, 2002: 241)

<sup>12</sup> This is in general parlance as called "*shaji xiahou*" (scaring off the monkey by killing the chicken) and is meant as a warning against bribery. Once the cargo is impounded, it takes at least 2-3 days for the investigation, and the company involved may miss its shipment date, and can be even subject to downgrading of their rating with consequent penalty of 30% of imported value, in the way of import deposit. (Yeung and Mok, 2002)

not accord the favour demanded by a high ranking official. (Details of this favour were not revealed by Mr. Pon because of confidentiality).

Reviewing these three sector policies, as Yeung and Mok (2002: 242-243) put it, "in reality the implementation of such policies directly and indirectly imposes higher transaction costs on foreign-financed firms' daily operations, which offsets some of the economic benefits gained under the central government's preferential FDI policy and thus diminishes their competitive advantages over locally funded firms in Guangdong (PRD)." *Taishang* are seen similar effect in the two deltas. Yeung and Mok note the special impact of these policies on foreign SMEs with limited capital. Taiwanese SMEs feature largely in the two deltas, especially in the PRD. They also consider there is a possibility that some of the important foreign firms may well leave the PRD because of their frustration at the "bureaucratic maze". For similar reasons (see Table 6.3), Taiwanese firms have been migrating from the PRD to the YRD.

The research in essence points to improvement in the relationship between local officials and Taiwanese and other investors. There is a greater transparency than previously with a pressure from central government to combat the old habits of bribery and corruption though this tendency has not been wholly eradicated in some of lower levels of government. Bureaucracy is less of a handicap than before. Competition to attract development has made for a greater willingness to smooth the path for Taiwanese and other investors. Set against the aim to be of assistance to Taiwanese investors is the need of authorities to keep careful watch of the financial implications. For their part, *Taishang* are anxious to minimise their cost and ensure that bureaucratic complications do not unduly affect the conduct of their businesses: TMAs and TAOs are useful to this end.

### **Preferential Policy in Different Locations**

Local operation of businesses is affected by the rules issued by local governments at the lower levels below county level, despite their not having formal legislative powers. The necessary documentation is not legally binding and therefore strictly speaking unenforceable in Chinese courts but in practice, investors comply with them for fear of difficulties with local authorities. (Ambler, Witzel and Xi, 2009:117) In this way, FDI general rules can be set aside by local governments to suit their own objectives.

Above these lower level of local government, preferential policies of the major cities in the PRD and the YRD are set out in Appendices 6.A to 6.M. Preferential policies for FDI consist to a large extent of the provision of favourable tax treatment (such as enterprise income tax at the national level and local income tax at the local level), ranging from 30% to 15% in terms of enterprise income tax depending on the location. Please see Table 6.2 for an overview of enterprise income tax preferential policies for FDI in various locations of China. Other preferential treatments are given in various ways such as personnel management (labour), administration of land, charges rates such as water and electricity, bank loans and the government's guarantee of investment.

**Table 6.2**  
**FDI Enterprise Income Tax Benefit**  
 (Applicable to FDIs with a contract of 10 years or longer)

	Special Economic Zone ( <i>Jinji Techui</i> ), National Economic Technology Development Zone ( <i>Guojiaji Jinji Jishu KaiFaChui</i> ), National High and New Technology Development Area ( <i>Guojiaji GaoShin Jishu KaiFaChui</i> )	Approved coastal city, provincial capital, Old town of the city situated in Economic Technology Development Zone	Other locations
Basic Tax Rate (Conditions below are not applicable to this rate)	15%	24%	30%
Tax-Free Period (the 1 <sup>st</sup> and 2 <sup>nd</sup> year after a company's profitable year)	Exempted	Exempted	Exempted
Half-Tax Period (the 3 <sup>rd</sup> to the 5 <sup>th</sup> year after a company's profitable year)	10%	12% (24% $\times$ 0.5)	15% (30% $\times$ 0.5)
Continuing Tax Reduction Period After the 5 <sup>th</sup> year of a company's profitable year: (1): the 6 <sup>th</sup> to 8 <sup>th</sup> year of the advanced technology company's turnover (2): the same year of export-oriented company reaching 70% of the sale for export	10%	12% (24% $\times$ 0.5)	15% (30% $\times$ 0.5)

Source: Author's analysis

Another difference is that every city has its target which may differ from that of others. They may concentrate on certain areas such as specialised industries and high-tech industrial parks, for inward investment.

The biggest proportions of Taiwanese investment enjoyed by the cities are found in Kunshan city (county-level city) of Jiangsu province (YRD) and Dongguan city of Guangdong province (PRD). Kunshan city is a city which in common with certain others (Shenzhen and Zhuhai) especially welcomes Taiwanese firms and gives them special treatment such as “Honorary Citizenship of Kunshan”<sup>13</sup> and “Friends of Kunshan” (author’s fieldwork 2008 and Lee, 2008). To be specific, the majority of Kunshan city FDIs comes from Taiwanese capital (See Table 6.3 and its note). According to the chairman of TMA Kunshan and the interviewees, Taiwanese business proposals are generally placed at the top of the priority list. During the informal meeting, some of the established *Taishang* in Kunshan city lobby for the new *Taishang* who have connections with them and are interested in investing there. Usually, they can get positive responses from the local officials. By contrast, these sources show that Dongguan city (PRD), like Nanjing and Wuxi, welcomes foreign investment equally from all nations and feels no need to single out Taiwanese. The reasons they give are that those cities have changed their business recruitment strategies so as to be fair to companies of all nationalities; in addition, Nanjing and Wuxi governments do not traditionally have strong connections with *Taishang*. This is an indication of

<sup>13</sup> The ‘Honorary Citizenship’ of Kunshan (Kunshan rong yu shi meng in Chinese) is designed to show appreciation and affirmation of contributions to local economic development by foreigners. ‘Honorary Citizens’ have been invited as guests to the Local People’s Congress to discuss Kunshan’s development strategy or as consultants to mayors on economic policies and they enjoy the following privileges: priority in business dealings; preferential policies; free visits to three tourist attractions in Kunshan; free health checks at the Kunshan government-owned hospital; free subscription to the Kunshan government-owned newspaper; and free choice of schools for their children. From 1996, Taiwanese took the majority of honorary citizenships. A similar pattern applies to ‘Friends of Kunshan’, 60 per cent of whom by 1998 were Taiwanese, rising to 75 per cent by 2002. 23 ‘Friends of Kunshan’ (Kunshan zhi you in Chinese) enjoy all the benefits of Honorary Citizens plus being special consultants to the Communist Party Secretary and Mayor of Kunshan. (Chien, S.S. and Zhao, L.T., 2008: 437)

the different way local governments respond even within the same city and therefore investors need to be alert to the importance of differentiating according to the special situation of precise locations.

**Table 6.3. Key Investment in Kunshan from 1991 to 2005**

From new to old (timeline)	Taiwanese company name	Industry
	Getac Kunshan Computer	notebook PC
	Vimax Kunshan projectors	optical components
	WS Info Comm Kunshan	notebook PC
	Compal Opt. Kunshan	notebook PC
	Compal Info Kunshan	notebook PC
	Compal Info Tech Kunshan	notebook PC
	WJ Info Comm Kunshan	notebook PC
	Micro Unite Kunshan	motherboard and display card
	Nan Ya Co-Generation	rubber
	Wistron Info Commom Kunshan	notebook PC
	Kunshan Kapok	notebook PC
	Twinhead Kunshan	notebook PC
	Taichia Glass Fiber	glass fibre
	PFG Fiber Glass Kunshan	glass fibre
	Nan Ya Epoxy Resin Kunshan	epoxy resin

	Nan Ya Electronic Materials Kunshan	copper clad laminates
	WUS (Kunshan) PCB	notebook PC assembly
	Liufeng Machinery	motor vehicle parts and accessories
	Giant China	bicycle industry
	Cheng Shin Rubber China	rubber
	Uni-President (Kunshan)	food processing
	Fox Conn (Kunshan)	IT component, PC connector
	Sakura Bath and Kitchen Products	houseware products
	Fujiwa Machinery	automotive driving, brake and engine
	TG Changjiang Glass	glass fibre

Source: Adapted from Chang et al. (2007); Chien and Zhao (2008)

Note: The importance of Taiwanese involvement in Kunshan is reflected at both national and local levels. First, at the national level, Kunshan is one of the localities in China with the most Taiwanese investment. As one of nearly 700 cities, Kunshan alone attracted more than 10 per cent of Taiwanese outward FDI in China by 2005.<sup>11</sup> Over 1,000 Taiwanese companies, including over thirty publicly listed on the Taiwan Stock Exchange, have invested in Kunshan over the past 15 years. Among the top 100 Taiwanese investment companies in China in 2005, thirteen were located in Kunshan – eleven in electronic engineering and IT (Compal [China] Factory, Compal [Kunshan] Factory, Vamo [Kunshan], East China MKL, Fox Conn [Kunshan], Mitac [Kunshan], Altec [Kunshan], Kunshan Coretronic Flat Display, Sampo [Kunshan], Kapok [Kunshan], WUS [Kunshan]), one in mechanical engineering

(Giant Bicycle [China]), and one in food (Uni-President [Kunshan]). On top of that, at the local level, Taiwanese FDI is the most important source of economic development in Kunshan. Until 1997, there were only twelve investment projects over US\$50 million in Kunshan. Of those, eight were from Taiwan. By 2002, Taiwanese investment in Kunshan was US\$4.5 billion, which was more than 70 per cent of the total FDI in Kunshan. Statistically, since 2000, 50 per cent of fiscal revenue, 60 per cent of tax, 70 per cent of sales, 80 per cent of investment and 90 per cent of trade are contributed by Taiwanese investment. In addition, in 2010, Taiwanese investment in Kunshan also constituted 50 per cent of Taiwanese investment in Suzhou, as well as 25 per cent of Taiwanese investment in Jiangsu province

In the early years of Taiwanese investment in China during the late 1980s and early 1990s, investors tended to focus on the PRD area and Fujian province which have proximity advantages and historical connections with Taiwan. Later, Taiwanese investment spread to the YRD area and the north part of China. Investment in Jiangsu province and greater Shanghai has grown at a particularly fast pace. For example, Taiwanese investment in Shanghai, which was 15.7 billion US dollars in 1994, accounting for 16.4% of Taiwanese total investment in China; this figure increased in 1995 to 22.4 billion US dollars (20.5% of Taiwanese total investment).

Mr. Frankie Pon's experience was that "local officials in the PRD tend to concentrate more on their local economic development and gain and they have a different mentality of dealing with FDIs than other officials, say Shanghai", while Mr. Raymond Tang for his part encountered a tendency by local officials in the YRD to observe the rules "because most of them like to get promoted either in the Communist Party or in the government. Therefore, they must be very careful to avoid accusations of corruption or other deficiency. Of course, there always are exceptions and different city officials may act or think very differently than their counterparts in

other cities within the YRD.” The general conclusion is that the YRD is more welcoming to Taiwanese investors, while the PRD welcomes all FDIs for the reasons mentioned above. The distinction is however not huge between these two deltas. The differences all come down to each single city within the PRD and the YRD. The actual preferential treatments the local officials of the PRD and the YRD give to Taiwanese investors are based on very similar factors. As Table 6.3 shows, there has been a shift in choice of location by Taiwanese from the PRD to the YRD for various reasons (1.) the welcoming attitude of the YRD to Taiwanese companies; (2.) the presence of well-established Taiwanese companies providing a cluster effect for new investment by Taiwanese (3) greater predictability of rules and regulations because of their stricter and more consistent application – this being advantageous to Taiwanese with their familiarity with the system. These three factors are seen as a combination of general relative impartiality in the application of rules to all countries and at the same time Taiwanese without discrimination as regards preferential policies are able to benefit from their long-standing connections and the friendlier contacts through the usual courtesies (*Guanxi*). This is expressed in interviewee GY3’s comment:

“we are trying to be fair on approval of foreign investment in our region. We follow the rules but as you know in terms of priorities, we as humans cannot be perfect (*Jinshan Jinmei* in Chinese in original)... in Kunshan, Yiwu and Suzhou for examples, as you may be aware, there are many Taiwanese investments and they have had a relatively good relationship with local government ranging from mayors, TAO officers, and even city party secretaries... I know they are well-connected and they frequently meet with Chinese officials for meals or playing golf...and TMAs seem to do quite well in these particular cities as well as Shanghai... I am sure if

Taiwanese fellow companies consider coming to invest in those cities of YRD, the local officials will give them attention and convenience (*fangbian* in Chinese in original)...I think this kind of long-term relationship gives *Taishang* an edge over other foreign investors. ”

Taiwanese investment as in the case of all foreign investment operates according to the *Law on Chinese -Foreign Equity Joint Venture, 1993* and the *Law on Foreign-Capital Enterprises, 1986 and 1990*. Until the late 1980s, the general policy of China was inimical to links with Taiwan. Since then, there has been a gradual easing of relations. From 1988, protective rules were enacted by the Chinese central government favouring Taiwanese investors (see Chapter Three). The process of improving the cross-strait relationship culminated in the Three Direct Links Agreement of 2008 and has been extended since. Financial costs and logistic difficulties were thereby eased for participating Taiwanese companies. This trend has been followed by the special benefits given to Taiwanese investment by the 2010 ECFA signed by both Chinese and Taiwanese authorities. The ECFA is a quasi-free trade agreement between Taiwan and China which *inter alia* aims to reduce cross-strait trade taxes and barriers.

A key element in the way each region or city treats foreign investment is the role played by the persons in power and in administration (party secretary of the area and the mayor). The hierarchical political system in China makes it difficult for subordinates to challenge their superiors' direction and orders, but a countervailing influence is to be found in kinship or corruption. A decision to favour particular investment by superiors charged with investment

policies and administration would not easily be countered except by private lobbying of the same officials or by a still higher ranked official to review the process. (GY1 and PG1 and Mr. Telek)

In the PRD, Interviewee GP2 refers to the way *Taishang* operated in the PRD in the earlier decade following in the opening investment to foreigners in the 1980s.

“when the relationship was eased in the 1980s, many *Taishang* came to Guangdong province especially Dongguan, Shenzhen, Chongshan and Zhuhai.” Because of the situation between Taiwan and China at that time, Taiwanese investment had to be channelled through a third country. The resulting higher costs of business operation caused *Taishang* gradually to choose for their preferred location “Guangdong or the neighbouring province of Fujian. The welcome policy of Guangdong did make it a lot easier for them to come to cities like Shenzhen or Dongguan.” Most *Taishang* tended to be small or medium firms and “some of the companies’ organisation and management were not functioning well. That led to those companies’ business closure or bankruptcy. Of course, other factors like ambiguous and inconsistent laws and regulations at that time in Guangdong, local officials being unfamiliar with rules and companies being cheated by their Chinese partners if there were any, also contribute to such investment failure.”

The shift in Taiwanese preferential locations from the PRD and reasons therefore are also described by the interviewee GP3:

“In the beginning, Taiwanese investment in the PRD was given priority in terms of approval of business investment and operational benefits and discount... Later on,

after the mid-1990s, more and more other foreign investors showed interest in doing business in China and flooded into the PRD, mainly for manufacturing industry. Due to this high demand and our limited resources, governments attempt to cater for business people's need and try to treat each business proposal and application equally. Therefore, less and less cities in the PRD give priority to the Taiwanese. However, the political-business *Guanxi* Taiwanese have built with the local officials over the years still helps *Taishang* to smoothly run their business in some cities such as Dongguan and Zhuhai...TMAs in the PRD play an important role between the Chinese local government and *Taishang*... Because of the peculiar cross-strait political situation, there was no formal platform for both governments to talk to each other, especially when it came to the problems *Taishang* faced. Here TMAs therefore act as middlemen to resolve *Taishang*'s concerns. TMAs also have a good relationship with local officials."

Mr. Lin said that "in general local governments in PRD prefer more organised TMAs. Even though good *Guanxi* exists between local officials and us, *Taishang* are not favoured as much as Hong Kong investors. Guangdong province has gone through different phases of business strategy over the years...so giving preferential treatment exclusively to *Taishang* or Hong Kong or Macau does not match their core objective – of gradually stopping high-polluting and high-energy-consuming industries moving into Guangdong". On a side note, it is interesting to note interviewee Mr. Huang's observation that "the image of *Taishang* is not too good in Chinese people's eyes because of their (partly true) impression that *Taishang* are arrogant, occasionally cheat and take advantage of the system.... But I do not think that this results in preferential

treatment or policies having been reduced throughout the years." It is evidence of perceived faults of Taiwanese people being overlooked against the drive for greater economic performance.

In the YRD, a similar trend is seen, but perhaps not so markedly as in the PRD. Taiwanese interviewee Mr. Chiu mentioned that "the whole YRD area is trying to follow central government's plan to encourage some manufacturing industries to move into the central, western or north-east parts of China. They try to encourage high-technology and green industries to the YRD... though this change cannot happen 'overnight' as local governments have to take account of existing business contract to which they are committed... In addition, *Taishang* in some cities have a powerful say because of their business presence and large quantity of investment such as in Kunshan and Suzhou... I think Taiwanese favourable status in some cities in the YRD will not suddenly disappear, at least not for another 5 years."

The interviewees in general conclude that more YRD city officials apply preferential policies than those of cities in the PRD. As a result, there has been a gradual shift of Taiwanese investment from the PRD to the YRD. Table 6.3 statistics show the change of distribution of Taiwanese investment from 1991 to 2007. The percentage of investment in Guangdong province of PRD has decreased over the years while the investment in Jiangsu province of YRD has increased. Many factors contribute to this phenomenon and two key elements of these are the preferential treatment by local government and the established supply chain of Taiwanese enterprises' vertical integration.

The most concentrated areas for Taiwanese investment in China are Jiangsu province, Guangdong province, Shanghai municipal city, Zhejiang province and Fujian province. Before 1993, Guangdong and Fujian provinces (50% in total Taiwan investment) were *Taishang* favourites; between 1994 and 1997, investment in Jiangsu province surpassed that in Fujian province; under the cluster effect of Taiwanese investment in Suzhou, Kunshan, and other major cities in Jiangsu province, from 1998 to 2002, Jiangsu province replaced Guangdong province as the top location for Taiwanese investment in China (see Table 6.3), a position they still occupy.

Some of the interviewees did not perceive any great difference in the treatment of foreign investors by the local governments of the two deltas. For example, non-Taiwanese interviewees Mr. McLeod and Mr. Shaw (PRD area) say that they do not notice any difference in preferential treatment that Taiwanese investors get which they do not obtain. Some interviewees such as Mr. Hunter and Mr. Naert (YRD area) indeed feel that local officials in the YRD are easy to deal with, providing investors follow the rules and comply with the local requirements. Mr. Hunter added that there is a clear advantage for Taiwanese in being able to get a sense of the full meaning of phraseology from their shared culture, this does not signify to them that they are treated preferentially. To compensate for this, their company hire Chinese as part of their management team or as a liaison with the local government officials in order to avoid any misunderstanding.

**Table 6.4 Top Five Areas for Taiwanese Investment in China 1991-2007**

Year/num	1991-2002	2003	2004	2005	2006	2007
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1 <sup>st</sup>	Guangdong	Jiangsu	Jiangsu	Jiangsu	Jiangsu	Jiangsu
	(32.18%)	(33.79%)	(35.83%)	(39.11%)	(31.78%)	(38.53%)
2 <sup>nd</sup>	Jiangsu	Guangdong	Guangdong	Guangdong	Guangdong	Guangdong
	(25.32%)	(26.69%)	(20.23%)	(20.31%)	(18.52%)	(19.84%)
3 <sup>rd</sup>	Shanghai	Shanghai	Shanghai	Shanghai	Shanghai	Shanghai
	(14.08%)	(14.34%)	(16.93%)	(16.94%)	(13.63%)	(14.44%)
4 <sup>th</sup>	Fujian	Zhejiang	Zhejiang	Zhejiang	Zhejiang	Zhejiang
	(9.55%)	(6.39%)	(9.93%)	(8.07%)	(7.73%)	(6.93%)
5 <sup>th</sup>	Zhejiang	Fujian	Fujian	Fujian	Fujian	Fujian
	(5.42%)	(6.39%)	(6.52%)	(6.63%)	(6.80%)	(3.90%)

Source: *Investment Statistics Annual Report 2006, Investment Commission of MOEA, Taiwan*

Note: 1. The percentage in the bracket ( ) is the Taiwanese investment against all Taiwanese investment in China.

2. Jiangsu, Shanghai and northern Zhejiang are parts of the YRD while Guangdong is within the PRD.

3. Fujian is a province which is neither in YRD nor in PRD. The figure shows the Top 5 Areas (Municipal City or Provinces) for Taiwanese investment in China.

## 6.2 Sectors of Industries

At the time of the opening up of investment by Taiwanese companies in China in the late 1980s, there was a concentration on the labour intensive manufacturing sector especially the original equipment manufacturers (OEM). Then and in the 1990s, there were less FDIs in the PRD and the YRD regions and there was less competition. As a result, the local governments in these

regions offered better incentives in terms of preferential policies. These were a driving factor for many Taiwanese manufacturers migrating to these regions. Some of the companies succeeded while others failed. Footnote 1 of this chapter summarises the challenges faced by foreign firms, and reasons for success and failure have also been discussed in previous chapters.

The importance of having sufficient protection for business secrets by way of patents and copyrights has become apparent to all foreign investors as underlined by various interviewees. The pioneers had to learn the lesson the hard way and later investors have been able to benefit from their experiences. To quote interviewee Mr. David Chang, "the violation of copyrights has been a serious issue in doing business and investment in China, though this situation has improved in recent years".

Interviewee Mr. Jack Lin said, "I know some of business people who were related to my business, either my clients or previous business partners. They went to China 20 years ago to run OEM factories and production line in specialised sponge but they failed. The main reason they recalled is that their technology know-how was soon copied by other competitors, especially local people. Those people stole their skills and registered the patent in China as their own kind."

Interviewee Mr. Michael Tseng also said: "When we consider the preferential policies from the local governments, we ought to take into account how and how well the local governments will safeguard our patents and technology know-how. We also have to see whether there is any mechanism in place in the government to monitor and punish such 'pirate behaviour'. This is a very important element during our decision-making for invested location."

While the protection of patent and technology know-how is the significant concern for the traditional manufacturing companies or OEMs, it has slightly less impact in the high-technology FDIs, such as the semi-conductor industry and pharmaceutical companies. This mainly is because such high-technology companies require a substantial amount of capital, expensive equipment and trained experienced engineers. This industry has its own uniqueness with more difficult replacement capacity. The more likely concerns for the high-technology companies are high-skill human resources and the core technology know-how (which can be a form of business secret). Those companies worry that some key R&D researchers and experienced engineers will be head-hunted or voluntarily move to another competitor company. This is a particular concern to Taiwan to which high-tech companies feature high in the economy.

For the FDIs in either secondary or service/tertiary industries, local officials in both of the two regions in general want to create a well-functioning business environment for investors. In terms of preferential treatment; however, local officials in the YRD and the PRD have shifted their preference from accepting all industries to high-technology or novelty industries (such as green technology) over the past 25 years after China's 'open door' policy.

Interviewees Mr. Chen, Mr. Chiu, Mr. McLeod and Mr. Naert state that: In the YRD and the PRD, generally speaking, the local governments gradually show more welcome to less-polluted, high-tech or high added value industries, which are given priority status. This trend has increased over the years. Local governments' concern over FDI recruitment planning has followed from the increasing labour cost in the coastal area of China.

Taiwanese will need to keep a watchful eye over the likely trends in Chinese policies.

Interviewee GY2 commented that “there will be more areas attracting foreign investment in the central and western regions, while the conditions for setting up FIEs [foreign invested enterprises] will be relaxed and the same is true for the equity holding proportion of FIEs.” The government is responding to the environment and wage inflation pressures by a greater focus on investment in central and western regions of the mainland (People’s Daily, September 8<sup>th</sup> 2000) and even encouraging Chinese investment abroad in response.

Favoured projects<sup>14</sup> for the inner regions are listed in the *Priority Industrial Catalogue of Foreign Investment in the Central and Western Region*. The advantage of proximity of the YRD and the PRD to Taiwan will decrease. In the past few years, many labour intensive or traditional manufacturing companies have had to re-locate their production and business in inland China (such as western China) or simply move their businesses to other countries, such as Vietnam or Indonesia. The influential factors do not only come from the increasing labour cost and changes of investment recruitment policies of the YRD and the PRD, but also the preferential policies from other local governments of China, i.e. Sichuan province, a recent booming province. As noted elsewhere, central government has responded to inflationary and environmental pressure in the more developed and densely populated regions by encouraging moves to the lesser developed or less favoured parts of China. In parallel, local governments in other regions have promoted preferential policies which are now proving a magnet for Taiwanese companies to move production from their earlier bases or to attract new companies (e.g. Sichuan or Hunan provinces).

<sup>14</sup> Firms investing in these areas are not required to pay tariff and import linkage tax on equipment, supporting technology, accessories and spare parts imported for self-use.

Tax reduction aimed at encouraging industries, the rules governing return of taxes on exported goods, Chinese labour law and land policy are in Mr. Tseng's view "crucial to investors... After July 2007, many such benefits from the return of taxes for exports have been cancelled by the government. A consequence has been chaos in world steel production, China being the greatest consumer of steel in the world." These changes in regulations and policies have made some FDIs move to the other parts of China. Mr. Tang and Mr. Telek both mentioned that some of their production has moved to western China because of the changes made by the YRD governments and new incentives offered by central and the local governments of their newly invested regions (Sichuan and Hubei provinces respectively).

All in all, in the PRD and the YRD generally, export oriented firms, technology intensive and intelligence intensive projects, construction projects for energy, transportation, harbour, projects with foreign investment over \$30 million and with a long investment recovery period can obtain reduced or exempted tax rates. (See Appendices 6.A and 6.M for more details regarding preferred industries and tax benefits). The Jiangsu provincial government of the YRD especially encourages foreign investors to set up export-oriented or technologically advanced enterprises and will give them preferential treatment with respect to taxation, credit, supply of water, electricity and gas, and telecommunication and transportation facilities. "Planning prices are normally stipulated in the business contract in the beginning of the operation" (Interviewees GY1 and GY2). Appendix 6.A lists the charges such export-oriented and technology advanced enterprises will incur at various planning prices for cost of water and electricity as compared

with other foreign-invested enterprises who are charged on the same basis and at the same price paid as local state-owned enterprises.

Well-capitalised foreign enterprises have a natural advantage over many less well-capitalised Chinese companies who look to banks to provide financial backing. Banks in the YRD are told to give priority to foreign-invested enterprises, in pursuance of FDI's preferential policies. Loans for their working capital are part of the banks' loan quotas. The banks concerned may have pressure exerted on them by local government, as many Chinese domestic companies require capital to start up their businesses "but the banks have to balance these needs against the necessity of balancing their resources" (Interviewee Mr. Sun). In the YRD and the PRD regions, large enterprises, companies within favoured industries and those companies with connections are given attention first. These bank loans privileges are not set out in written form, but are in practice common. According to interviewee Mr. Sun, a Shanghai branch manager of Chinese Merchants Bank, banks are told to give priority<sup>15</sup> to FDIs and up to 'certain companies' e.g. those in high technology or being part of large enterprises.

From the foregoing analysis of interviews and local governments' policies in the PRD and the YRD, one notes the evolution of investment by Taiwanese and other foreign investors in response to a transformation in the Chinese economy and the increase and planned migration of the population. So whereas in the early years of the opening up of China to Taiwan, the investment was significantly concentrated on certain coastal regions, notably the PRD, Taiwanese companies have been encouraged to move, first to the YRD and more recently to

<sup>15</sup> He also mentioned "we still need to look at the company's portfolio to examine the risks of non-performing loans and its justification of requested limits of loans".

other parts of the mainland. Similarly, whereas at first China welcomed investment from Taiwan with less emphasis on sectors, in the last decade there has been much less flexibility with greater priority given to high-tech non-polluting industries and large enterprises. The interviewees illustrate how preferential treatment is given by local governments according to government policies but mainly according to their views of the needs of their areas and political strategies are in practice of less importance to them. The favoured sectors are those, whether from Taiwan or elsewhere, which the local administrations view as contributing to the economic progress and general well-being of their population.

### 6.3 Size of Companies

Taiwanese small and medium enterprises are being significantly hit by the more recent tendency to greater alignment with the Chinese central government's push towards greater unification by economic, peaceful means ('*yi-shang-cu-tong*' in Chinese).

At the public hearings of Taiwan's Legislative Yuan<sup>16</sup> in 2006 and 2009, the *Taishang* expressed their disquiet at the reduction of preferential policies in China. Chinese preferential policies for Taiwanese investment were viewed as having two different approaches: one is to encourage investment from Taiwan to facilitate Chinese regional and overall economic development; and the other one is to reflect the Chinese political agenda and unification strategy '*yi-shang-cu-tong*'. Compared Lee's article (2008:145), this view echoes that of much existing literature and the hypothesis of this thesis: the old antagonistic attitudes of the Chinese and Taiwanese militarily

<sup>16</sup> Legislative Yuan is the highest level of law-enacting governmental body in Taiwan. The proceedings of the public hearings can be accessed through their website <http://www.ly.gov.tw>

and in relation to trade contacts have been replaced by a less confrontational approach, and the Chinese government has embraced the benefits of an opening up of external trade and other contacts, but still retains the ultimate objective of unification, but indirectly by softening up Taiwanese relations in the hope that Taiwan will eventually succumb to the perceived attraction of absorption by the mainland. The majority of the Taiwanese investors interviewed by the author have the sense that Chinese local governments implicitly impose their economic and political motivation in introducing or implementing preferential policies; though some Taiwanese apparently do not see themselves as "pawns" of the Chinese government.

Does size matter? In big companies such as Formosa Plastics and ASE Group, the Chinese local government nominate a Chinese representative called "*Chang-Zhang*" (in Chinese) as an employee paid by the government, to monitor the business operation and report back to the Chinese local government, according to interviewee Mr. Lin and Mr. Chiu. The business operation that "*Chang-Zhang*" monitors is related to many aspects of the company such as payroll, business license, environmental standard, permit of exportation. Local governments also notify foreign companies about any new policy or any amendment of existing policies through "*Chang-Zhang*". This unique Chinese governmental practice normally only applies to large enterprises. The Chinese government justifies this as a mechanism to ensure Taiwanese enterprises' business is in order and in the interest of the public (interviewees Mr. Chen, Mr. Tseng and Mr. Chiu). Taiwanese investors in both PRD and YRD normally regard this arrangement positively rather than as a threat and they think it is a mechanism for local governments to demonstrate their authority to FDIs. The investors try to treat this representative as a consultant giving voice to their concerns, easing relations with the government and updating

the representative on recent important activities of the company. They will ask this person for assistance to overcome any problems, whether operational or bureaucratic: after all, the larger the turnover of a company in a locality, the greater the benefits to the locality and its government. This unique treatment applied to *Taishang* is considered by the Taiwanese conglomerates as an alternative 'preferential treatment' and a way to exercise *Guanxi*. (Mr. Chiu, Mr. Lin and Mr. Tseng)

When big Taiwanese enterprises have a business dispute, they are given special attention by the authorities and may also receive additional support. This can be shown in the case of Shin-Kong Place, a retail department store chain and a joint venture between Taiwanese Shin Kong Group and Chinese partner Beijing Hualian Group. This dispute in the August of 2007 was caused by the fact that Beijing Hualian Group illegally expropriated the assets of Shin Kong Group. According to the report of Zheng-Zon Kang of *Commercial Times* (13/09/2007), because both firms involved are large enterprises and the Hualian Group is a state-owned enterprise, the issue became even more sensitive. Wu Yi, the First Premier of the State Council of the PRC, then directly intervened and coordinated her staff from the Department of Commerce to ensure a satisfactory outcome to the bilateral negotiations. The parties ultimately arrived at reconciliation, Beijing Hualian Group apologising and making a concession. Former president of Shanghai TMA, Hui-De Ye, mentioned that TAO in Beijing also played an active role in mediating the dispute and they were given the order from Ms. Wu Yi to actively coordinate the parties concerned and settle the argument in a way beyond normal business precedent.

Non-Taiwanese foreign investors in the YRD and the PRD feel that the scale of the company does help to get the central and local governments' attention. (Interview data) The Chinese government appreciates the contributions made by large and famous foreign firms and facilitates initial discussions of business proposals between those firms concerned and the local government. The local government will normally cooperate with the firms, as long as the latter are on good terms with the local officials and do not cause embarrassment or trouble in the area. Negotiations take time; there can be much bargaining but in order to please firms that are favoured, the local government are ready in certain cases to compromise to their own disadvantage (field interviews from Mr. Naert, Mr. Knight, Mr. McLeod). Interviewee Mr. Shaw explained, "the relationship that we, as an American company, with the Chinese local government is like the tit for tat of game theory... both sides need to watch out each other's actions and responses". A similar point is made by interviewee Mr. Telek who described preferential treatment for his company coming from "playing a good ping-pong<sup>17</sup> game with the local government...sometimes we need to take one step back and sometimes need to be proactive...If we want to get favoured, then handshake as initial cooperation before the game starts is not enough. The strategy of the ping-pong game with Chinese local officials is also important to ensure the smooth operation and maximum benefit our company can acquire".

The previous paragraph reflects a fairly uniform picture of the special treatment available to large firms. As far as SMEs are concerned, they can have the benefit of special treatment also but their negotiating power can be less and they are "often forced to have resort to middlemen to exert sufficient influence" (interviews from Mr. Tang, Mr. Lin and Mr. Knight).

<sup>17</sup> Ping-Pong is also called table tennis, being one of the popular sports in China. The tactics of the game are to hit the ball to the other side with power and skill. Normally in China, it is used as a metaphor to describe the strategies in the interaction of the two-party equation of business or government/business relationship.

#### 6.4 Discussion of Findings

This section discusses the findings derived from the analysis of interview transcripts and existing government preferential policies. The findings will then answer the research questions for this thesis. The key research questions are: (1) Do Chinese local governments implement their and the central government's FDI policy to treat Taiwanese investors more favourably in the YRD and the PRD than non-Taiwan investors? (2) What influences local governments' preferential treatment to Taiwanese investors in China and (3) Have the Chinese central government achieved their objectives of preferential FDI policies for Taiwan?

To answer the first research question, one needs to understand the way the preferential treatment functions in a particular area of the PRD and the YRD and to refer to local government districts' written policies or laws/regulations and to informal mechanisms. The policies and laws mostly relating to taxation benefits, charges, rent and utility rates are set out in written form, whereas those relating to frequent meetings, institutionalized contacts, expedition of business application, acceleration of dispute resolution, bank loans and the like are applied informally. Lee (2008:148) endorses Lieberthal and Oksenberg's statement (1988): "the Chinese government mechanisms and the various processes leading to these decisions are difficult to scrutinize or they lack the publicity that characterises the act of governments in more democratic states".

Written documents: Taiwanese interviewees consider that the central government's preferential policies of 1988 and 1994 (appendices 2.A and 2.B), relating to *Taishang* as expressed in written

form in their policies and rules, are not very precise and are simply aimed as a sort of assurance of their rights in the conduct of business operations. These written provisions are not specific enough to deal with all aspects of business, and do not address risks or difficulties that *Taishang* may face in China. However, being an authoritative expression of central government policies and laws, *Taishang* see them as a protective shield to rely on when encountering business disputes. As for the local governments' preferential policies in these two deltas (see Appendices 6.A to 6.M), it can be seen that Taiwanese investors do not get special rules to apply to them for tax exemptions, miscellaneous charges and rents. In other words, they are treated as other foreign investors. As the government officials of the YRD and PRD point out, "we should not single out *Taishang* in written form as China should abide by the WTO rules, and giving a special status to *Taishang* may lead to objections from other foreign investors and demands for similar treatment".

Informal mechanisms: Most preferential treatments accorded to *Taishang* in the PRD and YRD have been carried out by informal means: most interviewees in this research confirm the prevalence of this practice. As a result of their long-term business presence in China since the late 1980s and of the large amount of business capital and the number of the investors, *Taishang* have established several mechanisms to secure and solidify their relationships and interaction with the Chinese officials at all levels. These include institutionalized contacts (TMA) and frequent informal meetings. Through these and with additional resort to the Chinese government agency (TAO), *Taishang* can sometimes expedite their business applications, resolve their disputes and problems efficiently and obtain bank loans. *Guanxi* in these informal mechanisms become rather important as it is necessary for *Taishang* to be directed to the key or right person in order to receive preferential treatment. Research interviews reveal that *Taishang* have greater

access to channels to express their opinions about local government policy implementation. Lee's research (2008: 149) also notes that *Taishang* have "more opportunity to negotiate with local government in suggesting implementation and helping to determine the outcome of local government policy."

The preferential treatment that is given by Chinese local officials to Taiwanese investors is not easy to quantify, although the evidence has shown a general view that they do get favourable status as opposed to non-Taiwanese foreign investors, depending on their relationships with the authorities, size and the type of activities conducted and the location of their operations. There has been a gradual decrease in the preferential policies in the YRD and the PRD in the last 20 years. In practice, preference is given to certain cities or towns within the PRD and the YRD and to some selective industries such as high-tech enterprises, firms with large projects, technically enhanced firms and innovative industries (policies are shown in appendices 6.A to 6.M).

As for the second research question, it has been shown that, in the application of preferential policies, it is not sufficient to just look at the rules in practice. Factors which also count as outlined in Chapters Five and Six are *Guanxi*, new/old Chinese bureaucracy (evolution of approaches), uncertainty of the legal system, the nationality of the company, decentralisation of Chinese government, location of investment, industry of firms and the size of a company. All these criteria are interrelated and taken into account by such officials. Any criterion alone without a combination of other criteria cannot in itself suffice to obtain preferential treatment from the Chinese local government.

Generally speaking, cultural affinity in the YRD and the PRD no longer gives Taiwan's investors the absolute advantage it did as compared with non-Taiwanese foreign investors. In the final analysis, preferential treatment varies from case to case. A rough percentage of the localities in the PRD and the YRD that do actually give substantial favourable treatment to Taiwanese firms is less than half of municipalities/cities/towns in the PRD and YRD. This has reduced over the last two decades in response to rapid development in parts of China with shifting priorities of the central and local governments as a consequence, and taking account of successive five-year plans.

Laws regarding foreign business operation and investment in China have been more transparent in these past two decades and provided greater certainty. But also as a consequence, both Taiwanese and non-Taiwanese need to be careful to follow the laws and regulations (e.g. on taxation): there is little room for investors to avoid these laws, especially as the Chinese legal system becomes more mature. However, underlying these, the ingrained Chinese habit of *Guanxi* governing social conduct is still the first key to obtaining preferential treatment for either Taiwanese or foreign firms.

Interviewees Dr. Tao, Dr. Tong and Mr. Li, referring to their experiences and research in China, observed the existence of detriments encountered by investors, in the current Chinese political and economic environment. One of the targets of the Chinese government is to create fairer and more transparent legal channels and implementation of policies. However, "inconsistent and blurred policy implementation, 'rule of man' caused by *Guanxi* and authoritarian regime, ambiguity of law interpretation and lack of cooperation between government departments have crippled the government's efforts." (Dr. Tao) "It is a gradual improvement but in the short run,

special discount or treatments for firms with *Guanxi* will not be unheard of, regardless of which part of China and what nationality of the company.” (Mr. Li and Dr. Tong agreed).

The preferential treatment for *Taishang* is diminishing, and the reasons are mainly because of: the Chinese central government’s strategic planning which aims to balance China’s economic development geographically and also to look after their domestic companies; local governments’ pragmatism which concentrates on their own economic concerns and tailor preferential policies to suit their localities; and the importance of *Taishang* in dynamic and changing cross-strait relationship. With regard to the last reason, interviewee Mr. Yin-Long Yu from the Straits Exchange Foundation commented that “before 2008, especially during the DPP administration from 2000 to 2008, *Taishang* have acted more in transferring messages between the two governments. After 2008, this function for *Taishang* has been reduced because both Chinese and Taiwanese governments communicate and negotiate directly or indirectly on a more frequent basis. More frequent contact and greater familiarity with each other have made it easier for the parties to deal with each other harmoniously. With the lessening of *Taishang*’s importance as middlemen, *Taishang* receive less attention from the Chinese government. The bonus which used to come with being middlemen has reduced.” As a consequence, the preferential treatment given to *Taishang* as middlemen/messengers between two governments is decreasing because of the change in the significance of their role in the cross-strait inter- government relationship and less reliance can be placed on their importance in businesses/government relationships.

What are the deciding factors for local officials in the PRD and the YRD? This thesis analysis shows that preferential treatment is applied on a ‘case-by-case’ basis. Their approach can be summarised by way of the following criteria, which are considered below in what the researcher has identified to be their order of importance. (Certain other factors namely, “uncertainty of regulations”, “new/old bureaucracy” and “decentralisation process of government” which all affect the way Chinese local governments operate, have an impact on the way local officials interact with foreign investors, and how they interpret and implement the regulations applied to FDIs and *Taishang* and the balance of government/business relationship. They are all general considerations in judging the selected criteria and have not been separately listed, as not being capable of measurement.)

## 1. *Guanxi*

The research interviews note the impact of personal contact between Taiwanese investors and Chinese local officials as a way for local bureaucrats to bypass control by the state and deal directly with foreign businesses (see also Hsing, 1997:158). As Amber, Witzel and Xi (2009: 101) argue “*Guanxi* with government remains of primary importance for any businessperson, Western or Chinese.” Luo (2007) comments on the inevitability for businesses of facing *Guanxi* dynamics. In China’s new, fast-paced business environment, *Guanxi* has been more entrenched than ever, heavily influencing Chinese business practice. The evidence from primary data shows that all interviewees from FDIs and some government officials agree with that *Guanxi* is the most important factor to affect how local officials implement preferential policy and how FDIs benefit from preferential treatment.

In short, *Guanxi* is one of the key elements for foreign business sustainability and prosperity in China. FDIs with good *Guanxi* with the Chinese central and local government may therefore avoid frequent and deliberate scrutiny from local officials and find such officials able to operate out of expediency. (Interview data)

## 2. Location of company

Taiwanese as opposed to non-Taiwanese investment is welcomed and favoured only by certain cities of the YRD and the PRD. More cities in the YRD region than in the PRD have a preferential attitude and official treatment toward Taiwanese investors – though these are not normally expressed in written form. (Interview data)

Also varying with the preferential policies of the local government in these two deltas, they have slightly different tax breaks incentives to the FDIs and their economic aims are also slightly different. (Policies are listed in Appendices 6.A to 6.M)

Decentralization empowers and is giving local government more authority to make their own decisions relating to foreign investment. (This was mentioned in Chapter Five and literature review, Hsing 1997 and Chien 2010). This generally eases the burden of central government red tape for foreign investors, except where specific procedures laid out by the central government need to be followed. Where there is a difficulty in resolving a dispute by way of arbitration or resort to a court, the central government may, if approached, step in, in an effort to resolve the matter. This may take the form of central officials calling the parties to meet each other in the presence of the officials who may

give guidance and finally decide to steer the parties to a particular solution. But generally, Chinese central officials prefer not to interfere too much in local affairs.

### **3. Sector of the company and size of the company, equally important**

Size matters when it comes to obtaining favoured status. This is mainly because of the economic advantages and perspectives which large FDIs are anticipated to bring in technology, know-how, managerial talents, employment opportunities and social development.

Government regulation “2007 *Priority Industrial Catalogue of Foreign Investment*” shows that there are several sectors on which Chinese governments try to focus and give incentives to the FDIs. Sector of industry is a factor for local government in deciding whether to accord preferential treatment. This has been particularly apparent in the last decade, with the PRD and the YRD becoming somewhat saturated with FDIs as well as Chinese domestic companies. New high-polluting and high-energy-consuming companies are being progressively filtered out. These companies are encouraged both by the central and local government to move their production to the central and west parts of China. Preference in terms of taxation benefits, charges reductions etc, is given to enterprises with high technology, exported orientation and sector-specific such as energy and harbor.

### **4. Nationality of company**

Most interviewees including the government officials agree that the nationality of the company is a less important factor for the local governments to favour investors. Nationality of companies is generally not a big concern for Chinese local government in the PRD and the YRD. Foreign investment for them is mostly deemed a business transaction in a transnational context. The relationship between a foreign country and the PRC government is a diplomatic issue. But the general approach of local government is to view proposed investment by a foreign entity on a purely business basis unless otherwise specifically directed.

Chinese laws, regulations, and rules can become a double-edged sword for FDIs. In the early stages of Taiwanese investment in China, especially in the YRD region, Taiwanese small and medium enterprises took advantage of their language and cultural affinity to manoeuvre through the Chinese political and legal system to their favour. The ambiguity, inconsistency and opaqueness of Chinese laws played a part. After improvement of the legal framework, both in quality and quantity, Chinese officials are aware of and familiar with the legal concepts and practices and FDIs are covered by the laws more than was the case in the past. This change has led to Taiwanese and non-Taiwanese businesses operating on a more equal footing. (Interview data)

The final question discussed here is to tackle whether the preferential policies' implementation to *Taishang* matches the Chinese central government's political motivation. It is analysed in this thesis by referring to the views of four different groups involved: the first one is from the Taiwanese government's stance and reaction to the Chinese preferential policies for *Taishang*;

the second one is from the attitude of *Taishang*; the third is from the perspective of Taiwanese people in general living in Taiwan; and the fourth relates to Chinese local government's motivation in implementing preferential policies.

Cross-strait economic integration is predominantly done by inter-governmental agreement, negotiation and treaty as well as through sustained links between state and non-state actors (mainly *Taishang*) within or across national borders. However, the bottom-up process of Taiwanese residents' voice will to some degree affect the government's policies. As described in Chapter Three, according to the changes of the cross-strait relationship at different periods in the past 25 years or so, as well as the political attitude of the President toward China and cross-strait macro-economic mainland policy, Taiwanese government in general has responded positively to Chinese central government's preferential policies toward *Taishang*. Under domestic pressure from the opposition party and *Taishang* and the worry of being over-dependent on the Chinese economy out of concerns over security, the Taiwanese government has however not fundamentally changed its position on unification with its Chinese counterpart. From which one can conclude that the Taiwanese government has not been seduced by Chinese government's preferential policies in favour of *Taishang* to surrender its identity or made any radical concession to China.

As for the *Taishang*, all interviewees from Taiwanese companies were careful not to let their domestic political views or support for any of the Taiwanese parties affect the way they conduct their business in China. Such action, they explained, is simply to avoid unnecessary problems

from central government or the conservative local officials. It has not affected *Taishang*'s Taiwanese political affiliation or sympathy. Some of the interviewees mentioned that, in some cities, *Taishang* with strong political views of 'Taiwanese independence' will be blacklisted and labelled. New Taiwanese investors have learned from their predecessors' experiences to 'do in Rome as the Romans do' and try not to take sides.

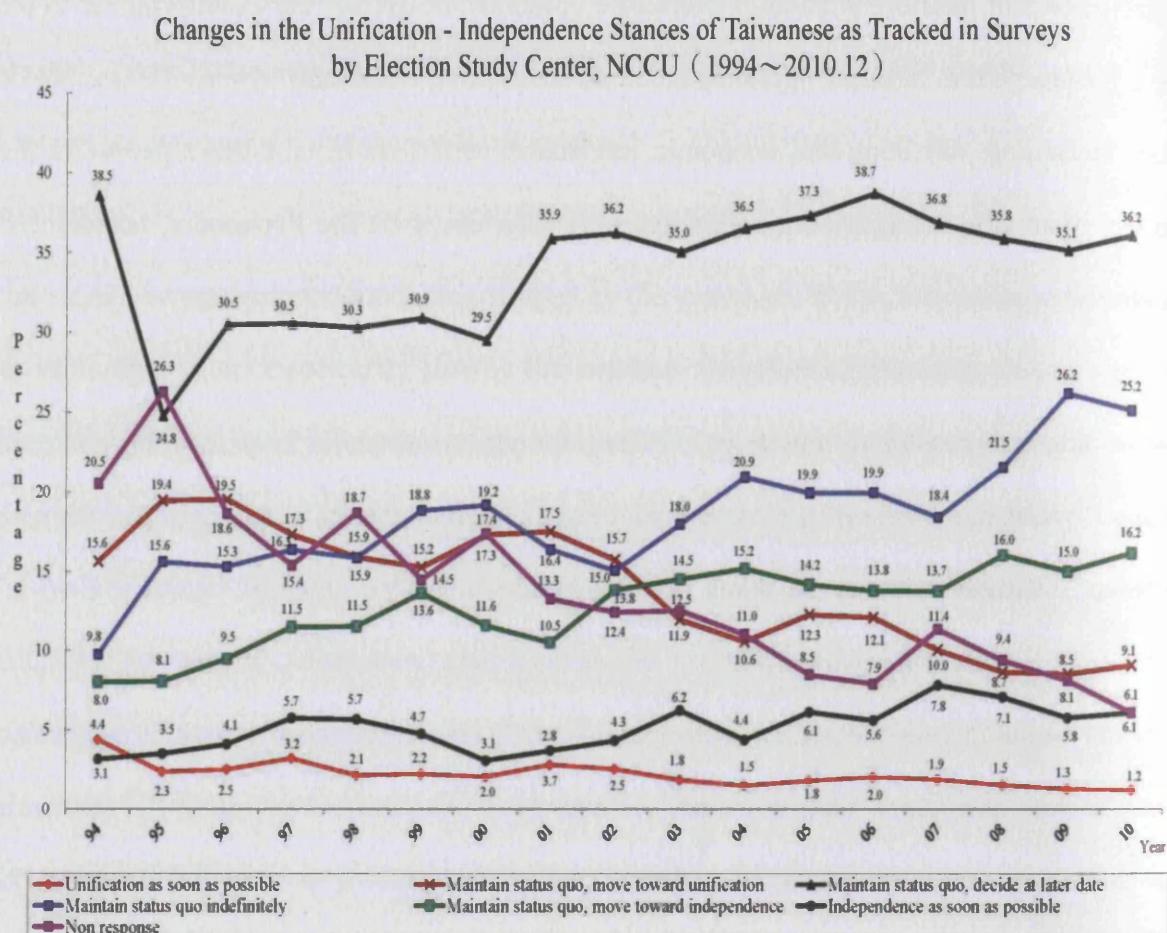
This should be set against the situation as seen by the generality of the Taiwanese population. At the same time as not necessarily sharing the political views of the *Taishang* and remembering that Taiwanese people in general have minimal interaction with Chinese central or local governments, one notes that data from surveys conducted by the Election Study Centre of Taiwan's National Cheng-Chi University regarding Taiwanese people's political attitude on independence versus unification and Taiwanese identity, shows a gradual shift in the population's attitude. Tables 6.4 and 6.5 respectively, referring to the years between 1994-2010 and 1992-2010, indicate that the percentage of the population favouring unification has decreased and that of those wanting to keep the status quo or more assertion of independence has increased. In other words, the movement of popular opinion is not necessarily progressively in one direction only. Surveys show a remarkable shift in Taiwanese self-perception over the past 18 years. The number of those identifying themselves as Taiwanese has risen from 17% to 52.6%, whereas those who see themselves purely as Chinese has dropped from 26% to 3.7% (see Table 6.5).

The number of those who are neutral, with a feeling of being both Taiwanese and Chinese, has not dramatically changed, from 46% to 40%. It can be argued that many factors contribute to this

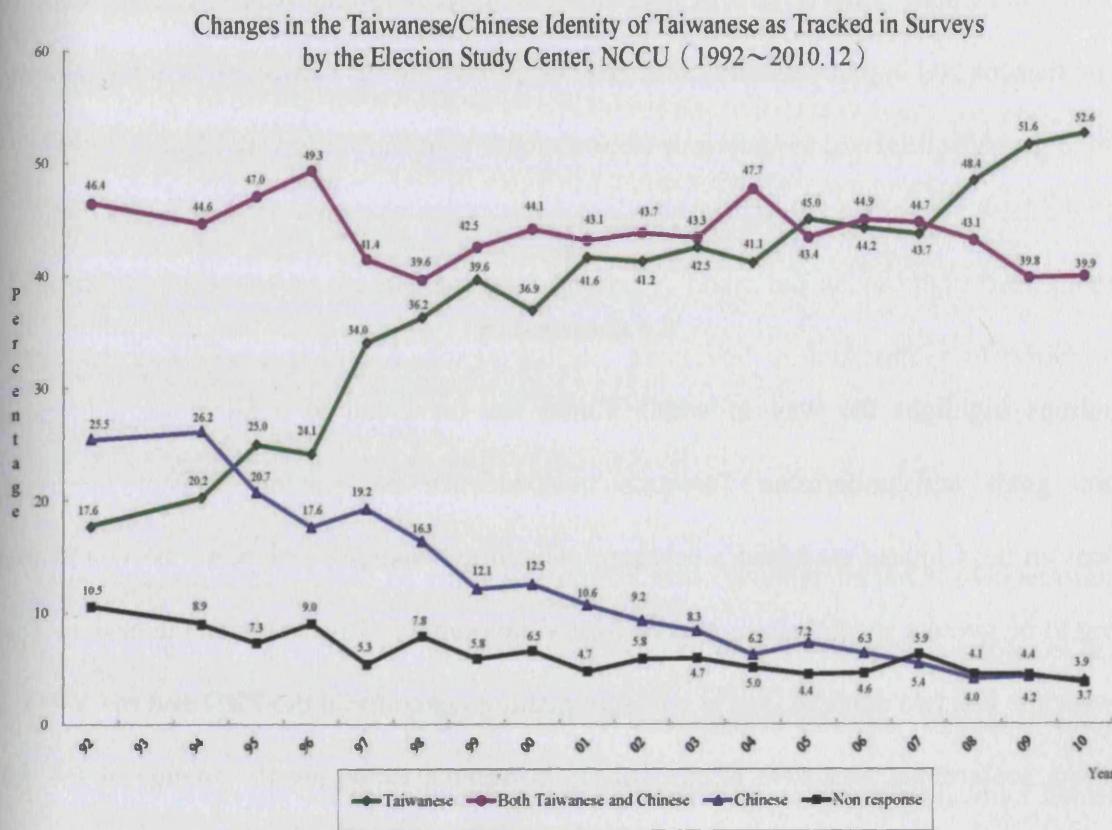
trend, one of the main factors being a result of Chinese government's propaganda and 'Taiwan policy' (*Dui-Tai Zhengce* in Chinese). The Beijing government not unreasonably suspects Taiwan's leaders of possibly pursuing a deliberate policy to "de-sinify" the island, counter to the Chinese government's "friendly" policies (such as preferential treatment). Nevertheless, "some officials in Beijing still hope that economic interaction with Taiwan will make people in the island feel more Chinese again, but many now have their doubts" (The Economist, January 13<sup>th</sup> 2005, special report).

These two tables have certain limitations: 1. The respondents are adults from all walks of life in Taiwan so it will not necessarily represent *Taishang*'s special political stance; 2. The Chinese government's Taiwan policy is also a key factor to affect Taiwanese opinions.

Despite the limitations of the surveys, one can conclude that cross-strait economic integration between Taiwan and China does not work completely in the Chinese mainland government's favour and does not fully reflect its political motive for offering preferential treatment to Taiwanese investors. One way of reaching China's political goal has been through the success of the Taiwanese economy being heavily reliant on the Chinese market, which may help or expedite toward closer future political integration of the two countries. But another fundamental issue will not easily be reconciled – Taiwanese abandoning a wish for a distinct identity in terms of nationality and political sovereignty which most of Taiwanese predominantly presently feel, and being sympathetic to unification and finally giving up their resistance to the idea of one nation.

**Table 6.4: Change in the Unification-Independence Stances of Taiwanese (1994-2010)**

Source: Adapted from Election Study Centre, National Chengchi University

**Table 6.5 Changes in the Taiwanese/Chinese Identity of Taiwanese (1992-2010)**

Source: Adapted from Election Study Centre, National Chengchi University

As to the Chinese local governments' approach to FDI preferential policies (particularly regarding *Taishang*), interviews with government officials both central and local showed a recognition of the difficulty of balancing central government and local governments objectives, there apparently being a divergence of motivation between the two levels of governments. In dealing with FDIs, local officials, unless specifically guided by the Party leader or their superiors, generally put their area's economic concerns first ahead of central government's political objectives when giving preferential treatment. Local development is also important to higher ranking local officials to remain in post. In dealing with Taiwanese firms, one would expect such

firms to be especially favoured as being 'fellow-countrymen', and so assisting in a drive for unification, in fact, these considerations seem to play very little part in the way decisions are made. This can be seen in the criteria of local officials for preferential treatment, most being for economic reasons and in part reflecting influence of *guanxi*. Being Taiwanese is not a primary criterion in giving incentives, as shown in the researcher's primary interview data.

### 6.5 Conclusion

The findings highlight the way in which China has contrived to achieve its political and economic goals and undermine Taiwan's independence by making Taiwan increasingly dependent on the Chinese mainland's economy. Given this specific situation, one would expect *Taishang* to be given a special status and be treated favourably. This has been the case to a large extent over the last two decades, but is now diminishing generally in the PRD and the YRD. The diminishing preferential treatment is particularly noticeable following the change of the ruling political party in Taiwan after the 2008 presidential election. Political dialogue has been resumed between Taiwanese and Chinese appointed delegations, rather than communicating with each other partly via *Taishang* as was the case during the DPP administration in 2000-2008. In addition, local governments are now concentrating on what they perceive to be their economic well-being, and adjusting their preferential policies accordingly, giving less weight to the central government's desire for especially favourable treatment of Taiwanese investment in pursuit of Beijing's long-term objective of unification.

## CHAPTER SEVEN

### Implications, Contributions and Conclusion

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#### 7.0 Introduction

China is the world's fastest emerging major economy - soon to surpass that of the US in size - and is naturally attracting increasing attention from the rest of the world, with its crucial influence on the international economy. There has accordingly been much interest in Chinese politics-business culture, perceived understanding of which is often clouded by misconceptions.

Without a full appreciation of Chinese political and business methods of operation, foreign investors can often be misled to adopt out of date views, for example, of the "communist" ethos driving policies and of commercial practice. There is often uncertainty given the widely held perception of China as a colossus to be either feared or unduly admired. It has been the objective of the researcher to provide an actual picture of the way Chinese authorities operate in practice, of the consequent impact on the case of Taiwanese investment, and of the changing nature of the background picture of business environment and government/business relationship.

Additionally, this thesis focuses on the importance of the short and long-term government strategies regarding their international relations relating to Taiwan and the Chinese mainland. For instance, it can be seen that China's long-term aims have remained constant in a wish for eventual absorption of Taiwan – replacing its previous more aggressive stance with a concentration on reducing Taiwan's independence by making Taiwanese increasingly linked to the Chinese mainland

economy. The Chinese government preferential policies are outlined in the law of 1988 “*The Regulations for Encouraging Investment by Taiwan Compatriots*”, the law of 1994 “*the Law on the Protection of Investment by Taiwan Compatriots*” and the 1994 government slogan “all *Taishang* compatriots will get treated better in China and China will win Taiwanese hearts” (*Tong-Den Yo-Shien, She-Dan Fang-Kuan* in Chinese).

To that end, *Taishang* have been seen as a way of satisfying ambitions of Taiwanese investors, while at the same time helping the overriding Chinese objectives. Indeed, in the last two decades, *Taishang* have enjoyed, to a large extent, preferential treatment in the PRD and YRD; but in fact this advantage has been increasingly diminished. One of the important drivers for this change has been the reality of relations of local government with Taiwanese investors, who have been acting with a great deal of pragmatism, concentrating on their own economic concerns and adjusting preferential policies to suit their localities. Another important driver for this change is the dynamics of cross-strait relationships. Before 2008, especially during the DPP administration from 2000 to 2008, *Taishang* have acted more as a conduit for conveying messages between the two governments. After 2008, the need of two governments to communicate and negotiate through *Taishang* has lessened because of the greater, and more frequent direct and indirect contacts between both Taiwanese and Chinese governments reflecting their easier relationship. *Taishang* have, therefore, acted less as middlemen, or significant links for the Chinese government, so reducing their previous advantages.

This final chapter shows the significance of the empirical findings of this research as well as original contributions, related implications for businesses and politics, and finally, it points out in the direction of possible future research. The research's empirical work gives credence to the theories on which the research is based. Its findings contribute to literature, theory and business practice. These findings and the methods used in the empirical work can provide pointers to and a foundation for further research. What has been attempted, what has been revealed, and what valuable issues have been raised in this study are also shown in this concluding chapter.

The chapter consists of six sections. Section 7.1 shows the connection between the research work completed, the original research questions, the previous work examined and discussed in the literature review, and summary and significance of the key findings. Section 7.2 uses a question-and-answer format to allow readers to easily refer to the answers to the main questions of this study, thus providing a summary of key findings stemming from primary data collected and supporting documents. Section 7.3 discusses the contribution of this work to theory, literature, and business practice, as well as offering suggestions based on the empirical findings of the 25 elite interviews. Section 7.4 refers to likely areas for further work. Given the rapidity with which the political-economic landscape is changing, future research could be facing a different situation when focusing on any area of research for further examination or exploration. Section 7.5 contains concluding observations and remarks.

### 7.1 Insights and Findings

To quote expats (Mr. Chiu and Mr. Tseng) in China, “you can write a book after staying in China for a week; you can write an essay after a month and if you stay over a year, there is too much to think about and you fall silent.” It seems that as one gets to know China more, there is yet more to be discovered and learned about the country.

To many researchers and investors, the Chinese business environment and regulations are somewhat fixed; but they are in fact complex, sometimes blurred and sometimes contradictory. This thesis provides a clearer understanding of the intertwined relationship between Chinese local government and foreign investors (with particular focus on *Taishang*), in the dynamic political, social, economic and cultural contexts. In accordance with the aim of this thesis, the researcher examines whether the relationship of the *Taishang* and the Chinese local government in the PRD and the YRD generally conform to the proposition that closer Taiwan-China relationship may have a negative spill-over effect, such as on the attitude of the Taiwanese people to close political links between China and Taiwan or eventual unification. As a result of cross-strait economic integration between Taiwan and China, both stand to gain benefits. Economically both countries are able to increase growth and achieve greater prosperity. On the other hand, the leverage China has through its greater size, resources and power makes Taiwan always vulnerable to any threat of economic sanctions. Politically, although Taiwan has avoided confrontation and obtained a seeming peace with China, such integration may not work completely to the Chinese mainland government’s favour/aim of reconciling Taiwanese people to their ultimate objective, as illustrated in Tables 6.4 and 6.5 in Chapter 6 of this thesis.

The researcher's findings accord with Kastner's argument under the China-Taiwan relationship matrix. Kastner's argument does not rule out the possibility that economic integration across the Taiwan Strait makes a military confrontation less likely and can be a stabilizing force in the China-Taiwan political relation, but it also shows that the evidence in support of such a proposition is ambiguous. His analysis suggests reason for caution, but at the minimum it should not be taken for granted that economic integration does indeed reduce the likelihood of a cross-strait military confrontation. From this thesis, it can be seen the conflict between Taiwan and China is basically controlled by the cross-strait policy and attitudes of both government leaders at the time. Economic integration acts as a stabilising force for cross-strait peace though it is not an absolute guarantee to avoid possible military confrontation. The findings of this thesis disagree with some scholars such as Barbieri (2005). She suggests that economic interdependence can actually promote conflicts.

Chapter Two and Three refer to successes and failures of foreign investors in China, the causes varying according to circumstances, including the Chinese government's position and special policies on FDIs. In these FDIs, because of these policies and regulations, Taiwanese investors are not only supposed to enjoy the benefits accorded to all FDIs, but also are expected to gain from the preferential treatment provided by the central or local government. Such preferential treatment policies one would expect to lead to better performance by Taiwanese as compared with other foreign investors.

The findings show that, to certain extent, they have benefited from this special treatment (interviewees Mr. Chiu, Mr. Tseng, Mr. Wang and Mr. Chen); but, in some cases, other foreign companies have performed better, though this depends on various factors in each case. These factors generally include the location of companies and their size/scale and the type of industry, all of which affect the preferential treatment accorded to Taiwanese companies. The situation in practice differs from the government slogan – “all *Taishang* compatriots will get treated better in China and China will win Taiwanese hearts”.

The preferential treatment given to Taiwanese investors is not always guaranteed. When they do get treated better, it is not mainly because they are Taiwanese but because of other reasons (*Guanxi* and economic reasons – location, sector, size and nationality of the company). Preferential treatment in this thesis generally refers to taxation benefits, the ease of access to bank loans, expedition of business license applications, waiver or discount of utility charges or rents and the convenience provided to FDIs that is not in written form. The research findings show that most preferential treatment to *Taishang* is by informal mechanisms rather than the assurance of being set in writing such as by regulations or laws. The importance of this finding is that in reality preferential treatment of enterprises in the PRD and the YRD does not exactly match most Taiwanese business entrepreneurs’ expectations and this empirical finding would merit further investigation. The order of importance of the criteria affecting local government’ implementation of preferential treatment is listed below.

Chapter Six provided an analysis of the result of interviews and documents by way of certain key findings which can be shortly summarised as follows. The most important factor affecting local officials' implementation of preferential treatment is the type of relationship between them and investors – *Guanxi*. The other factors/criteria were ranked in order as follows: location of company, size and sector of company (equally), and least important, nationality of company. (Evidence is provided in Chapter Six)

Field research laid stress on the great importance of *Guanxi* in day-to-day dealings with officialdom as a reflection of Chinese society and business relationships. It oils the wheel for investors in their dealings with all levels of Chinese government. They may thereby avoid 'frequent and deliberate scrutiny' and find a greater willingness to ease processes.

Taiwanese investors are still in practice accorded special treatment but to a much lesser extent than before, it being principally concentrated in cities of the YRD and to a lesser extent, in some cities of the PRD. With greater decentralisation, the importance of local initiatives governing investment requires investors to be constantly in tune with developing local policies.

The types of industries that are favoured show the change in governmental attitudes resulting from the great advances made in the industrialisation of China. The economy has evolved from one depending on basic heavy and manufacturing industries and reliance on other countries, to a greater level of sophistication and self-sufficiency – also from concentration on production and export to satisfying the domestic consumer market. The stage has been reached where certain areas of the

PRD and the YRD are now at saturation level and the highly-polluted or high energy-consuming investment is being steered to other regions. The emphasis has gradually changed from those industries to cleaner and more high-tech companies. Increased wealth has meant a greater sophistication in the attitude of the Chinese people to the environment and their living conditions and pressure is increasing from them for a better quality of development. The size of a company brings status and a greater welcome from government officials who appreciate the know-how, technology and managerial expertise brought to the area. Large companies have a ripple effect in attracting subsidiary or satellite development as well as the services and retail facilities which benefit the local population. These all enter into the authorities' calculation when deciding on the benefits of a development.

Nationality has become less important, as the quality of the business and economic benefit it brings to the area are at the forefront of officials' concerns. Taiwanese cannot be sure of preference though their shared culture and language does still provide advantages for the companies in their relationships with authorities. The research has shown that partly because of the decentralisation giving local government a primary decision role, when the economy of their area is all-important, the central government's strategic policy of unification does not greatly feature in local officials' motives in making decisions on investment; Taiwanese firms are not preferred for political reasons but for primarily economic reasons.

From the primary interview and documentary data of Chinese preferential policy (such as tax benefit illustrated in appendices), another important finding shows that there is a disjunction of motivation between Chinese central and local government.

Unless they are specifically guided by their party leader or government superiors, Chinese local authorities generally consider their own interests ahead of the central government political motivation, when it comes to giving preferential treatment. The central government's political motivation becomes incidental in local government's intention to implement such treatment. Chinese local officials do not seem to have an overarching loyalty to a 'greater China' concept that would lead them to favour Taiwanese firms as 'fellow-countrymen' over foreign entities, in the search for unification. This can be substantiated by the preferential treatment that is given through various criteria of local officials. Most of these are based on economic grounds (including personal connection) and being Taiwanese firms is not the primary criterion. This is supported by the researcher's interview data and is presented in Chapter Six. The significance of this finding is that the Chinese local government's preferential policy implementation has intensified the depth of the Chinese decentralisation process, under the Chinese authoritarian regime. This allows Chinese local officials to have very different political objectives than that of the central government, with relation to Taiwanese investment in China.

## **7.2 Answers to Research Questions**

Cross-case analysis through highlighted patterns compares Taiwanese and non-Taiwanese foreign investors in China and shows differences between the two regions of the YRD and the PRD. The following question-and-answer format follows the original set of research questions to provide a summary of the responses relating to this study.

Q1: From late 1980s until now, how have Chinese policies and regulations regarding Taiwanese investors changed? Has any increase or decrease of Taiwanese investment resulted from any change of Chinese policies or regulations regarding Taiwanese investors?

A1: There has been a gradual increase in the numbers of Taiwanese investors and capital since the late 1980s, regardless of the change of Chinese government policies or regulations. The amount of increase varies each year; nonetheless, it has never been a minus number in any single year since Taiwanese started to invest in mainland China. As to Chinese regulations and policies, they have been changed on a regular basis according to Chinese government's central planning and economic strategy to suit their interests at such times.

Q2: Does local government really implement the Chinese central government's policies and orders, i.e., is local action consistent with national orders and is it calculated to promote national policy objectives?

A2: Due to the corruption eradication policy of the central government, most officials will no longer accept bribes officially, especially customs inspectors who had a bad track record. This was what Chinese government officials interviewed asserted. However, some foreign investors (including the Taiwanese) expressed rather different opinions based on their own experiences. In fact, they meet some cases where some forms of inducement or what could be termed "bribery" are hinted at or expected but this is not openly acknowledged. As for the second part of the question, local authorities generally follow policies set nationally, including

by way of the five- year plans, and operate according to central directive and orders. The Communist party secretary of each locality monitors local officials and ensures that they act in line with party principles and orders. Nevertheless, particularly with the push to greater decentralization, local authorities have found room in many cases to apply their own view of the requirements of their areas. As to central government's policies relating to *Taishang*, government officials interviewed felt that those policies and the regulations thereunder are vague, leaving room for them to interpret in their own terms.

Q3: What is the interaction between Chinese local government and Taiwanese investors in the tertiary and manufacturing industries? How do Taiwanese investors feel about their treatment by local government?

A3: For Taiwanese business in both manufacturing and tertiary industries, the interaction between Chinese local government and Taiwanese investors is conducted through the methods of frequent informal or formal meetings and institutionalised contacts. In response to the second part of the question, preferential treatment is seen as carried out on a case-by-case basis. There is a difference in terms of preferential treatment given by Chinese local officials to Taiwanese enterprises. The difference ranges from minimal to large. Most companies involved in the researcher's interviews did not respond negatively about Chinese government treatment. Nevertheless, the interviewees mentioned some

reports and anecdotes indicating some cases<sup>1</sup> of bullying of Taiwanese businesses were done by the locals. The next section will explain and summarise circumstances where preferential treatment is given.

**Q4:** What is the interaction between Chinese local government and non-Taiwanese foreign investors in the tertiary and manufacturing industries? How do those investors feel about their treatment by local government?

**A4:** Interaction between Chinese local government officials and non-Taiwanese foreign investors has existed for the last 20 years and has matured over the years. Similarly Taiwanese and non-Taiwanese investors ‘test the water temperature’<sup>2</sup> before they can trust the locals and completely commit themselves to the Chinese market. This is normally done by mutual understanding, communication and regular and informal meetings. Foreign investors generally feel that they are treated fairly, although at times, they may have arguments with the local officials because of misunderstanding, their own mistakes or the local officials’ unreasonable requests. Foreign investors also have difficulties in discerning or differentiating whether they are treated better or worse than their Taiwanese counterparts.

### **7.3 Contributions and Implications/Significance of the findings**

With a view to a valid and reliable research technique, the researcher has embraced most of the methodological procedures and basic techniques of Ryan et al. (2002) and

<sup>1</sup>EETV (2011/09/07) reported a large Taiwanese food company *Sheng-Shiang-Zen* that their management and shares were replaced and stolen by a peculiar contract of their partner and the local court ruled in favour of their partner’s unlawful actions. The company has lost US\$ 1.6 million.

<sup>2</sup>*Test the water temperature* here means investors try to understand local government’s stance during their interaction and negotiation.

Yin (2003), such as use of a case study method, adopting an interview protocol, maintaining a chain of evidence, using replication logic, establishing a case study database, and identifying themes from data analysis. Please refer to Appendix 4.C for a tabular form of this methodological and research process. The researcher has produced an exploratory and explanatory case study with a view to providing a comprehensive professional analysis. In this multiple-case study, firstly each interview is significant and gives a fresh picture. Secondly, the distinction between the phenomenon being investigated and its context is given explicit consideration. Thirdly, the examination and display of substantial evidence from different perspectives has increased the quality of the case studies. The main contribution to methodology is the diversity of actors interviewed, thorough consideration and in-depth analysis.

In this section, the researcher clearly identifies the contributions made to theory, literature, and practice. In relation to theory, the researcher contributes to the study of and regional economic integration in the context of the unique China-Taiwan relationship. The researcher provides a detailed comparison of the relationships between economic and political actors in Chapters One to Three. Further, based on the empirical findings of the twenty five cases, the researcher finds that applying the approach of regional economic integration to the relationship between Chinese local government and Taiwanese investors in China, is a good guide; but in practice, Chinese local officials in the PRD and the YRD are unlikely to give preferential treatment exclusively to Taiwanese investors in every case. Indeed the Taiwanese in the last two decades or so have progressively found that preferential treatment has declined as compared with other investments. Although the Chinese central

government's motivation is manifest and has been clearly expressed as aiming for unification with Taiwan by economic and peaceful means, marked shifts in the Communist government's approach as compared with previous situations is to some minds and in particular to many Taiwanese investors (who even now are not confident of the benefits to be obtained by them) somewhat uncertain and possibly a hostage to later changes of course. In other words, not every Taiwanese investor benefits from this particular situation and timing. In practice, as most of the interviewees stress, that political-economic relationships within the transnational sphere do not simply conform to prescribed laws and guidelines but that human nature needs to be taken into consideration in such respects as culture, ethnicity and language affinity, not to mention corruption and greed.

This research in this thesis has added and contributed to the existing literature. First, the researcher has uncovered areas not extensively treated in previous literature. While study of FDI in China has produced much on the significance of interpersonal relationships in China, the role of Chinese government, risks and opportunities of conducting business in China, Chinese SPZs and regional economic integration in East Asia, there is little related literature linking preferential policies, Chinese government and Taiwanese investors. Nor is there much of a focus on comparing FDIs in the PRD and the YRD of China. This research has filled the gap in its examination of an under-developed aspect of East Asian political economy research.

This research has addressed important questions not previously asked or exactly answered in existing literature. Why are the questions important? - They are not only necessary to the existing literature of cross-strait political economy, but also of vital

importance for both Chinese and Taiwanese government policy-makers and Taiwanese business people in China. Understanding of the possible gap between Chinese government preferential policies and actual implementation can be a subject for reflection in setting future policy guidance for Chinese local government and can also point to the need for Taiwanese investors/or non-Taiwanese investors of planning or re-evaluating their investment plans in the PRD and the YRD of China and to re-position themselves in their government/business relationship with Chinese local officials. The research questions are also significant to the Taiwanese government as the issues the researcher raised can be a basis for future negotiations with Chinese central government to strengthen Taiwanese investors' presence and business operations in China and to consolidate the stable and progressive relationship with the Beijing government. The pursuit of the research questions can be significant for the way the main actors (Chinese and Taiwanese government officials and Taiwanese business investors) position themselves in the sphere of government/business relationships.

Second, as well as an overall view, the researcher has provided a detailed study of the application in practice of preferential treatment of Taiwanese investors by Chinese authorities and local officials. Previous FDIs including Taiwanese investment research and literature have mostly focused on industries in a single region of China or single industry in multiple regions of China, rather than a comparison of various industries, areas and nationality of FDIs. However, preferential treatment and policies contribute to Taiwanese investors' survival and success in China. The few studies on the relationship between Chinese local government and preferential treatment have received relatively little attention. Thus, the researcher trusts that his contribution will

provide useful background information to investors, in particular prospective investors.

Third, Taiwan's manufacturing sector (high-technology) and service (tertiary) sector are studied. The researcher has examined Taiwanese investment in high-technology, manufacturing and tertiary sectors in China. Most studies analyse successful Japanese, American, and European auto, other manufacturing, and pharmaceutical industries, but the results of such studies are not necessarily valid for other countries and industries.

Finally, the researcher constructs an analytical induction framework (Appendix 4.C), based on the research process of this thesis. This can be applied by researchers quantitatively and/or qualitatively.

The researcher believes that business investors who have interests in China would find this research valuable. From the amount of rich empirical data produced, foreign companies in China, or wishing to invest there, can understand what matters should be taken into account, especially when it comes to one of the main incentives for FDI i.e. China's preferential treatment; though its policies do not always stay the same, their interpretation and management are quite constant. The researcher thereby hopes to contribute to the growing academic body of cross-strait relationship research. Furthermore, he also hopes that the findings can be of some assistance in the development of policy-making by government, non-governmental organisations and international bodies. One thing to bear in mind is that this research is conducted in a specific setting of the unique and complex political and economic relationship

between Taiwan and China. Therefore, the contribution is geared to specific groups of people and organs and it may not be applicable to the regions and groups which have different dynamics from the Taiwan-China matrix.

#### **7.4 Opportunities for Future Research, Business and Politics**

As indicated in the previous section, the qualitative nature of this study and reliance on a situation which is subject to constant change, provides room for further examination by others with a different background, or may usefully be further examined in the light of additional available information or developments in the countries and regions under study.

Cultural understanding between investors and local agents does not guarantee the success of investment projects; and it is very difficult to measure the extent that critical cultural understanding and interpersonal networks contribute to the formation and operation of the enterprises. The evidence to underpin the research questions is based upon interviews and documents, so the analysis stemming from these methods is qualitative which requires care in pursuing it with impartiality.

Given the method adopted in this study, future researchers may wish to consider the impact of *Guanxi* on the area of study by means of another method, such as by greater use of quantitative data collection. Measurement of *Guanxi* and its relationship with Chinese FDI preferential treatment can be carried out by structured questionnaires and other quantitative data collection.

Future fine-grained analyses can be obtained by incorporating larger samples (e.g. more interviewees) and examining new variables such as Chinese domestic companies, and other researchers can build on the work in this research study and expand it into other areas (such as the areas outside the PRD and the YRD) in the future. The aim of the case study research is to test the hypothesis and produce possible theoretical generalisations. In addition, the process of theoretical generalisation in this case study can provide for application of understanding of the field of this study to wider social systems or norms, as more case studies are undertaken.

Although a doctoral dissertation is geared to an academic audience, its empirical work could be of assistance to others. Its findings could be relevant for at least four different audiences with a substantive interest in East Asian politics, economics, and transnational studies. People in various disciplines (e.g. transnational cultural studies and political economy), methodology researchers (e.g. case study researchers, interviewers), practitioners in the business world (e.g. managers and entrepreneurs), and politicians (e.g. societal, political fiscal policy-makers) are all possible audiences and/or future researchers.

For various disciplines, the findings of this study suggest that in the present circumstances, cross-strait exchanges and contacts are not only closer but also indispensable for both China and Taiwan. Such socioeconomic ties can be easily employed as instruments to achieve political goals. After the research was completed, some new questions arose: Are these favourable policies really effective in reaching

Taiwanese hearts and minds, and ultimately breaking the current cross-strait stalemate?

Is China's current highest ranked leader, Hu Jintao's seemingly friendly Taiwan policy able to reshape the future of cross-strait relations in the direction of China's wishes? With China's changeable and decreasing preferential policies to Taiwan, what is the direction and strategy for the Taiwanese macro-economy and outward investment? These new questions are waiting to be answered in order to gain a comprehensive picture regarding China's favourable policy for Taiwanese investment in China.

For methodology, this in-depth qualitative research and perception of a range of actors involved in the field provides readers with a series of systematic methodological procedures to be followed in future research. The most relevant evidence from interviews and documents for each interview has been investigated in-depth. Also, the types of interviewees recruited and the cross-interview conclusions have not been prejudiced by undue emphasis on any one of the interviews. The researcher argues that the test of reliability is satisfied. A later investigator following the same procedures described by the researcher can apply the same methods to a new case study. It is expected that similar findings and conclusions would be drawn if similar samples were interviewed.

Subsequent work by theorists could focus on the alignment of multiple theories from different perspectives, such as sociological, philosophical, political, and economical constructs. The researcher perceives that a theorist should be able to utilise theories to help practitioners, with due attention to practices. Based on this work's findings, future research projects could survey more cases/interviews with a view to

establishing the extent of the relationship between Chinese local government and foreign investors in different regions. It is also noteworthy that in order to identify the exceptions and possible cases of divergence, a theory should be problematised and related to specific conditions.

Business entrepreneurs would benefit from the findings of this research, and their management gain an understanding of the way Chinese government officials' attitudes and behaviours respond, not only to formally expressed rules but also according to how they perceive their superiors and party would evaluate their actions. They should also appreciate the influence of *Guanxi* in their interaction with foreign investors. Similarly, new companies considering establishing business ventures in China would find the lesson drawn from this research useful. Secondary and service-based Taiwanese companies can take advantage of the findings in this empirical study by considering whether they have established and aligned themselves with the local officials in the areas they intend to invest for their investment project and whether they fully understand the trend and conditions of preferential regulations they are offered. This research informs business plans and strategy in the areas in the way they contribute to the shaping of new business initiatives to favour Chinese-Taiwanese collaboration.

This study has made it clear to this researcher that the business world and academic researchers can, to their mutual advantage, narrow the gap between theory and practice in the operation of the Chinese political economy and by active contact, gain useful material for future application.

With business practitioners' interest and support, East Asian political economy and business researchers have a chance to look into the real social political and business situation in China, from which greater in-depth explanations and theories can be drawn. Such research work would provide deeper and richer understandings of the research topic studied, facilitate individuals working in similar areas, or make individuals aware of the problems and the possibilities for solutions.

For politicians: the review carried out in this thesis reveals the extent to which government policies and actions affect businesses, both immediately and in setting the tone for relationships with businesses and the confidence with which companies can operate. This researcher also hopes that it may give a greater awareness to politicians and officials at various levels of government of the implications for cooperation and mutual understanding. It enables them to be more aware of the consequences of their response to businesses and predict the reaction of entrepreneurs and of their citizens. Government officials' credibility depends on their awareness of what is happening and the way they adapt.

### **7.5 Concluding Remarks**

The researcher's hypothesis is that with the Chinese central government's political initiatives of aligning Taiwan with economic integration by attracting Taiwanese investment to China, Taiwanese investment should be favourably treated by Chinese local government in the YRD and the PRD, and the process of Taiwanese investment should be easier and operations run more smoothly. The researcher uses economic integration approach to help him form a hypothesis and understand the relationship between Taiwanese investors and Chinese local government in the PRD and the YRD

and ascertain how the preferential treatments are carried out, given various factors including the special political climate between China and Taiwan. But political-business relationships may be more complex than analysis by the theory and the chosen methods would suggest. For this research, being concerned with the situation in the FDIs, the propositions are based on interviews specific to these areas, and the researcher is not drawing conclusions necessarily applying to the rest of China. By comparing various cases through interviews, this thesis gives a greater understanding of Chinese preferential treatment to Taiwanese and non-Taiwanese FDIs in practice at the present time.

Previous work examining the success and/or failure of Taiwanese investment in China and the role of *Guanxi* has been taken further by this research in exploring and explaining the relationship between Taiwanese investors and Chinese local government; the changing nature of preferential treatment of Taiwanese investors and its impact on them; and the extent to which they are favoured in practice by local officials. The researcher's conclusion is that while Taiwanese investors generally do get preferential treatment from Chinese local government, as compared with other investors, there is no general rule which can give them assurance of this. From an examination of several criteria influencing local government's preferential treatment/policies, it seems that much depends on personal relations with Chinese officials, company size, location and industry as there is no general rule when it comes to preferential treatment in China. Chinese society is still heavily influenced by traditional attitudes and relationships and the application of laws is guided by 'rule of man' instead of 'rule of law'. Moreover, the incentives that Taiwanese investors have previously received are gradually decreasing. This mainly results from Chinese

local government's own specific interests and Chinese central government's yearly planning, which aims to balance the objectives of the country's economic development with that of achieving wider distribution of wealth and give greater support to Chinese domestic companies.

The researcher adds to previous research and finds that the political motivation of the Chinese authoritarian government is to encourage Taiwanese investment in China with a view to unification and it is not now so important in the local government's preferential policy-making in FDIs. The relatively unbending approach of government policies and practices, current some 30 years ago has given way - by the 'open door policy' of 1978 - to a more accommodative economic approach and more decentralisation; and financial, cultural and personal interests now are taken into greater account by local authorities. Those Taiwanese or other investors conducting business in FDIs can take advantage of political networks, and provided they have a sound business profile and structure, they are likely to have a good start in China and achieve better results, avoiding future detriment to turnover or possible loss.

In addition, in the context of the China-Taiwan relationship, the findings of this research, to a large extent, suggest: closer economic integration would promote peace and reduce the likelihood of war but not absolutely. However, this can be challenged in the context of the China-Taiwan relations, in the light of the situation in the past two decades or so, where there have been military tensions between Taiwan and China (notably in 1998 and 2000 missile crises) though when relations got strained in 1995, China went out of its way to reassure Taiwanese investors in China that they would not be affected by the tension. Can the improving Taiwanese business-Chinese

government relationship be a stabilising force for the cross-strait relationship in the future?

Furthermore, the conflict between China and Taiwan is temporarily eased through the willingness of dialogue, negotiation and cooperation in high politics through various channels officially and unofficially. The cross-strait relationship has shown constant improvement despite there being ups and downs at times. One fundamental issue that will not be easily reconciled between two states in a short time is the sense of belonging and sharing in terms of nationality and political sovereignty. The trend is shown in charts regarding Taiwanese people's political views and identity in Chapter Six. This reality is not going exactly in the way the Chinese CPC government hopes and does not completely reflect its political motive to encourage Taiwanese investment and offer preferential treatment to Taiwanese investors. In addition, in economic terms, the significance of the Taiwanese investment in China is less than the significance of Chinese economy to impact Taiwanese economy. Therefore, cross-strait economic integration does not lead to equally mutual dependency as China has a stronger leverage over Taiwan. Any potential war between Taiwan and China may be in the form of Chinese economic blockade which can be executed militarily or economically. One may question what the role of the USA will be in the China-Taiwan conflict in this 3-way relationship.

Finally, the researcher suggests future avenues for East-Asian political economy, and cross-strait relations research. He suggests a need for more fine-grained analysis of samples (i.e. FDIs) and the examination of new variables. In brief, an empirical research project is essential to help researchers fully understand the relationship

between foreign investors/*Taishang* and Chinese local government, how in reality the preferential treatment really works in the local government level of the PRD and the YRD of the People's Republic of China, and whether Taiwanese investors really get favoured due to their political status.

## Appendices

### Appendix 2.A Law of the People's Republic of China on Protection of Investment by Compatriots from Taiwan

The Standing Committee of the National People's Congress

Order of the President of the People's Republic of China

No. 20

Law of the People's Republic of China on Protection of Investment by Compatriots from Taiwan adopted at the Sixth Meeting of the Standing Committee of the Eighth National People's Congress on March 5, 1994 are hereby promulgated and shall come into force as of the day of promulgation.

President of the People's Republic of China, Jiang Zemin

March 5, 1994

Law of the People's Republic of China on Protection of Investment by Compatriots from Taiwan

Article 1

This Law is formulated to protect and encourage investment by compatriots from Taiwan, and promote the economic development on both sides of the Straits.

Article 2

Investment by compatriots from Taiwan shall apply this Law. Not being covered in this Law, the provisions concerning investment by compatriots from Taiwan in other laws or regulations, if there are, shall be applicable.

In this Law, investment by compatriots from Taiwan means investment made by corporations, enterprises, other economic organizations or individuals as investors from Taiwan region, in other provinces, autonomous regions or municipalities directly under the Central Government.

The State shall protect according to law the investment by investors from Taiwan, the profits gained from their investment and other lawful rights and interests.

For making investment, compatriots from Taiwan must comply with laws and regulations of the State.

Article 4

The State shall not nationalize or requisition investment by investors from Taiwan. Under special circumstances, when public interests require, investment by investors from Taiwan may be requisitioned by following legal procedures and appropriate compensation shall be made.

Article 5

The property, industrial property invested by investors from Taiwan, the profits gained from their investment and other lawful rights and interests may be transferred and inherited according to law.

Article 6

Investors from Taiwan may make their investment in convertible currencies, machinery and equipment or other material objects, or industrial property or non-patent technology, etc.

Investors from Taiwan may make further investment with the profits gained from their former investment.

Article 7

Investors from Taiwan may make their investments in form of equity joint venture, contractual joint venture or enterprise with the capital wholly owned by investors from Taiwan (hereinafter referred to as "Taiwan investment enterprises"), or in any other form provided for by laws or regulations.

The establishment of Taiwan investment enterprises shall conform to the industrial policy of the State, and shall be advantageous to development of the national economy.

Article 8

For establishing a Taiwan investment enterprise, one shall apply to the department or the local people's government specified by the State Council for approval, and having received the application, the examining organ shall decide to approve or disapprove within 45 days after receiving the complete application.

If approved, the applicant shall, within 30 days after receiving the approval, apply for registration to the authorities for enterprise registration according law, and acquire a business license accordingly.

#### Article 9

Taiwan investment enterprises shall conduct their operational and managerial activities in accordance with laws, regulations and contracts or rules approved by the examination and approval authorities, and their decision-making power for business operations and management shall not be interfered with.

#### Article 10

In areas where Taiwan investment enterprises are concentrated, associations of Taiwan investment enterprises may be established according to law, and their lawful rights and interests shall be protected according to law.

#### Article 11

The lawful profits gained by investors from Taiwan from their investment, their other lawful incomes and their assets after liquidation may be remitted to Taiwan or abroad according to law.

#### Article 12

Investors from Taiwan may appoint their relatives or friends as their investing agents.

#### Article 13

Taiwan investment enterprises shall enjoy the preferential treatment according to the relevant provisions made by the State Council concerning encouraging investment by compatriots from Taiwan.

#### Article 14

As for any investment-related dispute arising between an investor from Taiwan and a corporation, enterprise, other economic organization or

individual of other province, autonomous region or municipality directly under the Central Government, the parties concerned may settle it through consultation or mediation.

Where any party concerned is unwilling to settle the dispute through consultation or mediation or the consultation or mediation has failed, the dispute may, according to the arbitration clause in the contract or to the written arbitration agreement reached by the parties concerned after the dispute has arisen, be submitted to arbitration.

Where the parties have not concluded an arbitration clause in the contract, nor reached an written arbitration agreement after the dispute has arisen, any of them may bring a suit before a people's court.

#### Article 15

This law shall enter into force as of the date of promulgation.

The Standing Committee of the National People's Congress 1994-03-05

### Appendix 2.B Regulations relating to Taiwanese investment in China

In July 1988, the State Council of the PRC issued 'the Regulations for Encouraging Investment by Taiwan Compatriots'.

In 1992 the Taiwan authorities permitted Taiwanese nationals to carry out technical cooperation with, and make indirect investment in, the mainland via a third place or country.

In March 1994, the Standing Committee of the NPC adopted the Law on the Protection of Investment by Taiwan Compatriots.

In December 1999, the State Council formulated the Detailed Rules for the Implementation of the Law on the Protection of Investment by Taiwan Compatriots, and local people's congresses and governments accordingly worked out corresponding local regulations and administrative rules in light of local conditions.

A legal system was therefore formed or improved to protect the legal rights and interests of Taiwanese nationals in the mainland China. Relevant departments and local governments in China have made constant efforts to enhance investment environment and provide good service for Taiwan investors, thereby promoting their investments.

By the end of September 2003, a total of 59,458 Taiwan-invested projects had been approved on China, with the contractual value of Taiwan investment totaling US \$67.98 billion, and the actually utilized Taiwan investment totaling US \$35.71 billion. According to statistics from Taiwan, since 1993 Taiwan businessmen have considered China as their first choice for foreign investment.

#### As for the financial exchanges and cooperation

In 2002, mainland-based commercial banks officially started remittance and letter of credit business with the offshore bank units (OBU) of Taiwan-based banks.

In 2003, they further opened this business with the domestic bank units (DBU) in Taiwan. By October 2003, China had approved the establishment of 2 Taiwan-invested banks, representative offices of 7 Taiwan-based banks, 12 representative offices of 9 Taiwan-based insurance companies and 1 Taiwan-based insurance brokerage company, and 17 representative offices of 12 Taiwan-based securities companies.

In the process of promoting the 'three direct links', non-governmental trade organizations across the Straits have carried out in-depth discussions time and again on relevant technical and professional issues involved in the 'three direct links', and reached consensus in many parts. Negotiations on inter-Straits communication had went on successfully. Trial direct navigation across the Straits had smoothly operated. Delicate issues concerning two-way direct shipping between coastal areas of Fujian Province and Jinmen and Mazu had been properly resolved. Meanwhile, Taiwan-operated charter planes for the first time transported Taiwan's businesspeople across the Straits during the 2003 Spring Festival. All these facts show that without doubt, business people on both sides can find methods acceptable to both sides. In fact, both the technical and professional issues involved in the 'three direct links' have been settled. On 15 December 2008, both quasi-governmental agencies, Straits Exchange Foundation of Taipei and the Association for Relations Across the Taiwan Strait of Beijing, finalised the commencement of direct flight, shipping and post between Taiwan and China.

**Appendix 3.A Trade between Taiwan and Mainland China**

**Unit: US\$million**

Period	(A) Taiwan Exports to China	(B1) Taiwan Exports to HK (F.O.B)	(B2) H.K. Imports from Taiwan	(B1-B2) Difference between (B1) and (B2)	(c) Transit trade from Taiwan to Mainland China via HK	Estimated Exports to Mainland China*	Taiwan Imports from Mainland China**	Taiwan Imports from Mainland China	Estimated Total Trade between Taiwan and Mainland China
1987-1989	-	16752.7	16574.5	178.2	6365.2	6800.6	1354.5	8155.1	
1990	-	8556.2	7446.7	1109.5	3278.3	4394.6	765.4	5160.0	
1991	0.1	12430.5	9563.0	2867.5	4667.2	7493.5	293.2	7786.7	
1992	1.1	15415.0	11301.2	4113.8	6287.9	10547.6	747.1	11294.7	
1993	16.2	18452.6	12203.7	6248.9	7585.4	13993.1	1015.5	15008.6	
1994	131.6	21262.3	13936.3	7326.0	8517.2	16022.5	1858.7	17881.2	
1995	376.6	26105.9	16572.6	9533.3	9882.8	19433.8	3091.3	22525.1	
1996	623.4	26787.6	15795.1	10992.5	9717.6	20727.3	3059.9	23787.2	
1997	626.5	28688.1	15967.6	12720.5	9715.1	22455.2	3915.3	26370.5	
1998	914.9	25398.2	13342.9	12055.3	8364.1	19840.9	4113.9	23954.8	
1999	2602.1	26825.3	12875.2	13950.1	8174.9	21312.5	4528.9	25841.4	
2000	4391.5	32741.7	15919.5	16822.2	9593.1	25009.9	6229.3	31239.2	
2001	4895.4	28712.7	13837.0	14875.7	8811.5	25607.4	5903.0	31510.4	
2002	10526.9	32959.6	14859.8	18099.8	10311.8	31528.8	7968.6	39497.4	
2003	22890.8	30868.3	16051.7	14816.6	11789.4	38292.7	11017.9	49310.6	
2004	36349.4	32896.2	19719.5	13176.7	14761.9	48930.4	16792.3	65722.7	

2005	43643.7	34035.6	21567.5	12468.1	17055.9	56271.5	20093.7	76365.2
2006	51808.6	37381.2	24989.4	12391.8	18707.2	63332.4	24783.1	88115.5
2007	62416.8	37979.7	26295.2	11684.5	21206.6	74245.9	28015.0	102260.9
2008	66883.5	32689.9	24620.7	8069.2	20035.1	73977.8	31391.3	105369.1
2009	54248.7	29445.2	22519.1	6926.1	18029.4	62090.9	24423.5	86514.4
2010	76935.1	37807.1	2881505	8990.5	23013.1	84832.2	35952.2	120784.5
2011	57586.7	26633.8	20430.8	6203.0	15855.2	61701.3	29795.1	91496.4
Jen-Aug.								

Note: 1. A negative figure in column (B1-B2) will be treated as zero.

2. From Jan 2006, the Compilation of Customs Trade Statistics adopts the United Nations' International Merchandise Trade Statistics (IMTS) Compilers Manual, 2004. Total Exports include exports and re-exports, total Imports include imports and re-imports.

Source: Adapted from MAC cross-strait economic statistics Monthly

1. The data for (A) and (B1) are collected from ROC customs statistics, (B2) and (C) are from Bureau of Foreign Trade, ROC.
2. \*\* HK Customs statistics before 1993; ROC Customs statistics since 1994.
3. \*before 2001 the estimation method of Mainland Affairs Council (MAC) as: (B1-B2)+C.

But since 2002, MAC and Bureau of Foreign Trade decided to change the formula and switch to  $A+(B1-B2)*80\%+C-r*A$ .

“r” presents the average ratio of the import from Taiwan to Guangdong to all in China according to China Customs Statistics. Now the “r” is 33% from 1999 to 2002.

**Appendix 3.B Geographical patterns of Taiwan's FDI in the Mainland (in million U.S. dollars)**

	Guangdong	Fujian	Jiangsu	Shanghai	Hebei	Chongqing	Others (Beijing + Tianjin)
1992	112.04 (45%)	29.58 (12%)	34.39 (14%)				
1993	1047.81 (33%)	473.80 (15%)	833.31 (26%)				
1994	230.93 (24%)	96.62 (10%)	391.81 (41%)				
1995	222.75 (20%)	121.66 (11%)	394.77 (36%)				
1996	282.82 (23%)	110.88 (9%)	541.99 (44%)				
1997	1720.90 (40%)	472.23 (11%)	1247.30 (29%)				
1998	824.42 (41%)	150.79 (7%)	694.75 (34%)				
1999	500.11 (40%)	58.90 (5%)	475.01 (38%)				
2000	1019.70 (39%)	99.49 (4%)	1251.62 (48%)				
2001	787.97 (28%)	120.12 (4%)	1422.59 (51%)				
1991-2010	22041.95 (22.65%)	6743.87 (6.93%)	333382.31 (34.3%)	14144.91 (14.53%)	3531.61 (3.63%)	1281.40 (1.32%)	6736.45 (6.92%)
Jan-Sep/2011	1891.34	698.18	3455.05	1837.81	254.93	343.74	1954.10

	(16.93%)	(6.05%)	(29.94%)	(15.92%)	(2.21%)	(2.98%)	(16.93%)
Accumulation	23933.29	7442.05	36837.36	15982.71	3786.54	1625.14	8690.55
	(21.99%)	(6.84%)	(33.84%)	(14.68%)	(3.48%)	(1.49%)	(7.98%)

Source: Investment Commission, Taiwan Ministry of Economic Affairs.

Note: (1) Figures in parentheses represent the percentage of investment in the region in Taiwan's total investments on the Mainland.

(2) Others are the areas other than Jiangsu, Guangdong, Fujian, Zhejiang, Shandong, Hubei provinces and Beijing, Tianjin, Shanghai and Chongqing municipal cities.

(3) It can be seen that Taiwanese investment in Chongqing (Inland China) and other areas of China outside the YRD, PRD, Capital Region and Fujian, has increased between 2010 and 2011.

Appendix 3.C Taiwan's approved FDI in the Mainland by sector (in million U.S. dollars)

Year	Total	By Industry					
		Food & beverage	Plastic products	Basic metals	Electronic & processing	Precision instruments	Others
1992	246.99	46.42 (19%)	44.96 (18%)	10.66 (4%)	37.84 (15%)	18.02 (7%)	89.09 (36%)

1993	3168.41	324.56 (10%)	375.90 (12%)	256.50 (8%)	443.51 (14%)	286.49 (9%)	1481.43 (47%)
1994	962.21	145.85 (15%)	73.30 (8%)	90.33 (9%)	157.01 (16%)	44.16 (5%)	451.56 (47%)
1995	1092.71	117.45 (11%)	62.74 (6%)	116.81 (11%)	214.80 (20%)	29.45 (3%)	551.46 (50%)
1996	1229.24	121.70 (10%)	63.65 (5%)	128.12 (10%)	276.86 (23%)	39.90 (3%)	599.01 (49%)
1997	4334.31	333.07 (8%)	349.12 (8%)	395.97 (9%)	875.04 (20%)	247.25 (6%)	2133.86 (49%)
1998	2034.62	70.05 (3%)	64.18 (3%)	126.85 (6%)	758.98 (37%)	74.62 (4%)	939.94 (46%)
1999	1252.78	58.25 (5%)	99.07 (8%)	104.49 (8%)	537.75 (43%)	28.07 (2%)	425.15 (34%)
2000	2607.14	43.25 (2%)	184.78 (7%)	183.85 (7%)	1464.77 (56%)	84.80 (3%)	645.69 (25%)
2001	2784.15	58.42 (2%)	156.07 (6%)	193.80 (7%)	1254.83 (45%)	126.00 (5%)	995.03 (36%)

Source: Investment Commission, Taiwan Ministry of Economic Affairs

Note: Figures in parentheses represent percentage of sectoral investment in Taiwan's total investments on the Mainland.

**Appendix 3.D Trade interdependence across the Straits (in percentages)**

	Taiwan's exports to the Mainland as % of the Mainland's total imports	Taiwan's exports to the Mainland as % of Taiwan's total exports	Taiwan's imports from the Mainland as % of the Mainland's total exports	Taiwan's imports from the Mainland as % of Taiwan's total imports
1987	2.84	2.3	0.73	0.0
1988	4.06	3.7	1.01	0.0
1989	5.63	4.9	1.12	0.3
1990	8.24	6.2	1.23	0.6
1991	11.75	9.1	0.41	1.0
1992	13.09	11.9	0.88	1.0
1993	13.46	15.0	1.11	1.3
1994	13.86	15.7	1.54	2.2

1995	14.71	16.0	2.08	3.0
1996	14.93	16.5	2.03	3.0
1997	15.77	16.8	2.14	3.4
1998	14.15	16.6	2.24	3.9
1999	12.86	17.22	2.32	4.07
2000	11.11	16.46	2.50	4.4
2001	10.51	20.3	2.22	5.47
2002	10.68	23.3	2.45	7.04
2003	9.28	25.4	2.51	8.6
2004	8.72	26.8	2.83	9.95
2005	8.53	28.4	2.64	11.0
2006	8.0	28.3	2.56	12.2
2007	7.77	30.1	2.30	12.8
2008	6.53	28.9	2.20	13.1
2009	6.17	30.5	2.03	14.0
2010	6.08	30.89	2.28	14.3

2011	5.46	29.66	2.44	15.52
Jan-Aug				

Source: Hong Kong Customs Statistics, PRC Customs Statistics, Taiwan Ministry of Economic Affairs, and MOTTEC: Almanac of China's Foreign Economic Relation and Trade, with Zhang (2003)'s calculation.

**Appendix 3.E Value of Exports and Imports by Country (2006-2007)**

DATE : 2007/6/8

TIME PERIOD : 2006/01 - 2007/03

UNIT:AMOUNT(US\$)

TOTAL TRADE(re-exports & re- exports included)  
EXPORT+re-exports

IMPORT+re-imports

CODE NO	COUNTRY NAME	RANKIN G	AMOUNT	SHARE(%)	RANKIN G	AMOUNT	SHARE(%)	RANKING	AMOUNT	SHARE(%)
TOTAL	Global-country		529,327,058,67	100.000		278,458,191,88	3	100.000	250,868,866,	100.000
CN	CHINA	1	95,263,667,4	17.997	1	64,423,057,397	23.136	2	30,840,610,048	12.294
JP	JAPAN	2	77,145,743,4	14.574	4	20,459,119,339	7.347	1	56,686,624,157	22.556
US	UNITED STATES	3	68,114,254,7	12.868	3	39,709,789,213	14.261	3	28,404,465,503	11.322
HK	HONG KONG	4	48,281,188,1	9.121	2	45,930,557,055	16.495	21	2,350,631,095	0.937
KR	KOREA,REPUBLIC OF	5	27,602,486,0	5.215	6	8,990,235,415	3.229	4	18,612,250,669	7.419

SG	SINGAPORE	6	17,594,958,5 85	3,324	5	11,413,805,173	4,099	10	6,181,153,412	2,464
DE	GERMANY,FEDERA L REPUBLIC OF	7	13,822,289,5 83	2,611	8	6,163,662,891	2,213	6	7,658,626,692	3,053
MY	MALAYSIA	8	13,504,128,3 04	2,551	9	6,132,049,269	2,202	7	7,372,079,035	2,939
SA	SAUDI ARABIA	9	12,678,662,2 20	2,395	32	698,931,259	0,251	5	11,979,730,961	4,775
AU	AUSTRALIA	10	10,205,918,1 56	1,928	14	3,410,301,292	1,225	8	6,795,616,864	2,709
TH	THAILAND	11	9,962,665,40 0	1,882	10	5,777,790,153	2,075	13	4,184,875,247	1,668
ID	INDONESIA	12	9,571,541,71 0	1,808	15	3,124,852,770	1,122	9	6,446,688,940	2,570
PH	PHILIPPINES	13	8,924,949,02 1	1,686	11	5,639,125,302	2,025	16	3,285,823,719	1,310
NL	NETHERLANDS	14	8,440,625,77 3	1,595	12	5,489,437,334	1,971	17	2,951,188,439	1,176
ZZ	OTHER	15	7,500,138,72 9	1,417	16	3,029,293,486	1,088	12	4,470,845,243	1,782
VN	VIET NAM	16	7,247,208,38 0	1,369	7	6,176,400,502	2,218	35	1,070,807,878	0,427
GB	UNITED KINGDOM	17	6,641,754,91 3	1,255	13	4,378,585,772	1,572	22	2,263,169,141	0,902
KW	KUWAIT	18	6,263,818,82 1	1,183	69	137,441,503	0,049	11	6,126,377,318	2,442

AE	UNITED ARAB EMIRATES	19	5,062,877,73 <sub>8</sub>	0.956	24	1,425,779,621	0.512	14	3,637,098,117	1.450
IT	ITALY	20	4,715,672,83 <sub>6</sub>	0.891	17	2,816,988,863	1.012	24	1,898,683,973	0.757
FR	FRANCE	21	4,680,480,02 <sub>7</sub>	0.884	20	1,918,221,216	0.689	18	2,762,258,811	1.101
IR	IRAN(ISLAMIC REPUBLIC OF)	22	4,171,246,77 <sub>7</sub>	0.788	35	639,087,744	0.230	15	3,532,159,033	1.408
CA	CANADA	23	3,954,441,60 <sub>5</sub>	0.747	18	2,199,686,754	0.790	25	1,754,754,851	0.699
IN	INDIA	24	3,559,749,63 <sub>1</sub>	0.673	19	1,957,229,768	0.703	26	1,602,519,863	0.639
RU	RUSSIA	25	3,185,061,96 <sub>2</sub>	0.602	29	769,947,957	0.277	20	2,415,114,005	0.963
BR	BRAZIL	26	2,918,257,19 <sub>1</sub>	0.551	21	1,586,987,459	0.570	28	1,331,269,732	0.531
AO	ANGOLA	27	2,425,110,45 <sub>3</sub>	0.458	128	6,498,762	0.002	19	2,418,611,691	0.964
ZA	SOUTH AFRICA	28	2,393,070,76 <sub>0</sub>	0.452	27	1,150,821,857	0.413	30	1,242,248,903	0.495
CL	CHILE	29	2,257,459,08 <sub>4</sub>	0.426	47	337,051,645	0.121	23	1,920,407,439	0.766
CH	SWITZERLAND	30	2,015,847,59 <sub>0</sub>	0.381	46	418,999,474	0.150	27	1,596,848,116	0.637
ES	SPAIN	31	1,982,935,20 <sub>9</sub>	0.375	23	1,477,042,900	0.530	44	505,892,309	0.202

MX	MEXICO	32	1,935,549,11 <sub>6</sub>	0.366	25	1,346,541,950	0.484	42	589,007,166	0.235
BE	BELGIUM	33	1,931,680,78 <sub>4</sub>	0.365	26	1,222,008,392	0.439	37	709,672,392	0.283
TR	TURKEY	34	1,688,830,15 <sub>5</sub>	0.319	22	1,560,987,924	0.561	56	127,842,231	0.051
FI	FINLAND	35	1,560,844,77 <sub>5</sub>	0.295	28	904,202,961	0.325	40	656,641,814	0.262
SE	SWEDEN	36	1,341,267,15 <sub>9</sub>	0.253	34	641,809,892	0.230	38	699,457,267	0.279
IL	ISRAEL	37	1,339,007,63 <sub>4</sub>	0.253	38	596,853,617	0.214	36	742,154,017	0.296
OM	OMAN	38	1,332,017,18 <sub>4</sub>	0.252	98	31,183,332	0.011	29	1,300,833,852	0.519
AT	AUSTRIA	39	1,323,255,61 <sub>3</sub>	0.250	36	624,507,935	0.224	39	698,747,678	0.279

SOURCE: DIRECTORATE GENERAL OF CUSTOMS, MINISTRY OF FINANCE, Taiwan

REMARKS: --- MEANS NO DATA IS AVAILABLE OR DATA CANNOT BE REPRESENTED NUMERICALLY

### Appendix 3.F Value of Exports and Imports by Country (1989)

CODE NO	COUNTRY NAME	TOTAL TRADE(re-imports & re-exports included)			EXPORT+re-exports			IMPORT+re-imports		
		RANKING	AMOUNT	SHARE(%)	RANKING	AMOUNT	SHARE(%)	RANKING	AMOUNT	SHARE(%)
TOTAL	Global-country	118,567,787,22	2	100.000	66,303,563,222	100.000	100.000	52,264,224,000	100.000	100.000
US	UNITED STATES	1	36,038,385,296	30.395	1	24,036,080,635	36.252	2	12,002,304,661	22.965
JP	JAPAN	2	25,095,543,860	21.166	2	9,064,794,460	13.672	1	16,030,749,400	30.673
HK	HONG KONG	3	9,247,434,132	7.799	3	7,042,254,572	10.621	4	2,205,179,560	4.219
DE	GERMANY,FEDERAL REPUBLIC OF	4	5,237,649,247	4.417	4	2,577,918,538	3.888	3	2,659,730,709	5.089
AU	AUSTRALIA	5	3,168,677,041	2.672	9	1,537,654,548	2.319	5	1,631,022,493	3.121
GB	UNITED KINGDOM	6	3,028,567,041	2.554	5	2,101,800,464	3.170	9	926,766,577	1.773
SG	SINGAPORE	7	2,865,005,435	2.416	6	1,975,626,113	2.980	10	889,379,322	1.702
CA	CANADA	8	2,755,359,853	2.324	7	1,759,403,175	2.654	8	995,956,678	1.906
KR	KOREA,REPUBLIC OF	9	2,371,790,684	2.000	10	1,132,740,258	1.708	7	1,239,050,426	2.371

NL	NETHERLANDS	10	2,245,330,437	1.894	8	1,582,004,211	2.386	17	663,326,226	1.269
SA	SAUDI ARABIA	11	1,932,621,245	1.630	18	557,142,027	0.840	6	1,375,479,218	2.632
FR	FRANCE	12	1,882,021,046	1.587	12	1,087,001,332	1.639	14	795,019,714	1.521
IT	ITALY	13	1,658,477,970	1.399	14	869,398,103	1.311	15	789,079,867	1.510
ID	INDONESIA	14	1,640,274,635	1.383	13	934,087,597	1.409	16	706,187,038	1.351
MY	MALAYSIA	15	1,582,279,686	1.334	16	694,804,170	1.048	11	887,475,516	1.698
TH	THAILAND	16	1,500,310,615	1.265	11	1,110,149,060	1.674	22	390,161,555	0.747
ZA	SOUTH AFRICA	17	1,458,680,785	1.230	17	589,281,470	0.889	12	869,399,315	1.663
CH	SWITZERLAND	18	1,156,481,805	0.959	23	306,150,644	0.462	13	830,331,161	1.589
PH	PHILIPPINES	19	1,016,535,002	0.857	15	778,068,792	1.173	25	238,466,210	0.456
SE	SWEDEN	20	815,911,248	0.688	22	391,438,604	0.590	21	424,472,644	0.812
BE	BELGIUM	21	763,839,574	0.644	20	462,277,184	0.697	24	301,562,390	0.577
ES	SPAIN	22	715,138,740	0.603	19	505,496,241	0.762	27	209,642,499	0.401

BR	BRAZIL	23	697,060,879	0.588	47	60,079,165	0.091	18	636,981,714	1.219
ZZ	OTHER	24	644,355,012	0.543	21	419,543,874	0.633	26	224,811,138	0.430
KW	KUWAIT	25	573,087,300	0.483	33	138,627,737	0.209	20	434,459,563	0.831
CL	CHILE	26	555,346,820	0.468	38	114,053,734	0.172	19	441,293,086	0.844
MX	MEXICO	27	481,170,778	0.406	24	303,028,615	0.457	30	178,142,163	0.341
AE	UNITED ARAB EMIRATES	28	458,807,877	0.387	26	255,886,923	0.386	29	202,920,954	0.388
NZ	NEW ZEALAND	29	433,506,386	0.366	27	223,941,406	0.338	28	209,564,980	0.401
OM	OMAN	30	385,029,603	0.325	80	12,372,860	0.019	23	372,656,743	0.713
AT	AUSTRIA	31	359,657,148	0.303	28	220,556,800	0.333	34	139,100,348	0.266
IN	INDIA	32	349,557,215	0.295	29	214,173,179	0.323	36	135,384,036	0.259
PK	PAKISTAN	33	283,302,542	0.239	37	122,432,964	0.185	32	160,869,578	0.308
DK	DENMARK	34	278,259,930	0.235	30	161,004,025	0.243	37	117,255,905	0.224
TR	TURKEY	35	266,942,175	0.225	44	90,020,724	0.136	31	176,921,451	0.339

PA	PANAMA	36	262,569,300	0.221	25	262,055,687	0.395	115	513,613	0.001
FI	FINLAND	37	245,006,944	0.207	32	141,987,387	0.214	38	103,019,557	0.197
NO	NORWAY	38	175,805,840	0.148	43	96,105,949	0.145	40	79,699,891	0.152
GR	GREECE	39	174,628,363	0.147	34	134,931,074	0.204	51	39,697,289	0.076
IE	IRELAND	40	165,596,283	0.140	41	101,180,151	0.153	43	64,416,132	0.123
NG	NIGERIA	41	159,489,914	0.135	31	156,352,854	0.236	94	3,137,060	0.006
EG	EGYPT	42	155,391,577	0.131	35	124,685,476	0.188	56	30,706,101	0.059
IL	ISRAEL	43	148,207,866	0.125	40	106,033,032	0.160	47	42,174,834	0.081
AR	ARGENTINA	44	147,901,491	0.125	81	12,112,924	0.018	35	135,788,567	0.260
CN	CHINA	45	144,384,263	0.122	---	---	---	33	144,384,263	0.276

Source: Directorate General of Customs, Ministry Of Finance, Taiwan

Notes: --- Means no data is available or data cannot be represented numerically

## Appendix 4.A

### **Protocol<sup>1</sup> for Conducting a Multiple-Case Study of both Taiwanese and non-Taiwanese foreign investors in YRD and PRD of China**

#### A. Introduction to the case study and purpose of protocol

- A1. Research questions
- A2. Theoretical framework
- A3. Interview protocol in guiding interviews

#### B. Data collection and recording procedures

- B1. Name of sites to be visited, name, email, cell phone of contact person
- B2. Data collection plan: the calendar period for the site visits, the amount of time to be used for each visit, and the level of effort to do each case study
- B3. Preparation prior to site visits: identifies specific documents to be reviewed and where documents can be accessed

#### C. Outline of case study report

- C1. The background of each case
- C2. The key results of each case
- C3. Outcome from the practice

#### D. Case study questions

##### D1. Taiwanese companies in YRD

- a. What are the general interaction of your company and local authority? Why?
- b. What is formal or informal preferential treatment? Is there any? Why?
- c. Do you get treated differently than non-Taiwanese companies and the local competitors? Why?
- d. What is the procedure for a company to start a business? Why?

##### D2. Foreign companies in YRD

- a. What is the general interaction of your company and local authority? Why?

<sup>1</sup> This is a draft for conducting the multiple-case study. Questions are flexible.

- b. What is formal or informal preferential treatment? Is there any? Why?
- c. Do you get treated differently than Taiwanese companies and the local competitors? Why?
- d. What is the procedure for a company to start a business? Why?

#### D3. Taiwanese companies in PRD

- a. What are the general interaction of your company and local authority? Why?
- b. What is formal or informal preferential treatment? Is there any? Why?
- c. Do you get treated differently than non-Taiwanese companies and the local competitors? Why?
- d. What is the procedure for a company to start a business? Why?

#### D4. Foreign companies in PRD

- a. What are the general interaction of your company and local authority? Why?
- b. What is formal or informal preferential treatment? Is there any? Why?
- c. Do you get treated differently than Taiwanese companies and the local competitors? Why?
- d. What is the procedure for a company to start a business? Why?

#### D5. Government-related agencies:

- a. General procedure for Taiwanese and non-Taiwanese foreign investment in China? Why?
- b. Bureaucracy: whether support or prejudice certain business? Formal and informal relationship between investors and government? Why?
- c. Local protectionism: how about the local competitors? Why?
- d. Government Regulation: whether affects company's performance? Hidden agenda? Why?

## Appendix 4.B Interview protocol and questions

### Provisional Thesis Title:

China's embrace of Taiwan: whether Chinese local governments espouse the national policy of aligning Taiwan's economic self-interest with China's diplomatic interests.

Time Started:

Date:

Place:

Interviewee/Position:

Time Finished:

[Briefly describe the purpose of this study. Business card. Confidentiality. Eye contact.]

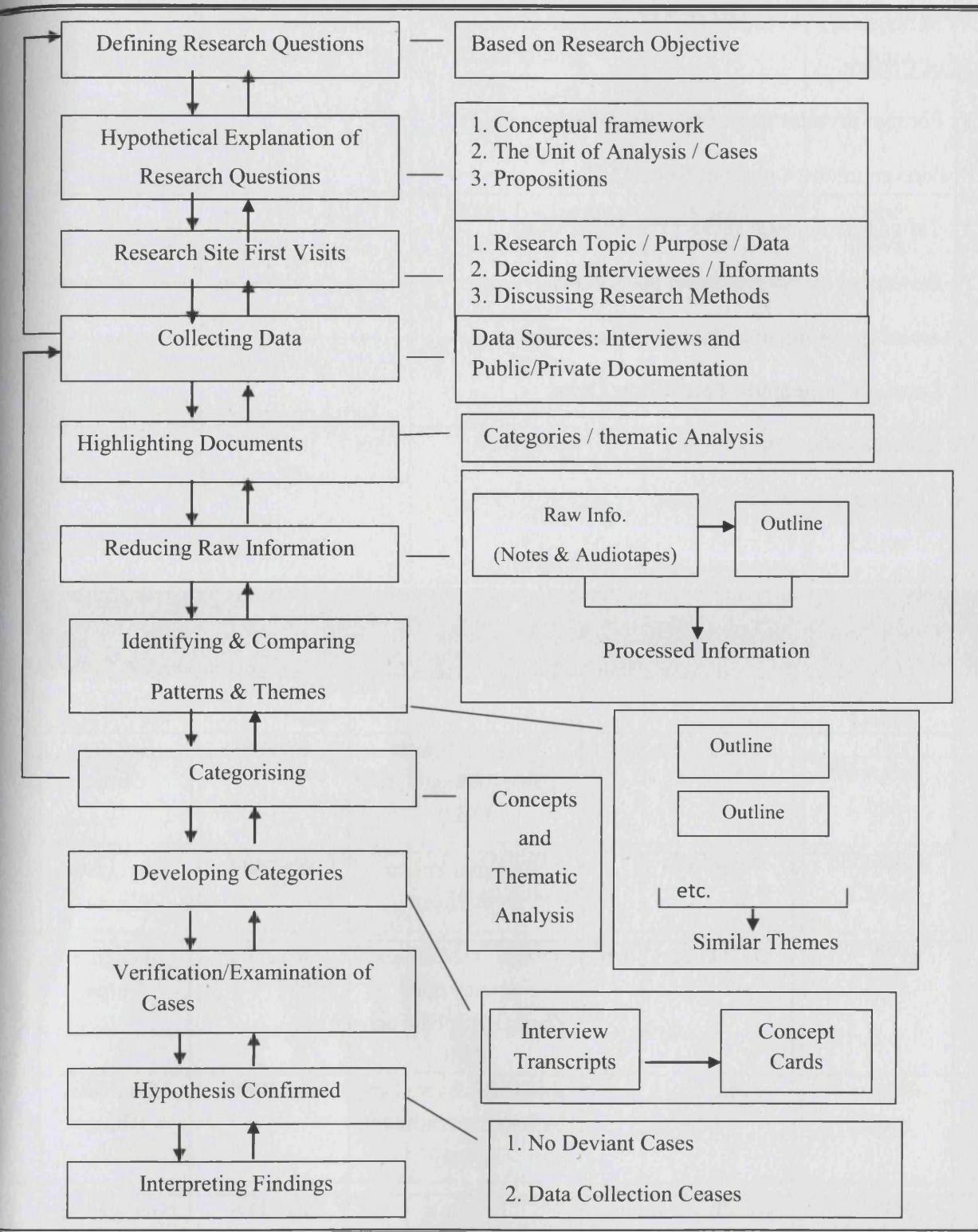
### [Why] Questions:

- 1) Is local politics at a municipal level an explanatory factor that affects the practice and policies of foreign private sectors within China?
- 2) Is local government the only effective factor in understanding foreign companies' development in the coastal area of China? why? if not, why? To what extent should we also consider the Chinese central government's stance and influence?
- 3) To what degree do local governments also influence Taiwanese investments when comparing with the treatment non-Taiwanese foreign investors get from local governments? Is this influence positive, negative, or of neutral in terms of facilitating the smooth development of foreign investments? How do local governments and central authorities communicate when their policies contradict?
- 4) Does this factor, local politics, only apply to certain of special economic zones or throughout all of China?
- 5) Have local governmental bureaucracies in China contributed to the establishment of international norms, environmental norms, corporate social responsibility norms such as global compact and international safety standards and the like?
- 6) How do you make the municipal government connections by which you intend to invest?
- 7) Who in the company is in charge of liaison with the local government?
- 8) How do you maintain a close relationship with the local authority or person?
- 9) Besides the municipal government, what other organization or persons possess the plenary powers/influence over foreign investment issues?

- 10) As given above, how do you balance the relation among these powers if any?
- 11) What is your main responsibility in the company?
- 12) Have you changed your managerial style when you came to China? If yes, why?
- 13) What are main requirements or personal characteristics you should have to succeed in the managerial position in a foreign company in China?
- 14) What would you suggest in terms of making a good relation with the government to secure the approval of company license?
- 15) Have you encountered the problem of the difference between fulfilling the contract and the regulations?
- 16) Are your company's competitors local enterprises or foreign enterprises? Have the combination of competitors changed?
- 17) What is your company's current strategy for management in China? What is the biggest challenge to achieve the goal?
- 18) Have you had some challenges in human resource? Do you localise in China?
- 19) Please briefly illustrate the relationship between your Chinese regional branch and headquarters of your company?
- 20) Do you feel that the Chinese local government or central government is in favor of the Taiwanese investors compared to your company or other foreign company in any aspect of business proposal, dealing and practice? If yes, to what extent and why is it?
- 21) Do Chinese local governments really implement their preferential policies (and the central government's policy) in the FDIs in their areas?
- 22) What is the most important criteria for Chinese local government to consider its preferential treatment?
- 23) Can you rank the importance of the criteria affecting the implementation of Chinese local government's preferential policy? These are Guanxi, size of the company (capital), sector of the company, location of the company.
- 24) Is there anything you would like to add?

[Thank informant for participating in this interview. "One single conversation with you is more enlightening than a decade's study." Assure confidentiality of informants and potential future interviews. Email or telephone contact? Write a thank you email]

#### Appendix 4.C The Process of Analytic Induction for this Study



Source: the researcher's own research

## Appendix 5.A List of interviewee

### List of Coding

FY: Foreign investor in Yangtze River Delta

FP: Foreign investor in Pearl River Delta

TY: Taiwanese investor in Yangtze River Delta

TP: Taiwanese investor in Pearl River Delta

GY: Local government in Yangtze River Delta

GP: Local government in Pearl River Delta

CA: Chinese academic scholar

TA: Taiwanese academic scholar

Code by category order	Name	Company	Interview Date	Interview Place
Government				
GY1	Mr. Ya-Fu Sun	Taiwan Affairs Office (also governs PRD)	08/2008	Beijing, China
GY2	Mr. Ni-Chi	Shanghai Police Department	08/2008	Shanghai, China
GY3	Ms. Doreen Shen	Jiangsu recruitment agency and ZhangJiang Hi-Tech Park	08/2008	Shanghai, China
PG1	Ms. Hai-Yin Chang	SZSITIC, Shenzhen business recruitment agency	09/2008	Shenzhen, China
PG2	Mr. Zhi-Gang Fan	People's Government of	09/2008	Guangzhou, China

		Guangdong Province		
PG3	Mr. Xun-Zhang Wang	General Office of Guangdong Provincial Committee of CPPCC	09/2008	Guangzhou, China
TG1	Mr. Yin-Long Yu	Straits Exchange Foundation	01/2009	Taipei, Taiwan
Taiwanese Company				
TY1	Mr. Tong-ching Chiu	ASE group	10/2008 and 05/2010	Kaohsiung, Taiwan & Shanghai, China
TY2	Mr. Michael Tseng	BenQ Corporation	10/2008	Taipei, Taiwan
TY3	Mr. Raymond Tang	BOCLH	07/2008	Shanghai, China
TY4	Mr. James Wang	Shi Mao Group	07/2008	Shanghai, China
TP1	Mr. Jui-Yen Huang	Hua-Nan Commercial Bank	09/2008	Shenzhen, China
TP2	Mr. Chi-Yueh Chen	Zse Mart Co. Ltd	09/2008	Zhuhai, China
TP3	Mr. Frankie Pon	Porng Da Enterprise Co., Ltd	09/2008	Dongguan, China
TP4	Mr. Jack Lin	Shuenn Jaan Machinery Co., Ltd	11/2008	Kaohsiung, Taiwan

Foreign company				
FY1	Mr. Henk Naert	(Furniture) Oukelai Investment Consultancy Co. Ltd.	1/2009	Beijing, China
FY2	Mr. Murat Telek	Demrad International Trading Co.,Ltd	09/2008	Suzhou, China
FY3	Mr. William Knight	JPMorgan Chinese Investment Trust PLC	01/2009	Shanghai, China and London, UK
FY4	Mr. John Hunter	Hunter International Associates Limited	05/2010	Shanghai, China and Swansea, UK
FP1	Mr. David Chang	Philips	07/2008	Shanghai, China
FP2	Mr. Guy McLeod	Airbus	11/2008	Hong Kong, SAR, China
FP3	Mr. Christopher Shaw	Lilly Corporation	07/2008	Shanghai, China
All others				
AC1	Mr. Li, Shiao- Shuan	Author and Lawyer	01/2009	Beijing, China
AC2	Dr. Dong Tao	Author and Credit Suisse	12/2008	Hong Kong, SAR, China
TA1	Dr. Zhen-Yuan Tong	National Chengchi University	10/2008	Taipei, Taiwan
TA2	Mr. Zhou-Yuan Chang	Taiwan Merchant Association (TBA) Shenzhen	09/2008	Shenzhen, China

British investor	Mr. John Hunter	Hunter International Associates Limited	05/2010	Swansea, UK
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## **Appendix 6.A An Overview of Preferential Policies in Taxation Incentives and Regulation in Jiangsu Province of the YRD in China**

The taxes governing foreign-invested enterprises include: Enterprise Income Tax; Local Income Tax; Value-Added Tax (VAT); Consumer Tax; Business Tax; Individual Income Tax; Urban Real Estate Tax; Vehicle and Vessel License Tax and Stamp Tax.

### **a) Enterprise Income Tax and Preferential Treatment**

Foreign-invested enterprises and foreign enterprises in China are governed by the "Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises."

The reduced enterprise income tax rate for Sino-foreign joint ventures engaged in port and wharf construction is 15%. The enterprise income tax rate for Sino-foreign joint ventures whose operating life will be 15 years and more, upon receiving approval from tax authorities in the province, autonomous region, or municipality directly under the control of the central government that they are located in, will be exempt from enterprise income tax for five years from the first profit-making year. These enterprises will also be granted a 50% reduction in enterprise income tax commencing from the sixth year until the tenth year (with tax rate not less than 10%).

### **b) Local Income Tax and Tax Exemptions**

Local income tax for foreign-invested enterprises and foreign enterprises is 3% of assessed income.

During the two-year period of tax exemption and the three-year period of reduced tax as granted by the central government regulations, exporting enterprises and technologically advanced enterprises with foreign investment are exempt from local enterprise income tax. Local income tax will be exempt after the above-mentioned five-year exemption period if more than 50 % of the output of an enterprise is exported the same year. Technologically advanced enterprises will continue to receive exemption from local tax for a period of three years after the above-mentioned five-year exemption period. Local income tax will be exempt if a foreign-invested enterprise in production is established and operated in an established Economic & Technological Development Zone under the approval of the Jiangsu Province.

### **c) Tax Rebates for Enterprise Profits Reinvested in China**

(i) Foreign investors who reinvest their profits in China in a business period of not less than 5 years will obtain a 40% rebate on income tax.

(ii) Foreign investors who reinvest profits to establish or expand an export-oriented or high technology enterprise within a period of not less than 5 years, will obtain a full rebate on income tax paid on the amount reinvested.

In the event of an enterprise of the above-mentioned nature withdrawing before it has been in operation for five years, all tax rebates must be returned to the relevant tax authorities.

**d) No Tax on Repatriated Profit**

For foreign investors who have received a share of profits after tax, or profits exempt from tax, from foreign-invested enterprises and who repatriate the profits abroad, no tax shall be paid on the repatriated profits.

**e) VAT, Consumption Tax, and Business Tax**

Foreign invested enterprises and foreign enterprises are governed by the interim provisions of the PRC on Value Added Tax, Business Tax, and Consumption Tax from January 1994. The former Industrial and Commercial Consolidated Tax is no longer in effect.

**f) Individual Income Tax, Reduced Tax and Tax Exemptions**

(i) Income from wages and salaries in excess of specified amounts will be subject to a progressive income tax, the rate of which ranges from 5 to 45 %.

Income derived from provision of personal services, royalties, dividends, the leasing of property and other kinds of income will be subject to a net rate of tax of 20 %.

(ii) The amount of each category of tax shall be calculated as follows:

\* for income from wages and salaries, tax shall be paid on the monthly income remaining, after deducting 800 yuan per month.

\* for income derived from the provision of personal services, royalties, or from the leasing of property, where the amount received does not exceed 4,000 yuan each time, expenses of 800 yuan can be deducted from income before tax is paid. Where the amount of income received exceeds 4,000 yuan an amount equivalent to 20% can be deducted for expenses. The remaining amount shall be taxed.

Income derived from interest, share dividends, bonus dividends and other sources will be taxed on the amount received for each payment.

(iii) The scope of tax exemptions or tax reduction. For foreigners working in foreign-invested enterprises and foreign enterprises, resident representatives of other economic organizations, or foreigners working in various Chinese institutions, the tax-free portion to be deducted from income for the individual income tax is 4000 yuan/month. For those live in China for less than 5 years, income obtained from outside China will not be subject to individual income tax.

**g) Pre-taken Income Tax**

Where foreign enterprises have not set up an office or other form of establishment in China but have income derived from within China from profits, interest, share dividends, rental income, royalties or other sources, or where even though they have an office or some other form of establishment in China is the income derived from within China from the above-mentioned sources not related to the activities of that office or establishment, above-mentioned income will be subject to income tax at a rate of 20%.

Where royalties have been received for patented technology provided for the purposes of carrying out scientific research, the development of energy resources, the development of transport and communications, the development of agricultural, forestry or animal husbandry products, or for the development of important technology, after permission has been received from the relevant tax authorities, those royalties received will be subject to income tax at a rate of 10%. In cases where the technology concerned is advanced or preferential conditions exist, exemption from income tax may be granted.

Where a taxation agreement exists between China and a foreign country, the tax rate on income derived from share dividends, interest or royalties will generally be between 10% to 15%. The tax rate on income derived from rental of property will range from 6 % to 10 %.

#### **h) Urban Real Estate Tax**

Urban real estate tax is to be paid by the owner of the property. Where a property has been mortgaged, the tax will be paid by the mortgagee.

The taxable value of property owned by an enterprise is to be calculated on the amount remaining after a 30% deduction from the original book value of the property. The annual tax rate is 1.2 %.

#### **i) Vehicle and Vessel License Tax**

The amount of annual license tax on passenger vehicles will vary from 180 yuan to 300 yuan per vehicle. The amount of annual license tax for trucks is 60 yuan per net tonnage. Tax on motorized boats shall be collected by customs on the basis of tonnage. Motorized boats are exempt from license tax.

#### **j) Stamp Tax**

A small amount of stamp tax will be paid on economic and technological contracts or various documentation produced in economic activities with the rate ranging from 0.1% to 0.005%.

### **2. Personnel Management**

#### **a) Recruitment**

The recruitment of staff and workers needed by a foreign-invested enterprise can be made openly in local labor markets.

#### **b) Labor Contract**

Labor Contracts should be signed between the foreign-invested enterprise and individuals concerned to identify the rights and obligations for both sides.

Enterprises shall not dismiss staff workers who are under medical treatment for work related injuries or occupational diseases, or who are receiving treatment in hospital or non-work related injuries, or female staff who are pregnant, on maternity leave or who are on leave to nurse their new-born children.

A foreign-invested enterprise may dismiss staff and workers who, within the employment contract period, become superfluous as a result of significant changes in production or technological conditions, or dismiss staff and workers in accordance with regulations set out in the employment contract. However,

workers and staff to be dismissed must be given one month's notification of dismissal. Staff and workers who have been dismissed by a foreign-invested enterprise, as well as those whose contracts have expired, should be given compensation calculated on the basis of one month's average pay for every full year served in the enterprise for the first 10 years, and 1.5 month pay for every full year commencing from the eleventh year.

#### **c) Salaries and Wages**

The wages and salaries of employees in foreign-invested enterprises shall be determined according to the principle of being no lower than 120% of the average wages and salaries paid to employees by the local state owned enterprises in the same industry. Any decision to increase, decrease or leave salaries and wages unchanged should be made by the enterprise on the basis of its economic performance.

Salaries for senior staff members of a foreign-invested enterprise should be decided by the board of directors and be specified in detail in the employment contract.

#### **d) Labor Insurance and Welfare Benefits**

Foreign-invested enterprises, in accordance with the relevant state and provincial regulations, should make payment of, or allocation of, funds for labor insurance, welfare costs and housing subsidies for Chinese employees.

#### **e) Labour Protection**

Foreign-invested enterprises must adopt the state and local laws and regulations regarding labor protection, and adopt the system of working hours currently run in China. However enterprises with foreign investment are free to make decisions on their own to reduce work hours.

Staff and workers in foreign-invested enterprises are entitled to regular holidays and other special holidays as determined by the state. Normal wages should be paid to employees during the above mentioned holiday and leave periods.

Foreign-invested enterprise must carry out the state and local laws and regulations concerning labour protection, production safety, and industrial sanitation, and, under the supervision of local labour departments, improve working conditions.

### **3. Administration of Land**

According to the policy of separation of the ownership and the use of land, foreign-invested enterprises may obtain the right to use land through offering, transference, lease or cession. At present, foreign investors must go through an offering procedure in order to start real estate, commercial, financial, tourist or entertainment projects. Those qualified may also go through transference or lease procedures. For projects of other trades, they should, in principle, likewise go through offering, transference or lease procedures. Only with permission can they conduct paid cession procedure.

a) a foreign-invested enterprise or would-be investor from abroad can apply to obtain the right to use land by using the original grounds of the Chinese enterprise;

- b) a foreign-invested enterprise or would-be investor from abroad can apply directly to the Land Administration Bureau of local governments for the right to use land through offering;
- c) a foreign invested enterprise or would-be investor from abroad may also obtain the right to use land from other land users through transference or lease;
- d) the right to use land can also be obtained by means of cession.

#### **4. Charge Rates**

##### **a) Water and Electricity Charges**

Water and electricity required in production by foreign-invested enterprises, shall be included in supply plans established by each city, and these enterprises will be guaranteed priority in their supply. For export-oriented and technologically advanced enterprises with foreign investment, the cost of water and electricity will be charged at the planning price; other foreign-invested enterprise will have their charges calculated on the same basis and be charged at the same price paid by local state-owned enterprises.

Foreign-invested enterprises would be exempt from additional complimentary charges for water and electricity construction and capacity enlargement.

##### **b) Communication Facility Charges**

Fees will be charged at the same rate as local state-owned enterprises in accordance with the regulations of the local people's municipal government.

#### **5. Bank Loans**

Foreign-invested enterprises shall be given priority by banks where they opened their account for the provision of loans for working capitals as part of the bank's loan quota.

Foreign-invested enterprises can, in accordance with the relevant bank regulations, apply to banks for loans under terms of mortgage of foreign currencies in their accounts as well as fixed assets.

Foreign-invested enterprises can borrow money from abroad to meet production and operating requirements. Borrowing is to be made and repaid by the enterprises concerned.

#### **Guarantee of Investment**

The foreign-invested enterprise which is approved by the Chinese government to set up in Jiangsu and meets the requirements for being a legal person, after registration has, according to law, the status of a legal person.

The legitimate rights and benefits of foreign invested enterprises including property ownership right and disposal right of foreign investors and their right to dispose of their legitimate income shall be protected by the Chinese laws.

- a) The government guarantees according to law the autonomy of enterprises in management and supports them to manage their enterprises according to international practice. The foreign-invested enterprises, by

themselves, have the right to determine, within the scope of their approved contracts and on their production and business plans, to raise and use the funds to purchase the material and sell their products.

b) The foreign-invested enterprise based on their production and operation requirement can on their own determine the structure and size of their staff and employ or dismiss administrative personnel at all levels.

c) The net profits distributed to the foreign investors in the foreign-invested enterprises after having fulfilled their obligations stipulated in the law, and the contract. The share of capital or other funds upon the termination or expiry of the joint venture, the after-tax salaries and other legitimate earnings of the foreign personnel in the enterprises can all be remitted abroad.

d) The foreign-invested enterprise can insure with Jiangsu branch of the People's Insurance Company of China or other approved organizations.

e) The proprietary technology approved in China and provided for the foreign-invested enterprise in Jiangsu by the foreign investors and registered trademark are both protected by China Patent Law and Trademark Law. When the right is being infringed upon, the injured party can ask the patent authority or the administrative authority of industry and commerce to handle the case, or bring the suit directly to the court.

f) The disputes, raised between the parties in joint venture or cooperative venture, during the implementation of the contract (agreement), that cannot be settled through consultation or negotiation, may be settled through arbitration according to the relevant written arbitration agreement. If there is no written arbitration agreement between two parties, either party can sue at people's court for settlement.

g) The state will not nationalize or expropriate the foreign-invested enterprises. Under extraordinary circumstances, when it is deemed necessary in public interests, the requisition would be carried out through legal procedures and reasonable compensation will be given accordingly.

h) The government especially encourages foreign investors to set up export-oriented or technologically advanced enterprises and will give them, then, the preferential treatment with respect to taxation, credit, supply of water, electricity and gas, and telecommunication and transportation facilities.

i) The foreign-invested enterprises may appeal to relevant government departments to solve their difficulties in the process of their investment, construction, production, management or liquidation.

j) The rights and interests of foreign investors in China are also protected by bilateral agreements of the investor's country, such as agreements on investment insurance or investment protection, and agreements on avoiding double taxation.

## **Appendix 6.B. Preferential Policies in Shenzhen of PRD**

### **Preferential Policy in Shenzhen by Industries**

The Shenzhen government has issued several preferential policies, such as "the Notice on Accelerating the Development of Shenzhen's Service Outsourcing Industry", The No. 1 Document in 2004, "the Decision on the Optimization of Regional Innovation System for A Fast and Sustainable Development of High and New Technology Industry", "Several Regulations on Providing Further Support for the Development of New and High Technology Industry", "Regulations on the Cultivation of Talents in High and New Technology Industry and on the Introduction of Talents" and "Measures on the Implementation of 'Providing Further Support to the Development of High and New Technology'".

## 1. General Industries

- A. For foreign-invested enterprises, corporate income tax rate is decreased from the original 30% down to the present 15%, while the local income tax levied at the rate of 3% is exempted.
- B. Foreign-invested manufacturing enterprises can enjoy 2 years of corporate income tax exemption and half reduction for the ensuing 3 years according to the regulations of the tax law. Certified export-oriented enterprises at the expiration of the tax exemption and reduction period enjoy a reduced rate of 10% for corporate income tax provided the export volume accounts for 70% or above of the total industrial output. Certified manufacturing enterprises using state-of-the-art technologies at the expiration of the tax exemption and reduction period are entitled to a reduced tax rate of 10% for a 3-year extension.
- C. Half of the land use fee for the land for industrial use utilized by certified export-oriented enterprises will be exempted. Half of the land use fee for the certified enterprises using state-of-the-art technologies will be exempted for 5 years.
- D. The foreign-invested enterprises engaged in the service sector with an investment of over US\$ 5 million and operation duration of over 10 years can enjoy 1 year of corporate income tax exemption from the profit-making year and half reduction for the ensuing 2 years.
- E. Sino-foreign equity joint ventures engaged in port and dock construction projects with an operation period of over 15 years may enjoy the exemption of corporate income tax for the first 5 years from profit-making year and half reduction thereof for the ensuing 5 years after their applications are approved.

## 2. Integrated Circuits Industry

- A. For integrated circuits manufacturing enterprises, from their being certified until the end of 2010, simultaneous levy and refund will be applied to the part exceeding 6% of the total VAT paid by integrated circuit manufacturers that are general taxpayers of VAT at the statutory tax rate of 17% for the sales of self-produced integrated circuit products. The refunded tax shall be used by the enterprises for R&D of IC products and expanded reproduction, and shall not be subject to the levy of corporate income tax.
- B. Accelerated depreciation can be applied to the production equipment of IC manufacturers. The shortest depreciation term of the production equipment of IC manufacturers can be three years after being approved by authoritative organizations in the case of domestically-invested enterprises, and by the State Administration of Taxation in the case of joint-venture or exclusively foreign-invested enterprises.

C. For the preferential tax policies applied to the IC manufacturing enterprises set up in Shenzhen, please refer to those applied to the foreign-invested enterprises engaged in construction of ports, wharves, energy and traffic projects with a duration of over 15 years, namely, these enterprises can enjoy 5 years of corporate income tax exemption from the profit-making year and half reduction for the ensuing 5 years upon enterprise application and authorization by taxation authorities.

D. IC manufacturing enterprises can set aside 15% of their yearly net sales as R&D fee. If the R&D fee drawn is not used up in the current year, the balance may be carried over to the next year. If the investment of an enterprise in R&D exceeds the amount of R&D fee drawn, the exceeding part may be stated as R&D expenses.

E. Self-use raw materials and consumables for production imported by integrated-circuit manufacturing enterprises are exempt from tariff and import-related VAT.

F. Integrated circuit technologies, complete sets of production equipment, equipment and apparatuses specially for integrated circuits imported by certified integrated-circuit manufacturing enterprises are exempt from tariff and import-related VAT, and this is not applied to the commodities listed in the Catalog of Non-Tax-Free Imported Commodities for Foreign-Invested Projects and the Catalog of Non-Tax-Free Imported Commodities for Domestically-Invested Projects stipulated by the State Council's Guofa [1997] No. 37 Document.

G. For the IC manufacturing enterprises with an investment of over RMB 8 billion or IC line width less than 0.25um, the preferential taxation policies for those foreign-invested enterprises engaged in energy and traffic prevail; the imported self-use raw materials and consumables for production shall be exempt from tariffs and import-related VAT.

H. Shenzhen Integrated Circuit Industrial Park is under planning with the first phase of construction of 3-5 square kilometers. The certified integrated circuit manufacturing enterprises within the Industrial Park will be exempt from the remuneration for assignment of the right to the use of land, municipal supporting facilities fees and land development fees.

I. If the domestic and foreign senior professional technical and managing personnel engaged by integrated circuit manufacturers purchase commodity residential houses in Shenzhen, the payment for such houses may set off their taxable income and the method of refund after levy may be adopted.

J. If the domestic and foreign senior professional technical and managing personnel and their families needed by integrated circuit manufacturers settle in Shenzhen, they shall be free from the restriction of the norm of registered permanent residence of Shenzhen and enjoy exemption for the city infrastructure expansion fee.

K. Integrated circuit design enterprises are regarded as software enterprises, and enjoy the relevant taxation policies for the software enterprises.

### **3. Software industry**

A. By 2010, simultaneous levy and refund will be applied to the part exceeding 3% of the actual VAT paid by the general taxpayers of VAT at the statutory tax rate of 17% for the sales of self-produced software products. The refunded tax shall be used by the enterprises for R&D of software products and expanded reproduction, and shall not be subject to the levy of corporate income tax.

If the general taxpayers of VAT export products of localized transformation such as conversion of imported software, the exported software may enjoy the simultaneous levy and refund policy according to the standards for self-developed and produced software products.

B. Certified new software enterprises may enjoy 2 years of corporate income tax exemption from the profit-making year and half reduction for the ensuing 3 years. Software enterprises included in the country's planning or key software enterprises defined by provincial and municipal governments enjoy 5 years of corporate income tax exemption and half reduction for the ensuing 5 years. For the corporate income tax paid for the third to fifth year which is levied at half reduced rate, the municipal financial authority shall provide corresponding allowance.

C. The pay and training expenditures of software manufacturing enterprises can be deducted from the taxable income according to the actual sum.

D. If key software enterprises included in the country's planning did not enjoy tax incentives in the current year, the corporate income tax shall be levied at the deducted rate of 10%.

E. The self-use equipment, technologies (including software), accessories and parts imported together with the equipment according to the contract that are imported by software enterprises are exempt from tariff and import-related VAT, and this is not applied to the commodities listed in the Catalog of Non-Tax-Free Imported Commodities for Foreign-Invested Projects and the Catalog of Non-Tax-Free Imported Commodities for Domestically-Invested Projects.

F. Software enterprises are encouraged to pass international qualification certifications such as GB/T19000-ISO9000 certification or CMM certification. The Municipal Foreign Trade Development Fund supports those enterprises that have passed international qualification certification over CMM-2.

G. Shenzhen has established a software enterprise development center. The government shall provide subsidy to new software enterprises entering the center from a special fund for science and technology.

H. Software system analysts and system engineers engaged in software work and software development personnel with university education or above, or college education or above and semi-senior professional titles or above or with important inventions and creations, their spouses and minor children are allowed to settle in Shenzhen (irrespective of transfer with spouse or work transport) and exempted from city infrastructure expansion fee.

I. For the software purchased by enterprises and institutions if the purchase cost attains the standard of fixed assets or the software forms a part of intangible assets, the software can be calculated according to fixed assets or intangible assets. For domestically-invested enterprises, this shall be reported to the tax authority for approval; for the foreign-invested enterprises with a total investment of over US\$ 30 million, this shall be reported to the State Administration of Taxation for approval; for the foreign-invested enterprises with an investment of less than US\$ 30 million, this shall be reported to the tax authority for approval, and its depreciation or amortization duration can be shortened as short as 2 years.

#### 4. Logistics

A. For the logistic distribution centers and logistic enterprises set up in the 6 major logistic parks of Shenzhen, the price of land for their new constructions shall be charged at a preferential rate of 20%; for the projects in Sungang Logistic Park, the charge can be collected respectively at 50% of

commercial and warehousing counterparts; for the projects in the other 5 logistic parks, the charge can be collected respectively at 25% and 75% of commercial and warehousing counterparts; the land price for logistic distribution projects can be paid in installments, with the maximum duration of 3 years. For the electricity used for the large-sized refrigerated warehouses and distribution centers of commercial, trade and circulation enterprises, the charge can be collected as per the standards for industrial electricity charging rate.

B. Enterprises for certified key logistic projects will enjoy preferential policies in using land and electricity, and can use "green channel" during project setup and construction with a fast approval process.

## 5. Finance

A. Financial agencies with headquarters or regional headquarters in Shenzhen can enjoy a one-time subsidy from the special-purpose fund as per the standard of 1000 yuan per square meter for their new office buildings.

B. Educational departments will give support to senior management personnel of financial agencies in terms of their children's schooling, and municipal and the district educational department shall arrange for their children to study in key schools. Upon approval by relevant departments, the children of foreigners can enjoy the preference to study in Shenzhen's international schools or other schools.

C. Sino-foreign joint venture or foreign banks established in Shenzhen Economic Special Zone with a total investment of over US\$ 100 million and a duration of over 10 years may enjoy 1 year of corporate income tax exemption from the profit-making year and half reduction for the ensuing 2 years; their income from financial business can enjoy 5 years of business tax exemption from the opening day.

## 6. Venture Investment

A. If venture investment agencies invest in the projects listed in the Guide to Venture Capitals' Investment in Hi-Tech Industries, and the total investment exceeds its registered capital or accounts for 70% of its total investment, and no less than 30% is invested in startup enterprises, then the venture investment agencies will enjoy the preferential policies for hi-tech enterprises.

The accumulated investment specified in the previous clause shall include the sum refunded and realized investment from invested enterprises within 5 years on calculation; and the investment by venture investment agencies shall be calculated according to the actual invested sum.

B. Venture investment agencies can draw from the risk compensation fund as per 5% of the yearly gross income to compensate for the investment losses of preceding years and the current year; the balance of the risk compensation fund can be carried forward to the next year, however, the total sum shall not exceed 10% of the net assets of the venture investment agencies in the year.

C. If venture investment agencies invest in Shenzhen's hi-tech industries and other technological innovation industries, and the sum exceeds 70% of their investment, the agencies can enjoy the relevant preferential policies of Shenzhen upon approval by the technological authority of the Municipal Government.

D. From 2000 onward, the municipal finance would prepare 10 million yuan, while the Three funds for technologies would prepare 20 million yuan every year to encourage overseas students to start up their

businesses in Shenzhen. First, the special-purpose fund will be used to set up and improve the Overseas Students Venture Park in the Hi-Tech Industrial Park; second, the fund will be used for preferential discount of loans for the hi-tech enterprises set up by the overseas students. \*

E. The following encouraging policies will be employed for overseas students to undertake scientific research, investment and establishment of all kinds of industries in Shenzhen: those engaged in scientific research with research subjects certified by the Municipal Technological Bureau as hi-tech projects can obtain one-time scientific research startup subsidy of RMB 100-150 thousand yuan;

Authorities shall actively support those overseas students engaged in go-between services such as evaluation, consultation and advising, or third industries. Overseas students will enjoy preferential policies for their investments in domains except those forbidden by the country.

In the case of becoming a partner with patent or non-patent technological results, the evaluation of technological result can account for 25% of the registered capital, upon the certification by the Municipal Technological Bureau, the evaluation of hi-tech results can account for 35% of the registered capital. Other forms can be undertaken if there are additional agreements between the partners.

F. Venture investments are encouraged to foster the venture investment market. Overseas and domestic investors are encouraged to set up venture investment agencies in Shenzhen. If venture investment agencies invest in the projects in compliance with Shenzhen's hi-tech industry direction, the accumulated sum exceeds their registered capital or exceeds 70% of their investment, and no less than 30% is invested in startup enterprises, the agencies can enjoy the relevant preferential policies of Shenzhen. For those hi-tech projects in compliance with the government's direction, especially those incubation projects, the municipal technological development fund will adopt multiple forms to inject matching investment to the venture investment agencies. Warranty compensation funds and re-warranty systems will be set up to encourage the warranty agencies set up by governmental and social capitals to give more support to the technological innovations of medium and small-sized technological enterprises.

G. Expand the space of software and technology incubator through "reconstruction of workshops and replacement of industries". The Municipal Government will arrange for special-purpose funds, while district governments and relevant enterprises will contribute at a proportion of no less than 1: 2 to reconstruct the existing old workshops into software parks and technological incubators.

H. Support the development of incubators. A maximum of 3 million yuan will be subsidized to the technological enterprise incubators certified by the technological authority of the Municipal Government, so as to support the construction of public facilities of the technological enterprise incubators such as public service platform, network communications, and facilities and instruments for professional labs. The Municipal Government will invest to set up professional biological incubators.

I. The Municipal Government will arrange for a proportion of the three funds of technology to serve as the special-purpose fund for construction of technological enterprise incubators, and subsidize on a one-time basis those certified technological enterprise incubators. The subsidy for each technological enterprise incubator shall be 20% of its total investment, and the maximum sum shall be RMB 3 million yuan.

J. The certified technological enterprise incubators shall be subsidized by the municipal finance from the day of being certified by referring to the supporting policies for hi-tech enterprises.

K. According to the actual conditions, accelerated depreciation can be applied to the public service facilities of technological enterprise incubators upon approval by the tax authority according to related regulations, thus advancing the update and innovation of technological enterprise incubators.

L. In terms personnel transfer, graduates assignments, residence registration and procedures for going abroad or to Hong Kong and Macao, the enterprises to be incubated in the technological enterprise incubators will enjoy the preferential policies for the hi-tech enterprises of Shenzhen.

## 7. Processing with Imported Material

A. Except the commodities listed in the Catalogue of Import Commodities for Foreign-invested Projects Not Exempted from Import Tariff, the unpriced equipment provided by foreign investors for processing with imported material shall be exempted from customs duty and import-related value added tax.

B. Except for the projects otherwise specified by the state, the imported materials and parts for processing with imported materials shall not be subject to quota permit management in principle.

C. The materials and parts imported by enterprises of category A for processing with imported materials shall be held by the customs in bond and not subject to the bank security deposit account system. The materials and parts imported by enterprises of category B for permitted processing with imported materials shall be subject to the "idling" bank security deposit account system.

D. An enterprise engaged in processing with imported materials that pay annual processing fees of over HKD 1 million may apply for direct cargo transport between Shenzhen and Hong Kong & Macao.

## 8. Public Utilities

The government encourages social funds and overseas capitals to construct public utilities by means of solely-funded enterprises, joint-venture enterprises, cooperation, and so on, and to undertake franchised operations of public utilities.

### Appendix 6.C. preferential policies in Guangzhou of PRD

State regulations provide that the income tax for enterprises with foreign investment is 30% of taxable income, but enterprises operating within the jurisdiction of Guangzhou municipality will enjoy a favorable tax rate of 24% and enterprises operating within special pilot zones will enjoy an even more favorable rate of 15%.

Any enterprise with foreign investment in a production-based industry and contracted to operate for a period of not less than ten years shall, from the first year of profitability, be exempted from income tax for two years and have a further 50% tax exemption in the third to fifth years.

### Appendix 6.D. preferential policies in Dongguan of PRD

According to the relevant state and provincial regulations, foreign investors will enjoy the following preferential policies when they invest in Dongguan City, Guangdong Province, PRC.

#### I. Exemption or Reduction of Enterprise Income Tax

The income tax of foreign invested enterprises is 25%.

(I). The income tax of the following foreign invested enterprises shall be levied at the rate of 15%:

1. With the approval of the State Taxation Bureau (STB), foreign-funded enterprises located in the old sections of the cities which are called coastal open areas, special economic zones and economic and technological development zones, projects falling into the category of technology-intensive and knowledge-intensive projects, or projects with over US\$30 million of foreign investment and the cycle of investment return is long, or projects of energy, transportation and harbor construction;

2. Sino-foreign joint ventures engaged in the construction of harbor and berth;

3. Such financial institutions as foreign funded banks and Sino-foreign equity banks set up in special economic zones and other areas approved by the State Council, with the minimum requirement being that foreign investors' financial inputs or the operating funds injected by the head office of a bank to the branch exceeds US\$10 million and the term of operation exceeds 10 years;

4. Foreign Invested enterprises deemed to be high-tech and new-tech enterprises located in areas determined to be high- and new-tech development zones by the State Council;

(II). Should the foreign partner to an foreign-invested enterprise directly re-invest the profit gained from the enterprise in that enterprise, expand the registered capital or use it to fund the setting up of other foreign-invested enterprises with an over-five-year term of operation, on the application of the investor and with the approval of taxation authorities, shall have 40% of the already paid income tax on the portion used for re-investment refunded; should the foreign investor use its profit derived from the foreign-invested enterprises to launch or expand a product-exporting or technologically-advanced enterprise in China with an over-five-year term of operation, with the verification and approval of taxation authorities, the amount of enterprise income tax already paid on the portion of profit used for re-investment will be refunded.

(III). If the foreign-invested enterprises have paid the income tax for the part of revenue derived from abroad, the enterprises can be approved to deduct this part of income tax from the total income tax which shall be paid in China; however, the amount of deduction can not exceed the revenue derived from abroad.

(IV). The profit derived by foreign investors from foreign-invested enterprises shall be exempt from income tax.

(V). If foreign-invested enterprises invest in the industries under encouraged catalogue and class B of restricted catalogue, purchase domestic equipment within their total investment capital, should the equipment be under the catalogue of tariff-ex-emption equipment, the value-added tax that has been paid by the enterprises should be totally refunded as well as to be taken as credit for enterprise income tax.

(VI). If annual loss is incurred in the foreign-invested enterprises located in China, the enterprises are permitted to compensate for the loss by using the revenue derived from the next tax year; if it is still not

enough, it can compensate for the loss the same way year by year; however, the time limit is five years. For foreign-invested enterprises that incur loss at the initial stage, the year when the enterprise can make profits after they compensate for the losses will be considered the first year of profit making.

(VII). If the annual increase of the costs for technological development of foreign-invested-enterprises is over 10%, (including 10%), with the approval of the taxation authorities, the enterprises can be approved to deduct the amount 50% of its actual costs used for technological development from its total taxable income of the year. Detailed implementation shall be in accordance with the Administrative Provisions on Deducting Enterprises' Technological Development costs from the Total Taxable Income Before Tax issued by the State Taxation Bureau.

## II. Exemption or Reduction of Tariff, Value-added Tax, Consumption Tax and Business Tax

(I). Since January 1, 1998, projects listed in the Encouraged Entries of the State Industrial Catalogue Guiding Foreign Investment (jointly promulgated by the SDPC, SETC and MOFTEC and revised in March 11, 2002) as well as all the permitted projects exporting all products, can have their imports of equipment exempt from import tariffs and import stage VAT, on condition that the imports are within the investment volume, for the projects' own use and are not included in the Catalogue for Imports not Exempted from Tax in Foreign Funded Projects. The imports for the own use of the projects financed by foreign government loans and international financial organizations and imported equipment which are not evaluated by foreign investors of processing trade shall be exempt from import tariffs and import stage VAT in accordance with the Provisions of Tariffs-Free Import Equipment for Foreign Investment Projects, i.e., imports not included in the Catalogue for Imports not Exempted from Tax in Foreign Funded Projects, for the above mentioned projects, techniques, auxiliary equipment and spare parts imported according to the contract together with the equipment shall be exempt from import tariffs and import stage VAT.

(II). The Sino-foreign equity joint venture banks or foreign banks set up in special economic zones, starting from the date of operation, shall be exempt from the business tax for 5 years.

(III). The agro-based produce sold by the foreign-invested enterprises engaged in animal and plant cultivation, forestry, animal husbandry and aquatic industry shall be exempt from the value-added tax.

(IV). Processing and assembling goods for export and the related processing cost shall be exempt from the value-added tax and the consumption tax.

(V). For export products from compensation trade projects, should the value-added tax have been charged in the production stage, tax rebates shall be granted after such goods have cleared the customs. For export goods under compensation trade, tax rebates shall be granted without presenting certificates of export exchange earnings receipt.

(VI). For the already established "encouraged" foreign-invested enterprises, foreign-invested R & D centers, technologically-advanced and product-exporting foreign-invested enterprises, during their technological transformation, if they import self-use equipment and related technologies, components and parts, which are within the original approved business scope and which cannot be produced domestically or the functions of local products cannot meet their needs, such imports shall be exempt from tariffs and import stage taxes.

(VII). When foreign-invested R & D centers import self-use equipment and related technologies, components and parts within their investment volume, which cannot be produced domestically or the functions of local products cannot meet their needs; such imports shall be exempt from tariffs and import

stage taxes. Their income from technology transfer will be exempt from business tax under the same conditions as the domestic enterprises.

(VIII). For foreign enterprises transferring technologies to the enterprises within China, if the technologies are advanced or the terms of conditions are favorable, with the approval of the tax authorities of the State Council, they can be exempt from business tax and enterprise income tax. Foreign-invested enterprises are exempt from business tax on the income from the technology transfer.

## **Appendix 6.E. Preferential Policies in Zhuhai of PRD**

### **Preferential Policies - Business Income Tax**

State regulations provide that the income tax for enterprises with foreign investment is 30% of the taxable income, yet those enterprises operating within the jurisdiction of Zhuhai municipality will enjoy a favorable tax rate of 15%.

Any enterprise with foreign investment in a production-based industry and contracted to operate for a period of not less than ten years shall, from the first year of profitability, be exempted from income tax for two years and have a further fifty percent tax exemption in the third to fifth years.

For enterprises that export their products (after the above-mentioned 5 year tax incentive period expires) the rate of corporate income tax shall be reduced if 70% or more of their total production is exported.

Technically advanced enterprises meeting the required standards can enjoy favorable corporate income tax, even after the above tax benefits expire.

Income tax for financial institutions such as foreign funded banks and/or joint venture banks, which are located in Chengdu, shall be levied at a reduced rate upon approval by tax authorities where foreign investment or operational capital from the head office to the Zhuhai branch exceeds US\$10 million and the contracted operating period exceeds 10 years.

Foreign investors who reinvest their profits/dividends from their enterprises in China for a period of or over 5 years can be refunded 40% of the tax they have paid on the reinvested amount. For reinvestment that is injected into an export-oriented enterprise or enterprise with advanced technology, all the income tax that was paid on the reinvested amount will be refunded.

Equipment imported by overseas-funded projects for their own use may be exempt from customs duties and import value added taxes, provided these projects are listed in the appropriate catalogue of eligible projects.

## **Appendix 6.F. Preferential Policies in Nanjing of YRD**

1. The enterprise income tax is levied at a reduced rate of 15% for the following enterprises.

- (1) Enterprises with foreign investment set up in Nanjing High and New Technology Development Zone (including 5 square kilometers in Jiangning Economic and Technological Development Zone) and identified as a high-tech enterprise;
- (2) Productive enterprises with foreign investment set up in Nanjing Economic and Technological Development Zone;
- (3) Technology intensive and intelligence intensive projects; projects with foreign investment over US\$ 30 million and with long investment recovery period; construction projects for energy, transportation and harbor.

2. The enterprise income tax for productive enterprises with foreign investment set up in urban areas of Nanjing is levied at a reduced rate of 24%.

3. The enterprise income tax due from productive enterprises with foreign investment with an operation term of 10 years or over is exempted for the first and second year, and levied at half rate for the third to the fifth year starting from the first profiting year.

4. The enterprise income tax due from Sino-foreign joint venture enterprises engaged in harbor and dock construction with an operation term of 15 years or over is exempted for the first to fifth year, and levied at half rate for the sixth to the tenth year starting from the first profiting year.

5. For banking institutions with sole foreign investment or Sino-foreign joint venture banks, the enterprise income tax due from those with foreign investment or operation capital allocated from head office to the branch exceeding US\$ 10 million, and with operation term of 10 years or over is exempted for the first year and levied at half rate for the second to third year starting from the first profiting year.

6. For product export enterprises run with foreign investment, after expiration of terms for enterprise income tax exemption and reduction according to taxation law, the enterprise income tax for those with export product output value in the current year of over 70% of the enterprise product output value during that year can be levied at half of the rate specified in the taxation law.

7. For enterprises with advanced technologies run with foreign investment, after expiration of terms for enterprise income tax exemption and reduction according to taxation law, the enterprise income tax for those continuing to be enterprises with advanced technologies can be levied at half of the rate specified in the taxation law for three more years.

8. In case foreign investors of enterprises with foreign investment directly invest the profits obtained from enterprises into the enterprise again as additional registered capital, or as capital investment to set up other enterprises with foreign investment with an operation period no less than 5 years, 40% of the enterprise income tax paid for the reinvested portion will be rebated; In case foreign investors make direct reinvestment to set up and expand product export enterprises or enterprises with advanced technology, with an operation period no less than 5 years, all enterprise income tax already paid for the portion of reinvestment will be rebated.

9. Starting from January 1, 2000, for any enterprises with foreign investment with technological development expense growing by 10% or more over the previous year, subject to approval by the taxation authority, it is permissible to offset the income tax payable during the current year with 50% of the actually incurred amount of technological development expense.

10. For any enterprise with foreign investment established in China that purchases equipment made in China within the total amount of investment, if the investment project falls into encouraged category in Guidance catalogue of industries for foreign investment as specified in the Notice of State Council on adjusting taxation policy on imported equipment?, except commodities included in Catalogue of imported commodities with no tax exemption for enterprises with foreign investment?, 40% of the investment for purchasing equipment made in China can be offset from the increased amount of enterprise income tax paid in the current year of purchasing the equipment over the previous year.

## Appendix 6.G. Preferential Policies in Suzhou of the YRD

### Start-up Procedure

Investors who wish to set up their operations in Suzhou Industrial Park may select from the following options:

- 1) Buy land to build their own factories;
- 2) Rent ready-built factories of different types, such as: Terrace Factory, Workshops, Freestanding Factory and Multi-storey Factory.

If the enterprise is export oriented, FDIs are advised to locate in Export Processing Zone (EPZ), where the above options are also available.

### Tax Incentives

The preferential tax incentives available to foreign manufacturing enterprises and infrastructure developers in the park are shown in the table below.

Corporate Income Tax	Tax Rate	Reduction/Exemption Policy
<b>Foreign Invested Enterprises of Manufacturing Nature</b>		
<b>General</b>	15%	Exempted from 3% Local Corporate Income Tax.
<b>Period of operation exceeds 10 years</b>	15%	As above. In addition, 2 years exemption plus 3 years half tax at the rate of 7.5% from the first profit-making year.
<b>Exporting enterprises</b>	15%	As above. After first 5 years of enjoying the additional tax incentive, if export value in any year exceeds 70% of output value, tax rate is reduced to 10%.
<b>Technologically advanced enterprises</b>	15%	As above. After first 5 years of enjoying the additional tax incentive, further 3 years of Corporate Income Tax rate at 10%.
<b>Others</b>		

<b>Enterprises developing harbors, wharves &amp; other infrastructure</b>	15%	If intended period of operation exceeds 15 years, exemption for 5 years from the first profit-making year and reduced tax rate of 7.5% for another 5 years.
<b>Financial Institutions with more than US\$10 million capital investment</b>	15%	Must exceed 10 years period of operation exemption for 1st profit-making year and reduced tax rate of 7.5% for another 2 years.
<b>Tax Rebates for Re-investments</b>		
<b>Re-investments in the same enterprise, or a new FIE</b>	40% Rebate	New FIE must have an operation period of more than 5 years; rebate amount is 40% of corporate income tax that has been paid on sum re-invested.
<b>Re-investment in export-oriented or advanced technology enterprises</b>	100% Rebate	New FIE must have an operation period of more than 5 years; 100% rebate on corporate income tax that has been paid on sum re-invested.
<b>Withholding Tax</b>		
<b>Dividends remitted to foreign shareholders</b>	0%	Complete Exemption
<b>Interests, rental, leasing payment, capital gains, or franchise fees</b>	10%	May be further reduced depending on Double Taxation Agreements signed between China and other countries after payment of 5% business tax

#### Appendix 6.H. Preferential Policy of Ningbo of YRD

1. Foreign-invested manufacturers in Ningbo can enjoy preferential reduced income tax rates of 24% or 15% according to the investment region and project type and those with an operational period of ten years or more can be exempted from corporate income tax for the first two years of profitability, plus a 50% reduction for the following three years.
2. Foreign-invested enterprises involved in agriculture, forestry and livestock operations, export-oriented enterprises and advanced technical enterprises can extend their tax-free or reduced-tax period upon approval after the above-mentioned preferred tax period expires.
3. Foreign investors can enjoy a drawback tax on reinvestment, income tax reduction or exemption on transfer of advanced technologies and instruments and income tax reduction or exemption on profits remitted abroad.

4. Instruments, tools or equipment for self-use within the total amount of investment can be imported on a value-added tax free basis, except the goods listed in the Catalogue of Non-Tax-Free imports for Foreign-invested Projects.

5. As for investment in projects that are encouraged by the government such as large foreign-invested projects, new and high-tech projects and development zones and industrial parks at all levels, particular preferential policies on land price and associated facilities are to be offered.

## **Appendix 6.I. Preferential Policy in Shanghai of YRD**

### **Local Tax Preferential Policy**

#### **1. Corporate Income Tax**

Foreign invested enterprises (Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures and wholly foreign-owned enterprises) as well as foreign enterprises which have established organizations on the mainland and are engaged in commercial activities are subject to corporate income tax at a rate of 30% and local income tax at a rate of 3%. Certain manufacturing foreign invested enterprises in Shanghai pay income tax at a reduced rate of 24%, and those in the economic and technological development zones of Shanghai and Pudong New Area pay income tax at a reduced rate of 15%.

#### **2. Value Added Tax, Consumption Tax and Business Tax**

##### **A. Value Added Tax**

Enterprises or individuals who sell commodities, engage in repair and maintenance or the import and export business in the territory of China are subject to a value added tax in line with Chinese laws. The standard rate for value added tax is 17%, but the rate for a few commodities such as grain, cooking oil, water, forage, fertilizer, pesticides, and farm machinery is 13%.

##### **B. Consumption Tax**

Producing, processing and/or importation of the following 11 commodities in the territory of China are subject to consumption tax: tobacco, alcoholic drinks or alcohol, cosmetics, skin and hair care products, jewellery, fireworks, gasoline, diesel, tires, motorcycles and/or cars. Consumption tax is calculated in two ways. One way is to calculate according to quantity (i.e. gasoline is RMB 0.20 per litre) and the other method is to set the tax rate according to the price or type of commodities (i.e. the rate for a car with an engine cylinder capacity under 2,200ml is 8%).

##### **C. Business Tax**

Enterprises or individuals whose businesses are in the sectors of transportation, post and telecommunication, finance and insurance, construction, art, sports, entertainment, and services are subject to business tax. The business tax rate is between 3% and 5%, with the exception of the entertainment sector which is between 10% and 15%.

#### **3. City Real Estate Tax**

Realty taxes are levied at an annual rate of 1.2% based on the original value of the real estate, after an

allowable 20% deduction. The tax rate is 12% on rental income. Buildings constructed by foreign-invested enterprises themselves or purchased by foreign-invested enterprises in the Pudong New Area and Economic and Technological Development Zones, shall be exempt from paying real estate tax for 5 years from the month of completion of construction or month of purchase.

#### **4. Individual Income Tax**

Individual income tax shall be levied on those who have income derived from working in any of the following service businesses in the territory of China: design, decoration, installation, drafting, chemical analysis, testing, medicine, law, accounting, consulting, lecturing, the press, radio broadcasting, translation, examination and checking of manuscripts, writing, painting, sculpture carving, movies and television, audio recording, video recording, performances, display, advertising, exhibition, technical services, introduction services, brokerage services, agency services and others. Taxable income is the remaining sum of the income after 800 RMB is deducted if the said income is under 4,000 RMB. If the said income is over 4,000 RMB, 20% of the income shall be deducted and the remaining sum is the amount taxable. The tax rate is 20%. If an individual's taxable income is over 20,000 RMB but under RMB 50,000, the tax rate on the portion of income which exceeds 20,000 RMB shall be increased by 50% from its original rate. The tax rate on the portion of income which exceeds 50,000 RMB shall be increased by 100% from its original tax rate.

### **Appendix 6.J. Preferential Policy in Wuxi of YRD**

#### **Preferential Policies Business Income Tax**

1. State regulations provide that the income tax for enterprises with foreign investment is 30% of the taxable income, yet those enterprises operating within the jurisdiction of Wuxi will enjoy a favorable tax rate of 15%.
2. Any enterprise with foreign investment in a production-based industry and contracted to operate for a period of not less than ten years shall, from the first year of profitability, be exempted from income tax for two years and have a further fifty percent tax exemption in the third to fifth years.
3. For enterprises that export their products (after the above-mentioned 5 year tax incentive period expires) the rate of corporate income tax shall be 10% if 70% or more of their total production is exported.
4. Technically advanced enterprises meeting the required standards can enjoy three more years at a rate of favorable corporate income tax of 10%, after the above tax benefits expire.
5. Foreign investors who reinvest their profits/dividends from their enterprises in China for a period of or over 5 years can be refunded 40% of the tax they have paid on the reinvested amount. For reinvestment that is injected into an export-oriented enterprise or enterprise with advanced technology, all the income tax that was paid on the reinvested amount will be refunded.
6. Equipment imported by overseas-funded projects for their own use may be exempt from customs duties and import value added taxes, provided these projects are listed in the appropriate catalogue of eligible projects.

### **Appendix 6.K. Preferential Policy of Hangzhou of YRD**

Any foreign-funded project, which meets the following conditions, shall be exempted from certain tariffs and import value-added tax:

1. Equipment imported for self use within the total investment of the foreign-invested projects, which transfer technologies under the Catalogue for the Guidance of Foreign Investment, shall be exempted from the tariff and import value-added tax.
2. Equipment imported for self use within the total investment of the domestic-funded projects, under the Current Catalogue of Key Industries, Products and Technologies the Development of Which Is Encouraged by the State, shall be exempted from the tariff and imports value-added tax.
3. Any project which is in accordance with the above-mentioned regulations, the technology, fittings and spare parts imported along with the equipment according to the contract, shall be also exempted from the tariff and import value-added tax.
4. Tax deductions and exemptions on imported equipment, which is not included in above-mentioned regulations, shall be decided by the State Council.

#### **Appendix 6.L Provisional Regulations on Value Added Tax of the People's Republic of China (October-27-2007)**

(Promulgated on the Order of the State Council [1993] No.134 On Dec. 13, 1993)

Article 1 An institution or individual engaged in marketing goods and/or providing processing, repair and/or replacements services within the territory of the People's Republic of China shall be a payer of value added tax (hereinafter referred to as "taxpayer") and shall pay value added tax (VAT) in accordance with these Regulations.

#### **Article 2 Rates of VAT**

- 1 · The rate of VAT on goods marketed or imported by a taxpayer shall be 17%, except for those provided in 2 and 3 of this article.
- 2 · The rate of VAT on the following goods marketed or imported by a taxpayer shall be 13%:
  - (1) Cereals, edible vegetable oils;
  - (2) Running water, central heating, air conditioning, hot water, gas, LPG, natural gas, methane gas, coal/charcoal products for household use;
  - (3) Books, newspapers, magazines;
  - (4) Feed, chemical fertilizer, chemical pesticides, agricultural machinery, and farm-use plastic sheets;
  - (5) And other goods stipulated by the State Council.
- 3 · The rate of VAT shall be zero on goods exported by a taxpayer, unless otherwise stipulated by the State Council.
- 4 · The rate of VAT shall be 17% on the processing, repair and/or replacements services (hereinafter referred to as taxable labor service) provided by a taxpayer and any readjustment thereof shall be determined by the State Council.

Article 3 For a taxpayer dealing in goods or providing taxable services taxable at different rates, the volumes of the sales of goods and taxable labor service at different tax rates shall be computed separately. The volumes of sales not computed separately for different rates of VAT shall be subject to the highest rate.

Article 4 The tax payable on goods marketed or taxable services provided by a taxpayer (hereinafter referred to as goods marketed or taxable services) shall be the amount of the current amount of tax on sales minus the current amount of tax on purchases, except for those provided under Article 13 of these Regulations. The formula shall be:

Tax payable = amount of tax on sales - amount of tax on purchases

In the event the amount of tax on sales is less than the current amount of tax on purchases and insufficient to offset the amount of tax on purchases, the balance shall be carried over to the next term to be further deducted.

Article 5 The amount of VAT assessed on the basis of the sales volume of goods and/or taxable services at the rate prescribed in Article 2 of these Regulations and collected from the buyer by the taxpayer shall be the amount of tax on sales. The formula shall be:

Amount of tax on sales = sales volume x VAT rate

Article 6 The sales volume shall be the total payment for the price of the goods sold and other charges in addition to the price of the goods collected from the buyer by the taxpayer selling goods or providing services taxable, but excluding the amount of tax on sales.

The sales volume shall be computed in RMB. The taxpayer shall convert the payment settled in a foreign currency into RMB for computation at the current exchange rate.

Article 7 Should the goods sold or services taxable provided by a taxpayer be at a conspicuously low price and without a proper reason, the tax authorities shall determine the sales volume thereof.

Article 8 The amount of VAT payable on goods or services taxable bought by the taxpayer (hereinafter referred to as goods and taxable services bought) paid or borne by the taxpayer shall be the amount of tax on purchases.

The amount of tax on purchases permitted to be deducted from the amount of tax on sales, in addition to those as provided by Article 3 of these Regulations, shall be limited to the amount of VAT payable indicated in the following tax credit vouchers:

1. The amount of VAT payable indicated on the special VAT invoices obtained from the seller;
2. The amount of VAT payable indicated on customs duties payment vouchers obtained from the customs house.

The amount of tax on purchases of tax-free agricultural products permitted to be deducted shall be computed on the basis of the purchase price and a 10% tax credit. The tax amount shall be computed by the following formula:

Tax amount on purchases = payment for the purchase x tax credit rate

Article 9 In case a taxpayer in purchasing goods or services taxable has not obtained or kept the voucher for VAT deduction or the VAT deduction document has not indicated the amount of VAT and the relevant matters in accordance with the regulations, the amount of tax on purchases shall not be deducted from the amount of tax on sales.

Article 10 The amount of tax on purchases of the following items shall not be deducted from the amount of tax on sales:

1. Fixed asset purchased;
2. Purchased goods or taxable services to be used in items not taxable;
3. Purchased goods or taxable services to be used in tax-free items;
4. Purchased goods or taxable services to be used for collective welfare or for personal consumption;
5. Purchased goods or taxable services abnormally damaged or lost;
6. Purchased goods or taxable services abnormally damaged and consumed in the course of making products or semi-finished products.

Article 11 A simplified system of computation of tax payable shall be applied to small-scale taxpayers engaged in selling goods or taxable services.

The norm for the scale of such taxpayers shall be determined by the Ministry of Finance.

Article 12 The VAT rate for small taxpayers engaged in selling goods or taxable services shall be 6%.

Any readjustment thereof shall be determined by the State Council.

Article 13 The amount of tax payable on the goods or taxable services which a small-scale taxpayer sells and is computed in accordance with the volume of sales and at the tax rate provided by Article 12 of these Regulations shall not be deducted by the amount of tax on purchases. The amount of tax payable shall be computed by the following formula:

The amount of tax payable = amount of sales x tax rate

The amount of sales shall be determined with reference to the provisions of Article 6 and Article 7 of these Regulations.

Article 14 A small-scale taxpayer using a sound accounting assessment system and capable of producing documents indicating his accurate performance of tax obligations may not be deemed as a small-scale taxpayer with the approval of the relevant tax authorities and the amount of tax payable thereof may be computed in accordance with the relevant provisions of these Regulations.

Article 15 The tax payable on goods imported by a taxpayer shall be computed on the basis of the composite assessable price and the tax rate provided in Article 2 of these Regulations that shall allow no deduction by the amount of tax on purchases. Formulae for the composite assessable price and tax amount payable are as follows:

Composite assessable price = customs dutiable value + customs duty + consumption tax

Tax amount payable = composite assessable price x tax rate

Article 16 The following items are free from VAT:

1. Agricultural products sold by farmers themselves;
2. Contraceptive medicine and tools/devices;
3. Old books;
4. Imported instruments and meters to be used directly in scientific research and experiments and/or teaching;
5. Imported goods and equipment granted gratis by foreign governments or international organizations;
6. Equipment needed for processing with supplies provided, assembling with parts provided and other compensation trade;
7. Goods imported by organizations of the handicapped and to be used only for the handicapped;
8. Used articles sold by the user(s).

Except for the above-listed, any item for VAT exemption or reduction shall be determined by the State Council. No locality or department shall determine any item for VAT exemption or reduction.

Article 17 A taxpayer dealing also in items entitled to tax exemption or reduction shall be subject to separate computation of the sales volumes of those items entitled thereto; and no tax exemption or reduction shall be granted to those items without separate computation of the sales volumes thereof.

Article 18 When a taxpayer's sales volume is below the starting point of VAT, it is free from VAT.

Article 19 The time at which VAT payable shall arise:

1. For sales of goods or taxable services, on the day the payment for the sales is collected or the bill payable for the sales is collected.
2. For imported goods, the day the import is declared at the customs house.

Article 20 VAT in general shall be collected by tax authorities and VAT on imports shall be collected by the customs house in behalf of the tax authorities.

VAT on imported goods for personal use carried on by the user or mailed in shall be collected together with the customs duties. A detailed procedure thereof shall be formulated by the Tax Rules Committee of the State Council together with the relevant departments.

Article 21 A taxpayer selling goods or taxable services shall issue to the buyer special VAT invoices and indicate thereon the sales volume and the tax amount payable on the sales.

A general invoice instead of a special VAT invoice shall be issued whereupon an invoice is need in one of the circumstances cited below:

1. Selling goods or taxable services to a consumer;
2. Selling tax-free goods;
3. When a small-scale taxpayer sells goods or taxable service.

Article 22 Locations for paying VAT:

1. An owner of a fixed business operation shall file tax returns to the local tax authorities. When the head office and subsidiaries are located at different counties (cities), they shall file tax returns to their respective local tax authorities for tax payment; or with the approval of the State Administration of Taxation or the tax bureaus authorized thereby, the head office may file tax returns for the head office and subsidiaries to the local authorities of the head office for tax payment.

2. When the owner of a fixed business operation sells goods at another county (city), it shall apply to the tax authorities of its residence for a certificate confirming the tax administration over its out-port business operation and file tax returns to the tax authorities of its residence. Without a certificate for sales operation issued by the tax authorities of its residence, the owner of the business shall file tax returns to the tax authorities of the locality of its outport business for tax payment; and if the taxpayer fails to do so, the tax authorities of its residence shall levy the tax in arrears.

3. Owners of mobile business operations shall file tax returns to the tax authorities of the localities of the sales for tax payment.

4. For imported goods, the importer or its agent shall file tax returns to the customs house where import declaration is made.

Article 23 The prescribed time limit for paying VAT shall be one day, three days, five days, ten

days, 15 days or one month. The prescribed time limit to tax payment for a taxpayer shall be defined by the tax authorities in the light of the tax amount, and in case tax cannot be paid within the time limit, the taxpayer may pay tax on each transaction.

When a taxpayer's time allowance for tax payment is one month, he shall file tax returns within ten days after expiration of the time limit; if the term is one day, three days, five days, ten days or 15 days, the taxpayer shall make an advance payment within five days after the expiration of the term and file tax returns and clear the tax payable of the previous month within ten days beginning on the first day of the succeeding month.

**Article 24** A taxpayer shall pay VAT on imported goods within seven days beginning the next day of the issuance of the tax-paying certificate by the customs house.

**Article 25** If the goods a taxpayer exports enjoys zero VAT, the taxpayer shall complete the export procedure with the customs house and with the export declaration document apply to the tax authorities for reimbursement of the tax paid thereon at the end of each month. The concrete procedure thereof shall be formulated by the State Administration of Taxation. If the exported goods are returned or withdrawn from the customs house after the VAT thereupon has been reimbursed, the taxpayer shall pay back the reimbursed tax to the tax authorities in accordance with the law.

**Article 26** The collection and administration of VAT shall follow the relevant provisions of the Law of the People's Republic of China on the Administration of Tax Collection and these Regulations.

**Article 27** VAT shall be levied from enterprises with foreign investment and foreign enterprises in accordance with the relevant resolutions of the Standing Committee of the National People's Congress.

**Article 28** The Ministry of Finance shall be responsible for the interpretation of these Regulations and formulate the Rules for the implementation thereof.

**Article 29** These Regulations shall go into effect as from January 1, 1994. The "Regulations of the People's Republic of China on Value Added Tax"(Draft) and the "Regulations of the People's Republic of China on Product Tax" (Draft) promulgated by the State Council on September 18, 1984 shall be abrogated therefrom.

#### **Appendix 6.M Income Tax Law of the People's Republic of China on Enterprises with Foreign Investment and Foreign Enterprises (October 27, 2007)**

(Adopted at the 4th Session of the 7th National People's Congress on April 9, 1991  
and promulgated on the same day on Order No. 45 of the President of the People's  
Republic of China)

**Article 1** Enterprises with foreign investment in the People's Republic of China shall pay income tax on their income from production, business operations and other sources in accordance with the provisions of this Law.

Foreign enterprises shall pay income tax on their income from production, business operations and other sources within the territory of the People's Republic of China in accordance with the provisions of this Law.

Article 2 "Enterprises with foreign investment" mentioned in this Law refer to Chinese-foreign equity joint ventures, Chinese-foreign cooperative enterprises and foreign-funded enterprises set up within the territory of China.

"Foreign enterprises" mentioned in this Law refer to those foreign companies, enterprises and other economic organizations which have set up establishments and sites engaged in production or business operations in China, and which, though without establishments and sites set up in China, have income from sources in China.

Article 3 Enterprises with foreign investment with head offices set up in China shall pay income tax on their income from sources in and outside China. Foreign enterprises shall pay income tax on income from sources in China.

Article 4 The taxable income of an enterprise with foreign investment or a foreign enterprise with establishments or sites set up and engaged in production or business operations in China shall be the remaining amount out of its gross income in a tax year after the costs, expenses and losses have been deducted.

Article 5 The enterprise income tax to be paid by an enterprise with foreign investment and the enterprise income tax to be paid by a foreign enterprise on the income of its establishments or sites set up and engaged in production or business operations in China shall be assessed on the taxable income at the rate of 30% and a local income tax shall be assessed on the taxable income at the rate of 3%.

Article 6 Pursuant to China's industrial policies, the State shall give guidance to foreign investors on their investment orientation and encourage foreign invested enterprises that adopt advanced technology and equipment and export all or the greater part of their products out of China.

Article 7 Those enterprises with foreign investment in special economic zones, those foreign enterprises with establishments and sites set up and engaged in production or business operations in special economic zones and those foreign-invested manufacturing enterprises in economic and technological development zones shall pay enterprise income tax at the reduced tax rate of 15%.

Those foreign-invested manufacturing enterprises set up in open coastal economic zones, and in the old urban districts of cities with special economic zones and cities with economic and technological development zones shall pay enterprise income tax at the reduced tax rate of 24%.

Those enterprises with foreign investment set up in open coastal economic zones, and in the old urban districts of cities with special economic zones and cities with economic and technological development zones or in other districts prescribed by the State Council and engaged in energy, transportation, ports, docks and other undertakings, which are encouraged by the State, shall pay enterprise income tax at the reduced tax rate of 15%, and the concrete procedure thereof shall be defined by

the State Council.

Article 8 A foreign-invested manufacturing enterprise scheduled to operate for at least 10 years shall be exempted from income tax in the first two years beginning from the year when it begins making profit and shall pay income tax at a 50% discount in the third year through the fifth year, but for those exploiting petroleum, natural gas, rare metals, precious metals and other similar natural resources, the specific provisions on the collection of enterprise income tax shall be formulated by the State Council separately. If an enterprise with foreign investment fails to operate for a full 10 years, it shall repay the amount of income tax already reduced or exempted.

Those regulations promulgated by the State Council prior to the implementation of this Law, that provide preferential treatment of a longer period of income tax reduction or exemption than the provisions in the previous paragraph of this Law to projects of energy, transportation, ports, docks and other important manufacturing projects or preferential treatment of enterprise income tax reduction or exemption to major non-manufacturing projects shall continue to be implemented after this Law comes into effect.

After the term for tax reduction or exemption provided in the previous two paragraphs has expired, those enterprises with foreign investment engaged in agriculture, forestry and animal husbandry and those set up in remote and economically underdeveloped regions may continue to enjoy a 15% to 30% reduction of the enterprise income tax in the succeeding 10 years provided that their applications are approved by competent tax authorities under the State Council.

In case any alteration of the provisions regarding reduction and exemption of enterprise income tax in the previous three paragraphs is required following the implementation of this Law, it shall be reported by the State Council to the Standing Committee of the National People's Congress to determine.

Article 9 The people's governments of the provinces, autonomous regions and municipalities directly under the State Council may decide in light of the local reality on reduction and exemption of local income tax on those industries and items in which foreign investors are encouraged to make investment.

Article 10 When a foreign investor of an enterprise with foreign investment makes direct reinvestment in the enterprise with the profit obtained from the enterprise, thereby increasing the registered capital thereof or use the profits from the enterprise to establish another enterprise with foreign investment with a scheduled operational period of no less than five years, the foreign investor may get a refund of 40% of the income tax already paid on the reinvested portion of income upon approval of application by the tax authorities, or enjoy preferential treatment otherwise prescribed by the State Council. If the reinvestment is withdrawn in less than five years, the refunded tax payment shall be paid back to the tax authorities.

Article 11 Losses sustained by enterprises with foreign investment or the establishments and other setups in China of foreign enterprises engaged in production or business operation may be made up for from the income of the next tax year; and if the income of the next tax year is insufficient to make up for the loss, it may continue

year by year for no more than five years.

Article 12 When an enterprise with foreign investment is allowed to pay on a consolidated basis the tax on an income from a source outside China of which the income tax has been paid outside China, that income tax shall be allowed to be deducted from the tax amount, but the deduction shall not exceed the tax amount assessed on his income from an overseas source in accordance with the provisions of this Law.

Article 13 When an enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations makes or collects payments for sales of goods and charges in business exchanges with its associated enterprises, it shall conduct those dealings as though among independent enterprises. If such payments and collections are not done as those among independent enterprises thus causing a decrease in the taxable income thereof, the tax authorities shall have the power to make appropriate adjustments.

Article 14 An enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations shall apply to the Administration of Industry and Commerce for registration, or alteration or cancellation thereof on account of the establishment, movement, merger, separation, termination or alteration of the principal items in the registration and then bring the relevant documents to the local tax authorities for tax registration or alteration or cancellation thereof.

Article 15 The enterprise income tax and local income tax shall be assessed on an yearly basis and quarterly advances thereof shall be paid within 15 days after the end of each quarter and settlement of the income tax shall be made with surplus returned and deficit made up within five months after the year-end.

Article 16 An enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations shall file tax returns with the local tax authorities within the prescribed time limit for advance tax payment and file year-end tax returns and accounting statements of final settlement within four months after the year-end.

Article 17 An enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations shall report its financial system and accounting system to the local tax authorities for the record and examination. The accounting records it provides should be complete and accurate and bookkeeping should be based on legitimate vouchers.

If the financial and accounting basis of an enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations is found at variance with the relevant taxation regulations of the State Council, income tax shall be assessed in accordance with the relevant taxation regulations of the State Council

Article 18 If the net asset or the remnant asset of an enterprise with foreign investment remaining exceeds the actually contributed capital after undivided profits, funds and

expenses are deducted at the time of liquidation, the balance shall be the liquidation gain liable to income tax in accordance with the provisions of this Law.

Article 19 If a foreign enterprise with no establishment or other setup in China has obtained profits, interests, rentals, royalties and other income from sources in China or it has establishments or other setups in China but has obtained the above cited income from sources without any connection with those establishments or setups, it shall pay an enterprise income tax at the rate of 20%.

With regard to the income tax payable in accordance with the provisions in the previous paragraph, the actual beneficiary shall be the taxpayer and the payer of those payments shall be the tax withhold(s). The payer shall withhold tax from every payment made. Each withhold shall hand to the state treasury each withholding within five days and file a tax withholding statement to the local tax authorities.

Tax reduction or exemption shall be applicable to the incomes listed below:

1. Profits a foreign investor obtains from an enterprise with foreign investment are free from income tax,
2. Interests an international financial organization obtains from loans to the Chinese government or to Chinese national banks are free from income tax,
3. Interests a foreign bank obtains from loans of preferential interest rates to the Chinese national banks are free from income tax, and
4. The royalties from technical know-how used in scientific research, exploitation of energy, development of transportation, production of agriculture, forestry or animal husbandry or the development of major technologies shall be eligible for the reduced rate of 10% of income tax upon approval by the competent tax authorities under the State Council, and royalties from advanced technology or which are obtained with special favor shall be exempt from income tax.

Besides those cited above, any tax reduction or exemption to be granted to income from profits, interests, rentals, royalties and other sources shall be determined by the State Council.

Article 20 Chinese tax authorities have the right to inspect the financial state, accounting and performance of tax payment of an enterprise with foreign investment or an establishment or setup in China of a foreign enterprise engaged in production or business operations and to inspect the situation of tax withholdings by tax withholders. The institutions or individuals being inspected shall provide the necessary information and shall not refuse the inspection or conceal information.

Tax inspectors sent by the tax authorities shall display identification and shall be responsible for the confidentiality of the information they have come into contact with.

Article 21 Income tax shall be paid in RMB in accordance with the provisions of this Law. Payment of income tax on income in a foreign currency shall be converted into

the local currency at the official exchange rate quoted by the state exchange control department.

Article 22 When a taxpayer fails to pay income tax in the prescribed time limit or a withholder fails to hand over to the state the withholding in the prescribed time limit, the tax authorities shall set a time limit for the payment thereof and levy a daily fine on the deferral at the rate of 2% from the day payment deferral begins.

Article 23 In the event of failure to make tax registration or alter or cancel tax registration with the tax authorities in the prescribed time limit, or failure to file tax returns, final accounting settlement statements or tax withholding statements to the tax authorities in the prescribed time limit, or failure to provide the tax authorities with the financial and accounting system of its enterprise for inspection, the tax authorities shall set a time limit to the procedure and impose a fine up to five thousand yuan.

Failure to make, alter or cancel tax registration with the tax authorities in the prescribed time limit, or to file tax returns, final accounting settlement statements or tax withholding statements to the tax authorities in the prescribed time limit despite the demand of the tax authorities for registration or submission of the documents within a prescribed time limit shall merit a fine up to 10,000 yuan imposed by the tax authorities, and if the case is grave, criminal responsibilities of the legal representative and the person with direct responsibility shall be sought with reference to Article 121 of the Criminal Law of China.

Article 24 In case a tax withholder fails to perform its obligation as provided in this Law and fails to withhold the tax payable or withholds only part of the tax payable, the tax authorities shall have it make up for the part of the tax not withheld within an imposed time limit and may in the meanwhile impose a fine no more than twice the amount of the tax not withheld.

In case a tax withholder fails to hand over the withheld tax payment to the state treasury in the prescribed time limit, the tax authorities shall make it hand over the withholding within the prescribed time limit and may in the meanwhile impose a fine of up to 5,000 yuan; in case the withholder still fails to hand in the money in time, the tax authorities shall pursue the tax payment and impose a fine of up to 10,000 yuan; and if the case is grave enough, the criminal responsibility of its legal representative and the person with direct responsibility shall be sought with reference to the provisions of Article 121 of the Criminal Law of China.

Article 25 In the case of tax evasion by concealment or deception, or failure of paying tax within the prescribed time limit as provided in this Law, and payment is still refused within the time limit despite the urge by the tax authorities, the tax authorities shall pursue the payment of the tax payable and impose a fine up to five times the tax amount unpaid; and in a grave case, the criminal responsibility of the legal representative and the person with direct responsibility shall be sought in accordance with the provisions of Article 121 of the Criminal Law of China.

Article 26 In case of a dispute with the tax authorities over tax payment, an enterprise with foreign investment or a foreign enterprise or a tax withholder shall pay the tax in

accordance with the relevant regulations before appealing to the higher tax authorities for reconsideration within 60 days after the reception of the tax invoice issued by the tax authorities. If the enterprise with foreign investment, foreign enterprise or tax withholder is not reconciled to the decision by the higher tax authorities, it may bring the case to a people's court within 15 days from the day the decision on reconsideration arrives.

If the party in question is not reconciled to the penalty imposed by the tax authorities, it may appeal to the higher tax authorities for reconsideration within 15 days on the day the notification of the penalty arrives. If the party concerned is still not reconciled to the decision of the reconsideration, it may bring the case to a people's court within 15 days from the day the notification of the decision of the reconsideration arrives. The party may directly bring the case to a people's court within 15 days from the day the decision on penalty is notified. If the party concerned fails to appeal for reconsideration or to bring the case to a people's court within the prescribed time limit and refuses to accept the penalty, the authorities that mete out the penalty shall request the people's court to enforce the penalty.

Article 27 Wherever an enterprise with foreign investment that has been founded before the promulgation of this Law finds the rate of income tax provided by this Law is higher or the preferential treatment to tax reduction or exemption poorer than that before the promulgation of this Law, the law and the relevant regulations of the State Council prior to the promulgation of this Law shall prevail in the term of operation already approved; if there is no approved term of operation, the law and the relevant regulations of the State Council prior to the promulgation of this Law shall prevail in the term prescribed by the State Council. The specific rules thereof shall be formulated by the State Council.

Article 28 Wherever the provisions of taxation agreements the government of the People's Republic of China has signed with foreign governments are found at variance with the provisions of this Law, the provisions of those agreements shall prevail.

Article 29 The State Council shall formulate the rules for the implementation of this Law.

Article 30 This Law shall come into force as of July 1, 1991. The "Income Tax Law of the People's Republic of China concerning Chinese-Foreign Equity Joint Ventures" and the "Income Tax Law of the People's Republic of China concerning Foreign Enterprises" shall be abrogated therefrom.

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