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"Like Fish in Water": Taiwanese Investors in a Rent-Seeking Society

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This paper examines Taiwanese investment in Jiangsu province where the largest Taiwanese investment in mainland China is concentrated. It is designed to help us better understand the dynamics of the political economy in China's transformation, especially how state policies work at the local level. It also provides an opportunity to observe how local agents of the state interact with small investors from Taiwan. The main argument is that the surge of Taiwanese investment into mainland China has been facilitated by the flexibility of Taiwan's unique industrial organization as well as shared cultural understanding and language affinity with local agents on the mainland. While not guaranteeing the success of investment projects, these factors do help lubricate the establishment of interpersonal networks and lower transaction costs. These are especially important given the institutional environment of a rent-seeking society in mainland China in which exchanges depend largely on the cooperativeness of local officials. Being familiar with similar experiences back in Taiwan, Taiwanese small investors have a clear advantage in cutting deals with local officials, often through various informal ways.

KEYWORDS: particularistic contracting; rent-seeking society; transaction costs; local agents; networks

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There have been tremendous investment flows from Taiwan to mainland China since the late 1980s despite continuing tensions between the

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two sides of the Taiwan Strait. This paper argues that the surge of Taiwanese investment into mainland China should be analyzed within the context of China's policy of reform and opening-up to the outside world. While most analyses of Taiwanese investment in mainland China emphasize cultural and linguistic links,[1] the analyses are usually narrow and lack sophistication. Cultural and linguistic affinities are certainly important factors for economic interactions across the Taiwan Strait; the usefulness of these factors can be better understood, however, as tools of communication that can effectively lower transaction costs and facilitate the establishment of interpersonal networks and business exchanges. This is especially important given the institutional environment of a rent-seeking society as a consequence of certain peculiar aspects of China's reform policies.

"Particularistic Contracting" and Rents

The core of China's reforms since the late 1970s was the "fiscal contractual responsibility system." In 1980, this system took the form of "sharing revenues and assigning responsibilities according to levels of administration," by which the central and local governments divided their revenues according to the revenue sources and ownership of enterprises. The key to this fiscal responsibility reform has been in profit-retention and profit-sharing arrangements. Like enterprises, local governments have been allowed to retain surplus revenue after paying a negotiated share of local taxes to the central government (mostly taxes on state and collective industries that constitute the core of the "within-budget revenues" [*yusuannei zijin*]). By the mid-1980s, all subnational levels of governments were subject to a bottom-up revenue-sharing system that required localities to submit a certain portion of their revenues to the upper levels of governments and then allowed them to retain all, or at least most, of the remainder.

[1] Wu Jieh-min, "*Guanxi* Across the Balance Sheet and the Taiwan Strait: Political Connections, Economic Structures, and Chinese Societies" (Paper presented at the Annual Meeting of the Association for Asian Studies, Chicago, March 13-16, 1997); Cen Huang, "The Organization and Management of Chinese Transnational Enterprises in South China," *Issues & Studies* 34, no. 3 (March 1998): 51-70.

Through this scheme, the central government endowed local governments with greater fiscal autonomy as well as financial responsibility. In a similar fashion, various profit-sharing arrangements were also made between local governments and firms, usually at a set rate for a fixed period of time ranging from three to five years.[2]

These fiscal contracts have taken a number of forms, with one of the most favorable being that given to Guangdong and Fujian provinces in the early 1980s. This form was one where the central government committed itself to a fixed amount of tax payments from the two provinces for five years (see table 1). In contrast, Tianjin, Jiangsu, and Shanghai were reduced to the role of "milk cows." They were required to turn over 60.5, 61, and 74 percent of their respective revenues to the central government. Other provinces signed a variety of contracts based on their financial status and political connections, which usually included a fixed sum plus some formula for sharing revenues collected above a targeted level.

While succeeding in strengthening the incentives for local governments to promote rapid economic development and maintain a high investment level, fiscal contracting exacerbated the problem of incentive incompatibility between different levels of governments. This dynamic interaction between the central and local governments over the division of financial resources has quickly taken on a different character as local governments and bureaucrats increasingly subordinate other objectives to the need to maintain a steady flow of revenues. Given the sustained erosion of industrial profitability within the state sector, the central government has adjusted its policies several times since 1985 in order to stabilize the upward flows of revenues. A main method used has been the fixing of deliveries through the scheme of long-term profit contracting.

In 1985, the fiscal contract system was revised and revenue was formally divided into three parts: two allotted to the central and provincial administrations respectively and one divided between them. Three years

[2]Jean C. Oi, "Fiscal Reform and the Economic Foundations of Local State Corporatism," *World Politics* 45, no. 1 (October 1992): 103, 111, 113, 118; Jean C. Oi, "The Role of the Local State in China's Transitional Economy," *The China Quarterly*, no. 144 (December 1995): 1137, 1145.

Table 1
Revenue Sharing Between the Central and Provincial Governments: 1985-90 and 1988-90

Province/ Municipality/ Region	Retention Ratio of the Budgetary Revenue Collected (%)		Amount Transferred to/from [–] the Center (million *yuan*)		Extrabudgetary Revenue as % of the Budgetary Revenue
	1985-90	1988-90	1985-90	1988-90	1987
Beijing	48.2	50 (4%)[a]	–	–	93.8
Tianjin	39.5	46.5	–	–	68.5
Shanghai	26.0	–	–	10,500	58.6
Jiangsu	39.0	41.0 (5%)	–	–	78.0
Zhejiang	55.0	61.5 (6.5%)	–	–	75.1
Shandong	59.0	–	–	289	96.7
Hebei	69.0	70.0 (4.5%)	–	–	89.2
Shanxi	97.5	87.55	–	–	100.9
Liaoning	51.5	58.3 (3.5)	–	–	95.9
Heilongjiang	96.0	–	–	299	85.1
Anhui	80.1	77.5	–	–	79.5
Henan	81.0	80.0 (5%)	–	–	59.7
Hubei	66.5	–	–	–4.78%	67.9
Hunan	88.0	–	–	800.0 (7%)[b]	84.4
Sichuan	89.0	–	–	–10.7%	94.5
Guangdong	–	–	+772	1,413 (9%)	70.1
Fujian	–	–	+235	–50	79.5
Jilin	–	–	–397	–107	111.7
Jiangxi	–	–	–239	–45	94.0
Shaanxi	–	–	–270	–120	100.9
Gansu	–	–	–246	–	83.2
Inner Mongolia	–	–	–1,783	–1,842	128.9
Guangxi	–	–	–716	–608	93.1
Guizhou	–	–	–743	–742	68.4
Yunnan	–	–	–637	–673	76.5
Xizang	–	–	–750	–898	–3,550.0[c]
Qinghai	–	–	–611	–656	155.0
Ningxia	–	–	–494	–533	117.1
Xinjiang	–	–	–1,450	–1,529	113.8
Hainan	–	–	–	–138	–

Notes:

[a]Guaranteed revenue growth in the sense that the regions are required to make up the loss in case of a shortfall.

[b]Annual growth rate.

[c]Budgetary revenue was –4 million *yuan* and the extrabudgetary revenue was 142 million *yuan.*

Source: Leroy Jin, *Monetary Policy and the Design of Financial Institutions in China, 1978-90* (Oxford: St. Martin's Press, 1994), 133-34.

later, in 1988, the financial-taxation arrangements were diversified, and six different formulae were applied to different provinces and municipalities. The formulae were conceived as follows: (1) the percentage of revenues that local governments can retain is proportional to revenue increments; (2) the share of revenue between the central and local governments is based on a fixed proportion; (3) apart from the fixed proportional share, local governments must share revenue increases with the central authorities; (4) local administrations must turn over a fixed amount of revenue but the amount increases annually by a certain percentage (9 percent for Guangdong and 7 percent for Hunan); (5) the amount to be turned over is fixed regardless of changes in local revenues; and (6) the amount of state subsidies to poor regions is fixed irrespective of fluctuations in their local revenue.[3]

Since not all revenues collected by a locality are subject to revenue sharing, the better the financial performance of enterprises and the faster the economic growth of the area, the greater the annual increase will be in the revenues available to the government jurisdiction. Therefore, this fiscal contract system has provided an economic foundation for rapid, local government-led growth—especially at the county, township, and village levels—by giving officials both the incentive and the investment funds needed to become effective promoters of local industrialization.

In addition to incentives concerning budgetary revenues, even stronger incentives are provided by extrabudgetary revenues (*yusuanwai zijin*), which are not shared with higher levels of governments. There has always been in Chinese fiscal practice a category named "extrabudgetary funds" that was not part of the budget renegotiated annually for each jurisdiction. Before the 1980s, this type was primarily composed of depreciation funds—a fixed residual that remained with the locality and provided a pool of funds that could be recirculated to enterprises in the form of grants for the renovation of capital equipment. The fiscal reforms of the 1980s created new sources of extrabudgetary funds that were not to be counted as

[3]*Zhongguo caizheng nianjian 1992* (Financial yearbook of China 1992), 151-52; *People's Daily*, June 14, 1993, 1; *China News Analysis*, no. 1508 (April 15, 1994): 3.

part of the revenue base to which fiscal contracts would apply and that therefore accrued wholly to the local jurisdiction. These included a new set of local taxes, a series of new nontax levies upon local enterprises which range from management fees, aid to agriculture funds, to various kinds of miscellaneous charges and fees.[4] Reports held that the level of taxation is "flexible" while "charges" are rigid.[5]

The additional incentive these extrabudgetary funds provided for local governments can be gauged from their explosive growth after early 1980. Between 1987 and 1991, provincial extrabudgetary funds increased by almost 60 percent—from 202.88 billion *yuan* to 324.33 billion *yuan*. Equal to only 20 percent of the national budget in the early 1980s, extrabudgetary funds grew to the same size as the national budget by the end of the decade. As the great majority of these funds accrued to local government coffers, their growth indicated a shift toward local fiscal power at the expense of the center. Except for 1985, the state budget was in the red throughout the 1980s. By 1993, the deficit stood at a record 20.5 billion *yuan* and the proportion of total government revenue controlled by the central government fell from an average of 50 percent in the decade before the reform to 28 percent in the next decade.[6]

While these reform measures have laid the foundation for rapid economic growth, the resulting investment and import hunger also brought about a desperate need for foreign exchange. In 1988, after five consecutive years of trade deficits and encouraged by the success of special economic zones (SEZs) in Guangdong and Fujian, China decided to further liberalize its foreign investment regime to encourage export expansion via

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[4]See note 2 above; Jean C. Oi, *Rural China Takes Off: Incentives for Industrialization* (Berkeley: University of California Press, 1999); Christine Wong, "Fiscal Reform and Local Industrialization," *Modern China* 18 (1992): 197-227; Wan Jieqiu, *Zhengfu tuidong yu jingji fazhan: Sunan moshi de lilun sikao* (State initiative and economic development: Theoretical reflections on the southern Jiangsu model) (Shanghai: Fudan daxue chubanshe, 1993), 107-8.

[5]*China News Analysis*, no. 1508 (April 15, 1994): 3.

[6]Wang Shaoguang, "The Decline of Central State Fiscal Capacity in China," in *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary*, ed. Andrew G. Walder (Berkeley: University of California Press, 1995), 87-113; Deng Yingtao et al., *Zhongguo yusuanwai zijin fenxi* (Analysis of China's extrabudgetary funds) (Beijing: Renmin daxue chubanshe, 1990).

the "grand international circulation" policy endorsed by then party general secretary Zhao Ziyang. As part of the shift toward this new strategy, some of the special provisions to attract foreign direct investment (FDI) that had been previously available only in the four SEZs were made much more widely available. For example, special tax concessions, liberalized land leasing, and other inducements were made available across the country. China also opened up sectors such as retailing, power generation, port facilities, and real estate development that had previously been off limits for foreign investors.[7]

Also decentralized to local governments is the authority to approve foreign investment projects (especially in trade and investment zones), tax rates for foreign-invested firms, export subsidies, allocations of foreign exchange at official rates, and access to the foreign exchange swap markets. The county government has full power to authorize projects over US$3 million; higher-ranking municipal authorities have the right to approve projects involving as much as US$10 million.[8] Municipal and county governments can, for instance, also issue import/export licenses, set up independent customs services, make grants of industrial and residential land for parcels under a certain size, and offer favorable investment conditions for foreign firms. In addition, local governments are now allowed to retain most of their foreign exchange earnings. Under these reforms, local officials have strong incentives to attract foreign investment in order to earn both foreign exchange and individual payoffs extracted via their approval authority.[9]

One peculiar feature of Chinese reform policies is what Susan Shirk has called "particularistic contracting"—preferential treatment given to selected localities and policies designed as ad hoc arrangements to be negotiated by different levels of governments for each individual unit or set

[7]Nicholas R. Lardy, *China in the World Economy* (Washington, D.C.: Institute for International Economics, 1994), 63-71; Nicholas R. Lardy, "The Role of Foreign Trade and Investment in China's Economic Transformation," *The China Quarterly*, no. 144 (December 1995): 1067.

[8]Susan L. Shirk, *How China Opened Its Door: The Political Success of the PRC's Foreign Trade and Investment Reforms* (Washington, D.C.: Brookings Institution Press, 1994), 53.

[9]Ibid., 31.

of funds. This type of selectivism can be identified in all fiscal, industrial, and foreign trade and investment reforms introduced since 1978. In terms of foreign exchange, for example, retention deals awarded to the SEZs and their home provinces were also unusually generous. The SEZs were allowed to retain all of the hard currency they earned from trade, in contrast to the average of 25 percent allowed other localities. Guangdong and Fujian also were granted special foreign exchange retention rates higher than those for other provinces.[10]

This selectivism is regarded as unfair to other provinces and the granting of special rights to particular provinces only fueled demands from other areas. Since political patronage could generate lucrative rents, how one is treated under the policy can make a world of difference. Hence the popular saying "policy is money" replaced the previous "time is money" throughout the 1980s and 1990s. This practice has continued even after the introduction of the "tax assignment system" in 1994. For example, in 1994 Guangdong's share of the national gross domestic product (GDP) was 9.4 percent, its provincial revenue income was 29.87 billion *yuan*, and its expenditures were 41.68 billion *yuan*. The deficit of 11.81 billion *yuan* was met by tax returns from the central government to Guangdong. In the same year, Jiangsu's share of the national GDP was 9.0 percent. Provincial revenue income was 29.34 billion *yuan* while its expenditures were 20.02 billion *yuan*, the latter being less than half that of Guangdong's.[11] Instead of receiving tax returns from the central government, Jiangsu was required to hand over 9.32 billion *yuan* to the center. This is a clear case of particularism generating totally different results. In the 1985-90 settlement, Jiangsu had to hand over to the central government 61 percent of its revenues. Even though its fiscal burden was slightly reduced during the 1988-90 settlement, the province still had to turn over 59 percent of its revenues to the center. For some of Jiangsu's major cities, the fiscal burden is even worse. For example, under the 1988-90 formula, Suzhou city had

[10]Ibid., 32-38.

[11]In 1995, the figures were 35.01 billion and 25.35 billion *yuan*, respectively; in 1996, they were 42.80 billion and 31.10 billion *yuan*, respectively.

to turn over 83.73 percent of its revenues; for Wuxi, 86.36 percent; and for Changzhou, 81.51 percent. In 1994, with almost the same level of GDP, the per capita income of Guangdong was 25 percent higher than that of Jiangsu.[12] In another example, in 1989 the city government of Wuhan in central China turned over to the state 50 million *yuan* of land-user tax collected from firms under its jurisdiction at a time of tremendous economic difficulty.[13]

Under conditions where the legal contractual framework is weak and increasing financial burdens are being bestowed on their shoulders, local governments and entrepreneurs can only resort to continuing bargains with the central government and to seek policy patronage because being chosen as a reform "experiment" or obtaining generous foreign exchange retention rates could mean windfall gains. As Shirk argues, upon seeing the economic benefits that Guangdong, Fujian, and the SEZs received from exports and joint ventures, officials from other provinces knew that they could not compete with the SEZs and their provinces for foreign business partners or export markets unless they were granted similar discretion over tax rates, preferential rates of revenues, and foreign exchange retention and other special privileges.[14]

With little incentive to increase revenue, those with no powerful patrons at the top could only devise various ways to divert revenues into extrabudgetary funds. While the central government has complained loudly about these illicit practices, in actuality at blame should be the central government's own unprincipled way of making policies—the "particularistic contracting system"—and high-level corruption for the pervasive opportunistic behavior at different levels of governments and throughout Chinese society as a whole.

Over the 1980s, the authority to regulate foreign investment was also

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[12]Hu Angang, "Tax Assignment System: Evaluation and Suggestions," *Zhanlue yu guanli* (Strategy and Management), 1996, no. 5:2; Ni Jiazhu and Yan Yinglong, *Difang zhengfu touzi xingwei yanjiu* (An analysis of local government investment behavior) (Beijing: Zhongguo jingji chubanshe, 1993), 115.

[13]Ni and Yan, *Difang zhengfu touzi xingwei yanjiu*, 115-16.

[14]Shirk, *How China Opened Its Door*, 33.

transferred to provincial and local authorities. They, in turn, could delegate lower-level governments to approve and regulate joint ventures. The power to approve new projects and grant more favorable treatment for foreign investors could often mean lucrative opportunities for local officials, some of which could come in the form of free trips abroad, foreign-made gifts, and even sponsorship for their children's study abroad. An example is the October 1986 provisions for the encouragement of foreign investment, which granted export-oriented and technologically advanced joint ventures the right to sell on the domestic market and convert *renminbi* earnings to foreign exchange. The policy delegated to provincial and local governments the authority to interpret the guidelines for establishing whether a joint venture qualified for placement into these categories.[15]

With newly gained economic authority, local officials have engaged in a bidding war to woo foreign investors by offering more generous tax breaks and cheaper land and by minimizing bureaucratic holdups since tax returns are sent up to the central government while various fees and charges are kept within the locality. For example, price gouging and land sales also provide local governments with lucrative deals. In some areas where foreign investment has concentrated, land sales have become one of the major sources of revenues for local governments and a main channel for attracting foreign investment to the region. Large areas of agricultural land have been transferred to industrial parks and commercial housing projects. The revenue generated from the sale of land leases in the coastal cities of south China accounts for more than 35 percent of the total annual revenue of these cities. In Shenzhen and Zhuhai SEZs, the figure can be as high as 50 percent.[16] In Haikou, the capital city of Hainan province, investment in real property constitutes half of the fixed social investment and contributes 23 percent of the total revenue of the city.[17] This phenomenon of land sales as

[15]Ibid., 46-47.

[16]*Shibao zhoukan* (China Times Weekly), 1992, no. 36, cited in You-tien Hsing, "Building *Guanxi* Across the Straits: Taiwanese Capital and Local Chinese Bureaucrats," in *Ungrounded Empire: The Cultural Politics of Modern Chinese Transnationalism*, ed. Aihwa Ong and Donald M. Nonini (New York: Routledge, 1997), 147.

[17]*Shijie ribao* (World Journal), December 23, 1992.

the major revenue source has also increased in recent years in the interior provinces.[18]

Processing fees have also been a major source of income for local governments. Foreign investors are required to pay a certain amount of foreign currency as processing fees. These fees are calculated roughly on the basis of the size of the labor pool employed by the investor. Finally, before 1994, there were multiple foreign exchange rates and, in addition, local governments could retain a portion of foreign exchange earnings.

Local governments that could not receive special policy blessings would then resort to the old tactic of the "flexible application" of financial and taxation regulations laid down by the central government or by manipulating the law.[19] Hence the competition for particularistic foreign economic benefits produced an "open-door bandwagon" that has effectively turned local governments into "commercial republics" in which rules can be bent, regulations ignored, and laws only used as references. All kinds of incentives can be offered in order to sweeten a deal. Local governments usually waive local taxes and land-user fees for foreign-invested firms in their development zones. During the first nine months of 1992, almost two thousand such zones were set up across the country. By early 1993 the press was reporting that "nobody knows exactly how many such zones, which attract investment with a variety of tax breaks and other favorable policies, have been launched in China."[20]

Competition with other localities for foreign investment provided local officials and firms with an incentive to collude with foreign busi-

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[18]This has been jeered as the "model of two *pi*" (Guangdong model of development): *zuipi* (lips) and *dipi* (land). Local governments accomplished crude capital accumulation by selling or leasing land to foreign investors and then using the money to build up infrastructure to attract more investors. See Charles H.C. Kao et al., *Taishang jingyan: Touzi dalu de xianchang baodao* (The Taiwan investment experience in mainland China: A first-hand report) (Taipei: Tianxia wenhua chubanshe, 1995), 75.

[19]*Liaowang* (Outlook), 1993, no. 42:16; Wei Wei, "Rebuild the Authority and Responsibility Relations between the Central and Local Governments," *Jingji yanjiu* (Economic Research), 1993, no. 9:32; *China News Analysis*, no. 1508 (April 15, 1994): 2-3.

[20]Shirk, *How China Opened Its Door*, 38, 41; Du Shaoping et al., eds., *Neilu kaifang chengshi yonghao guojia youhui zhengce baizhao* (A hundred methods for inland open cities to fully utilize state preferential policies) (Taiyuan: Shanxi jingji chubanshe, 1992); Lora Sabin, "New Bosses in the Workers' State: The Growth of Non-State Sector Employment in China," *The China Quarterly*, no. 140 (December 1994): 954-59.

nesses. Note that many of the foreign-invested firms are actually set up by domestic investors who are eager to search for ways to register their businesses as "*sanzi*" enterprises[21] in order to gain tax exemptions, favorable treatment with regard to financing, import/export autonomy, and sales-enhancing reputation.[22] While these irregular practices at the local levels make most foreign multinationals feel uncomfortable, they do not pose major barriers for small investors from Taiwan, Hong Kong, and other overseas Chinese communities who are not strangers to these informal ways of doing business.

Important is to note that the frenzy to attract foreign investment occurred within the context of the continuing erosion of profitability of local firms. For example, following the national trend, the profitability of rural industries in Jiangsu province fell from around 32 percent in the early 1980s to below 10 percent in the late 1980s and early 1990s.[23] Firms have strong incentives to team up with foreign investors because national tax policies discriminate in favor of joint ventures, and any firm with a 25 percent foreign equity participation qualifies as a foreign-invested firm and thus enjoys a much lower tax rate, free imports of equipment, and a certain number of luxury cars. For instance, before 1994 state and collectively owned enterprises were subject to a 55 percent income tax with an addi-

[21]"*Sanzi qiye*" refers to joint ventures, cooperative enterprises, and wholly foreign-owned enterprises—an expression also sometimes translated as "*waizi qiye*" (foreign-invested enterprises).

[22]FDI flows increased in part because of the phenomena of recycled capital of Chinese origin. Given the special tax and other incentives provided to foreign-invested firms, local governments and local firms moved money offshore to be recycled back into China disguised as "foreign investment." Since most provincial and municipal governments run firms in Hong Kong and elsewhere, information over the extent of such practices is hard to obtain. The author's own contacts with the business community and interviews in the mainland suggest that this is certainly a serious problem. The World Bank estimated that these might comprise as much as 25 percent of gross investment inflows in 1992. See Lardy, "The Role of Foreign Trade and Investment," 1067; Shirk, *How China Opened Its Door*, 47; author's interviews in Henan with a local joint-venture manager and a bank official, September 10, 1997. Even the official media has openly condemned the "large number" of such "sham businesses." See Sabin, "New Bosses in the Workers' State," 957. One Western source has gone so far as to claim that two-thirds of current foreign investment in China may have actually originated from within the country itself. See Sheryl WuDunn, "Booming China is Dream Market of West," *New York Times*, February 15, 1993, 6.

[23]Barry Naughton, *Growing Out of Plan: Chinese Economic Reform, 1978-1993* (New York: Oxford University Press, 1995), 150-51; Wan, *Zhengfu tuidong yu jingji fazhan*, 117.

tional adjustment tax levied over profits above a certain level. In contrast, after a three-year exemption and two-year reduction period, Taiwanese-invested firms were also entitled to a low 15 percent income tax if they are located in the SEZs and various development zones, and an even lower 10 percent income tax if they are designated as technologically advanced firms that meet certain export targets.[24]

Taiwanese Investors in a Rent-Seeking Society

In this wild rent-seeking environment, local officials have become the most important agents for Taiwanese investment in mainland China. Local officials tend to be more flexible regarding regulations than higher-level bureaucrats. The need to bypass formal bureaucratic procedures in order to keep production and delivery moving as quickly as possible is important, particularly for the small investors from Taiwan with only limited operational capital. Lower-level officials motivated by the new fiscal schemes are more willing to accommodate overseas investor needs by speeding up the application process for investment projects and by making flexible arrangements with individual investors. Such arrangements include more favorable tax breaks, land deals, relaxed customs inspection of imported materials and export-ready products, lax implementation of environmental and labor regulations, and permission to sell a higher percentage of their products on the domestic market. In one village in suburban Zhengzhou, Henan province, the local party secretary, who is also chairman of the village business group, offered foreign investors 60 percent of the shares for any project yet required these investors to provide only 40 percent of the investment capital. In one case, he even offered 60 percent of the shares for simply being allowed to use the brand names of one Taiwanese group in the food processing industry. At the same time, he also pledged to fend

[24]Chu Baolan and Dong Weiyuan, *Taiwan tongbao dao dalu touzi zhinan* (Mainland investment guide for Taiwanese investors) (Beijing: Zhongguo jingji chubanshe, 1993), 12. The 1994 tax reform leveled off tax rates for domestic firms to 33 percent in a new value-added tax.

off all kinds of harassment from various bureaucracies through a unified office set up to deal with tax and labor disputes.[25]

Tax relief has been one of the most critical investment conditions for foreign investors. While the standard enterprise income tax rate for foreign-funded ventures after 1994 is a fixed 33 percent, local officials in practice are free to exempt almost any percentage of income tax they see fit from centrally mandated taxes on a temporary annual basis. Foreign-invested firms are usually exempted from this tax for the first two to three profitable years. For the following three to four years, only half of the tax is imposed; in many cases the tax-free period is extended or the tax rates kept at 15 percent, even after the official tax-free period was over. Other favorable investment conditions that local governments have the authority to grant to foreign-funded ventures involve the transfer of profits out of China, relaxation of the rules on foreign exchange balance, reduction of public-utility fees and land prices, and exemption from import license requirements and social welfare contributions. Underneath the state policies, which are supposed to be applied universally, the actual investment arrangements are mostly tailor-made for individual enterprises and investors, and the profitability of the investment package is mostly dependent on the relationship between the investor and local officials.[26]

In the absence of private property rights and routinely enforced business laws, much depends on the flexible interpretation and implementation of regulations by local officials; the degree of flexibility tends to increase as one moves down through levels of the government hierarchy. Under these circumstances, private business must seek official backing to gain access to the licenses and credit necessary for the smooth running of business. However, reliance on these informal ties is susceptible to arbitrariness, rendering private business vulnerable to levies and rent-seeking by officials. For example, foreign investors in Fujian have begun to complain about the various fees they were charged. One firm was asked to pay hun-

[25]Author's interview in Zhengzhou, September 15, 1997.

[26]Shirk, *How China Opened Its Door*, 46-47; Kao Charng, "Current Mainland Foreign Investment Policies and the Trend of Taiwanese Investment in the Mainland," *Taipei yinhang yuekan* (Taipei Bank Monthly) 27, no. 7 (1997): 3-4, 9.

dreds of thousands of *yuan* for some kind of "construction file guarantee fee." After intensive "public relations" work, the fee was finally reduced to tens of thousands. In another case, tenants in an apartment built by foreign investors were charged 1.6 *yuan* per kilowatt-hour of electricity by local utility company instead of the standard 0.35 *yuan*. Local power suppliers argued that the 0.35 *yuan* rate applied only to apartments with 100 percent occupancy—a rate which usually takes more than two years to reach. Some firms were asked to buy products from firms related to certain bureaucracies.[27] Under these circumstances, private entrepreneurs often have to "lubricate all the joints" including police stations, the customs service, the public health departments, tax officers, local banks, and public-utility departments; success in business has come to depend largely on the relationship the investors have cultivated with local officials and bureaucrats.[28]

In an environment full of illicit practices, the definition of efficiency for investors is the level of cooperativeness of local officials. With the right connections and good relations, foreign investors can gain local official complicity in underreporting or splitting investments in order to avoid the involvement of higher levels of government. For example, Taiwanese-invested Changzhou Kymco Motorcycle Company has a total investment of US$40 million. However, this total was reported to the higher authorities to be only US$20 million, a figure within the purview of local government.[29] This relationship is always mutually beneficial, of course. While foreign investors benefit from political protection and favorable deals, local officials also gain. First, local officials benefit from attracting foreign investors who strengthen the economic base of their localities and generate employment. Through collusion with foreign investors, local officials also gain personal benefits, which can come in the form of free trips abroad, luxury cars, foreign-made gifts, and even foreign scholarships for their children.[30]

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[27]"Foreign Investors Complain about Investment Soft Environment," *Jingji cankao xiaoxi* (Economic Reference News), October 7, 1997.

[28]Dorothy J. Solinger, *China's Transition from Socialism: Statist Legacies and Market Reforms 1980-1990* (Armonk, N.Y.: M.E. Sharpe, 1993), 127-28.

[29]Author's interview with a local official, Nanjing, October 15, 1997.

[30]Shirk, *How China Opened Its Door*, 47.

The attraction of Taiwanese investment capital also helped revive the fortunes of some of the long-forgotten local gods. For example, between 1985 and 1993, the local authorities in Fujian approved a series of conferences on local gods in Fujian which were also worshipped by the people in Taiwan. Given that Taiwanese financial support was behind the majority of the conferences on the gods, the resulting local scrambling for money from Taiwan has virtually transformed popular worship of local gods into cash-crop opportunities.[31]

The commercialization of local popular culture can also be seen in increased pilgrimages to ancestral homes. For example, Anxi county in Fujian province is the ancestral home to more than 2 million Taiwanese. One such Taiwanese is Hsu Sheng-fa, vice-chairman of Taiwan's Straits Exchange Foundation (SEF) and former president of the National Federation of Industry. When Taiwan opened up visits to the mainland in 1987, Anxi county sent a folklore delegation to Taiwan to establish contacts. In 1996, they sent a photo collection of the county to Hsu. Excited with this gift, Hsu came to visit Anxi in the same year. Along with these contacts has come a flow of investment funds. Among the fourteen joint ventures in Anxi in 1997, five were set up by Taiwanese investors.[32]

The ability to make flexible deals with low-level Chinese officials has certainly been a great advantage for Taiwanese investors. Shared cultural understanding and language affinity have been an effective tool for communication between Taiwanese investors and their local agents. As one researcher has noted:

> Although it is not the only tool with which to build trusting relationships, doors open more quickly when knocked on by someone speaking a familiar language. Sharing a common language does not mean simply effective communication in technical terms. More important is the understanding of hidden messages, which determines the effectiveness of the communication. On many occasions, what is spoken is not as important as what is unspoken. Therefore, it takes both technical understanding of the spoken words and cultural understanding of the

[31] Kenneth Dean, "Conferences of the Gods: Popular Cults Across the Taiwan Straits" (Paper presented at the conference on "Economy and Society in Southeastern China," Cornell University, October 2-3, 1993), 3, 17, 19.

[32] *Xiamen ribao* (Xiamen Daily), October 31, 1997, 11.

hidden meaning to fully grasp the expectations of the participants in gift exchange.[33]

However, the importance of social networks is rather common across different cultures. The arts of gift exchange, for example, vary between societies depending on the specific historical and institutional context. While interpersonal connections are important across different cultures, a society full of rent-seeking opportunities can certainly inflate the value of interpersonal connections. This is especially so in a transitional economy in which the lack of an effective legal framework has made bureaucratic patronage a convenient alternative. Local officials acting as agents between plan and market have the power to create exclusive rights within their jurisdictions. For Taiwanese investors in mainland China, past experiences, a shared language, and cultural affinity certainly provide ready tools that facilitate the practice of gift exchange and hence the establishment of interpersonal connections between Taiwanese investors and local Chinese officials and reduce the transaction costs of doing business.[34]

Taiwanese Investors in Jiangsu Province

The Southern Jiangsu Model and Foreign Capital

Jiangsu province, adjacent to Shanghai in east China, is one of the most developed regions in China. In 1994, its GDP reached 405.74 billion *yuan*, the second largest in the nation. In 1995, its industrial output was the first in the nation, accounting for 12.9 percent of the national total. Twenty-six of the top one hundred economically strong counties are located in Jiangsu, six of which are also on the top ten list. Between 1979 and 1994, Jiangsu's annual GDP growth averaged 12.7 percent[35] (see table 2). Ac-

[33]Hsing, "Building *Guanxi* Across the Straits," 156-57.

[34]Ibid., 158.

[35]*Jiangsu nianjian 1997* (Jiangsu yearbook 1997), 731; State Council Third National Industrial Survey; Jiangsu Provincial Government, *Touzi Zhongguo dashichang: Jiangsu sheng zhuanji* (A guide to investment in China: Jiangsu province) (Hong Kong: Dagongbao chubanshe, 1995), 4.

Table 2
Jiangsu in the Chinese Economy (1994)

Item	National	Jiangsu	%	1996
Population (1994, 10,000)	119,850	7,020.5	5.9	7,110.20
Labor force (10,000)	14,833	909.8	6.1	905.52
GDP	4,380.0	405.7	9.3	600.42
Per capita income (*yuan*)	3,654.6	5,779.3	158.0	8,471.00
Agriculture	823.1	67.2	8.2	96.53
Manufacturing	2,125.9	218.7	10.3	307.41
Services	1,431.0	119.9	8.4	196.48
Revenues	518.2	29.3	5.7	42.80
Expenditures	582.0	20.0	3.4	31.10
Fixed capital formation	1,592.6	133.1	8.4	275.00
Consumer spending	1,605.3	128.8	8.0	193.29
Exports (US$ billion)	121.0	9.0	7.5	13.12

*GDP, agriculture, manufacturing, services, revenues, expenditures, fixed capital formation, and consumer spending in billion *yuan*.

Sources: Jiangsu Provincial Government, *Touzi Zhongguo dashichang: Jiangsu sheng zhuanji* (A guide to investment in China: Jiangsu province) (Hong Kong: Dagongbao chubanshe, 1995), 4-5; *Jiangsu nianjian 1997* (Jiangsu yearbook 1997), 588-93.

cording to the statistics released by Taipei's Ministry of Economic Affairs, since 1993 the province has also become the site of the largest Taiwanese investment in mainland China, capturing around 32.78 percent of all Taiwanese investment in mainland China.[36]

The essence of the success of what has become known as the "Southern Jiangsu" (Sunan) model of development is well captured by what Andrew Walder calls "local governments as industrial firms."[37] Unlike the Zhujiang model in southern Guangdong (where fast economic growth has

[36]According to statistics released by China's State Economic and Trade Commission, however, Jiangsu surpassed both Fujian and Guangdong in terms of both the number of Taiwanese investment projects and the amount of capital committed in 1992—1,403 items and US$1.4 billion. In the same year, Fujian had 724 items and investment capital of US$891.35 million, and the respective figures for Guangdong were 532 items and US$666.87 million. See *Zhongguo duiwai jingji tongji nianjian* (China foreign economic statistical yearbook) (Beijing: Zhongguo tongji chubanshe, 1994), 304.

[37]Andrew G. Walder, "Local Governments as Industrial Firms: An Organizational Analysis of China's Transitional Economy," *American Journal of Sociology* 101, no. 2 (September 1995): 263-301.

Table 3
Structural Similarities of TVEs in Southern Jiangsu, 1990

Unit: %

	Machinery Industry	Textile Industry	Chemical Industry	Metal Industry	Building Materials	Total
Suzhou	18.6 (2)	32.4 (1)	13.0 (3)	9.3 (4)	7.7 (5)	81.0
Wuxi	29.1 (1)	19.7 (2)	12.4 (3)	15.6 (4)	7.9 (5)	84.7
Changzhou	27.0 (1)	16.8 (2)	15.6 (3)	15.1 (4)	9.7 (5)	84.2

Source: Wan Jieqiu, *Zhengfu tuidong yu jingji fazhan: Sunan moshi de lilun sikao* (State initiative and economic development: Theoretical reflections on the southern Jiangsu model) (Shanghai: Fudan daxue chubanshe, 1993), 132.

been largely driven by foreign investment) and the Wenzhou model (where rapid growth occurred on the basis of individual family businesses), Jiangsu's success has largely been driven by the rapid growth of the collectively owned township and village enterprises (TVEs).[38]

For example, between 1979 and 1985, TVEs in Suzhou, Wuxi, and Changzhou grew at an average rate of 30 percent. By 1996, the total number of TVEs in Jiangsu had reached 914,000, with 8.795 million employees (even after a slight decrease from 9.52 million in 1994). In the same year, TVE total output value was 766.75 billion *yuan*, about 66.4 percent of Jiangsu's total industrial output, and TVE exports reached 105.72 billion *yuan*, about one-fourth of all exports by TVEs nationwide.[39]

However, rapid expansion of local industries also led to duplication and waste (see table 3). And duplication led to heightened competition and declining profits. In Jiangsu, profits of rural industries fell from around 32 percent in the early 1980s to below 10 percent in the late 1980s and early

[38]One can easily tell the difference between the Southern Jiangsu model of "getting rich collectively" and the more laissez-faire Zhujiang model simply by taking a train ride between Shenzhen and Guangzhou and between Shanghai and Nanjing. In southern Guangdong, one often sees a few grand houses surrounded by a scattering of dilapidated housing. In southern Jiangsu, mostly two-story houses that are identical to each other line up in clean streets in townships and villages. While the area between Shenzhen and Guangzhou are dotted with foreign-invested firms in leased factories, what dominates the economic landscape in southern Jiangsu are the tens of thousands of TVEs.

[39]*Jiangsu nianjian 1997*, 260; *Touzi Zhongguo dashichang*, 53.

1990s. In southern Jiangsu where the fastest economic growth in the province (country) occurred, profits further dropped to below 5 percent in the early 1990s.[40]

All these figures point to the limitation of local state-led growth and the necessity of technical upgrading. The governor of the province even openly called for abandoning the Southern Jiangsu model in 1997. Under the fiscal contract system, local governments aimed at maximizing their revenue tend to support industries with short-term investment, minimum funding, and quick returns (*duan, ping, kuai*), especially light industries. Also, since turnover taxes (*liu zhuan shui*) are included in the responsibility system, local governments prefer the production of goods that have a higher output value (e.g., the processing industry). For example, in southern Jiangsu, textile and light industries consist of roughly one-third of the total local output. In 1992, 53.08 percent of Jiangsu's enterprises were labor-intensive.[41] Since equipment upgrading is often beyond the technical and financial means of local governments and firms, Jiangsu turned to wooing foreign investors.

Since the mid-1980s, Jiangsu has promulgated a series of laws, regulations, and rules to encourage foreign investment as part of an effort to upgrade the province's industrial structure, improve management skills, and increase exports. At the end of 1986, the provincial government issued "Provisions for Encouraging Foreign Investment." According to this document, in addition to incentives provided by national policies, the province offered foreign investors an extra three-year exemption and three-year reduction rate of local taxes. Firms exporting more than 50 percent of their products would also enjoy exemption of all local taxes. Firms with an annual profit of more than 1 million *yuan* would enjoy only half the local tax rate in addition to various preferential treatments in terms of land and other kinds of fees. To improve the investment environment and reduce red tape, the provincial government also delegated approval power over foreign in-

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[40]Wan, *Zhengfu tuidong yu jingji fazhan*, 117; Naughton, *Growing Out of Plan*, 150-51.

[41]William A. Byrd and Alan Gelb, "Why Industrialize? The Incentives for Rural Community Governments," in *China's Rural Industry: Structure, Development, and Reform*, ed. William A. Byrd and Qingsong Liu (New York: Oxford University Press, 1990), 359-60.

vestment below US$5 million to six major cities—Nanjing, Suzhou, Wuxi, Changzhou, Nantong, and Lianyungang. All other cities have the power to approve investment below US$3 million. In 1992, the provincial government further delegated power to approve investment below US$30 million to twenty-one cities (counties) and three economic development zones in Lianyungang, Nantong, and Kunshan.[42]

The province also copied a well-established pattern in the SEZs by setting up development zones of its own. By 1996, a total of seventy-four such zones had been set up, with eleven at the national level and sixty-three at the provincial level or below.[43]

From 1978 to 1996, a total of 33,744 foreign-invested firms had been set up in Jiangsu, with a total contracted capital of US$51.49 billion. Between 1981 and 1995, FDI constituted about a third of the total fixed capital formation of the province. In 1994, total revenue produced by foreign-invested firms was 70.2 billion *yuan*. Note that most of the foreign investments in Jiangsu come from the overseas Chinese communities—Hong Kong, Macao, and Taiwan[44] (see tables 4, 5, and 6).

Foreign-invested firms have also played an important role in Jiangsu's exports. In 1990, exports by *sanzi* firms were only 6.5 percent of total provincial exports. The ratio increased to 13.1 percent the next year and, in 1992, grew to 28 percent. By 1995, *sanzi* exports constituted 36.7 percent of the total export value of the province. In 1995, 956 of these firms exported more than US$1 million, with the top 50 exporting more than US$10 million. In addition, these firms also provide supplies worth more

[42]*Touzi Zhongguo dashichang*, 120-21, 154, 120-68.

[43]By the end of 1994, these development zones have attracted 2,705 foreign-invested firms which accounted for 10.6 percent of the total number of foreign-invested firms in the province. Contracted foreign investment was US$7.91 billion which was 28.4 percent of the total foreign investment in Jiangsu. Realized foreign investment in these zones was US$2.39 billion, accounting for 25.6 percent of the provincial total. See *Touzi Zhongguo dashichang*, 59; *Jiangsu nianjian*, various issues. Average sizes of foreign investments in these zones are larger than provincial average. In Suzhou's high-tech development zone (the new district), among the 120 foreign-invested firms, the total investment was US$1.3 billion with an average of more than US$10 million per project: twenty with more than US$20 million, ten with more than US$50 million, and three with more than US$100 million. See Cheng Jiming, ed., *Dongya jingji yu Jiangsu jingji bijiao yanjiu* (A comparative study of economy in East Asia and Jiangsu) (Nanjing: Jiangsu renmin chubanshe, 1996), 111.

[44]Cheng, *Dongya jingji yu Jiangsu jingji bijiao yanjiu*, 111.

Table 4
Contracted Foreign Investment in Jiangsu, 1988-96

Unit: US$ million

Year	Number					Amount				
	Total	Joint Ventures	Cooperative Ventures	Wholly-Owned	Equipment	Total	Joint Ventures	Cooperative Ventures	Wholly-Owned	Equipment
1988	334	233	11	3	87	301.90	293.76	6.64	1.50	36.77
1989	353	279	8	3	63	194.65	183.74	8.05	2.86	22.67
1990	431	358	8	29	36	244.16	144.78	66.40	32.98	5.10
1991	1,412	–	–	–	–	945.55	–	–	–	–
1992	7,856	7,362	238	256	–	7,192.00	5,745.00	769.00	649.00	–
1993	10,248	8,986	448	814	–	10,832.00	7,468.00	1,348.00	2,017.00	–
1994	5,204	4,001	325	697	181	8,553.50	5,880.60	632.60	2,008.20	32.19
1995	4,273	2,827	265	964	217	12,970.00	6,621.60	675.18	5,672.80	16.32
1996	2,718	1,716	235	748	19	9,831.70	5,096.70	981.50	3,753.50	9.58

Sources: Calculated from data in *Jiangsu nianjian* (1990), 79; ibid. (1997), 610.

Table 5
Realized Foreign Investment in Jiangsu, 1985-96

Unit: US$ million

Year	Total	Joint Ventures	Cooperative Ventures	Equipment	Ratio (%)
1985	33.463	11.403	0.506	21.554	
1986	33.976	16.550	1.560	15.866	
1987	81.766	39.738	9.907	35.121	
1988	127.720	84.220	18.810	24.690	42.31
1989	122.420	72.930	20.710	27.780	62.89
1990	150.220	137.870	2.490	9.120	61.53
1991	240.520	200.990	8.960	7.280	
1992	1,412.830	1,182.280	97.750	9.900	
1993	3,014.320	2,304.380	275.200	12.470	
1994	4,197.850	2,954.990	331.550	21.150	
1995	4,867.560	3,321.660	276.840	86.980	37.53
1996	5,086.170	3,133.680	328.570	14.090	51.73

Sources: Calculated from data in *Jiangsu nianjian* (1990), 79; ibid. (1997), 610. Note that the category "wholly foreign-owned" is not included in the statistics for realized foreign investment.

Table 6
Leading Contracted Investors in Jiangsu

Unit: Firm; US$ million

	Hong Kong/Macao		Taiwan		Japan		USA		Singapore	
Year	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
Pre-89	–	–	7	2.070	–	–	–	–	–	–
1989	190	–	22	9.305	23	–	24	–	–	–
1990	233	159.06	60	28.414	36	–	31	–	12	–
1991	688	397.23	187	122.770	83	66.54	100	–	22	–
1992	4,656	4,727.00	1,320	1,344.000	319	282.00	787	627.0	135	212.0
1993	5,204	5,640.00	1,940	1,790.000	557	582.00	1,087	1,037.0	265	464.0
1994	2,095	2,955.00	998	960.000	469	843.00	571	897.0	200	763.0
1995	1,462	3,320.00	777	900.000	440	1,860.00	459	1,230.0	232	2,040.0
1996	855	2,430.00	527	810.000	243	760.00	354	1,460.0	111	210.0
1997 (Jan.-July)	270	880.99	253	456.460	–	–	–	–	–	(Korea)
Total	15,653	20,509.00	6,084	6,423.000	–	–	–	–	–	–
Actual	–	10,189.00	–	2,709.100	–	–	–	–	–	–
Ratio	–	49.7%	–	42.2%	–	–	–	–	–	–

Sources: Compiled from data in *Jiangsu nianjian*, 1990-97 issues, and data released by the Jiangsu Provincial Foreign Economic and Trade Commission (September 1997).

*According to the statistics released by the Jiangsu Provincial Taiwan Affairs Office, by the end of June 1997, the total number of Taiwanese-invested firms was 6,985, with a total contracted capital of US$10.60 billion. Given the inconsistency of data released by the Jiangsu Provincial Taiwan Affairs Office, however, this table uses data from the Jiangsu Provincial Foreign Economic and Trade Commission. See Jiangsu Provincial Taiwan Affairs Office, "Report on Taiwanese-Invested Firms in Jiangsu Province" (July 1997).

than US$208 million for other domestic exporters.[45]

Important is to note that TVEs have played an important role in attracting foreign investment. The first Chinese-foreign joint venture with a TVE was set up in 1984 and by September of 1994 more than 13,000 such joint ventures had been established, accounting for 54 percent of the total number of Chinese-foreign joint ventures in the province. Realized foreign investment in these joint ventures was US$2.5 billion, or 32 percent of the total amount of realized foreign investment in the province. Among the 3,743 Chinese-foreign joint ventures in Wuxi, 213 are with TVEs. Virtually all townships and villages have their own joint ventures. For instance, one township—Dongjiang—alone has more than 60 joint ventures under its jurisdiction. In Zhangjiagang, 50 percent of the TVEs have joined up with foreign investors. Also, there is a high ratio of realized foreign capital for joint ventures at the township and village level, which is 17.25 percent higher than the provincial average.[46]

Taiwanese Investment in Jiangsu

The first reported case of Taiwanese investment in Jiangsu—an inflow of only US$50,000—occurred in 1987, the same year that Taipei lifted the rule banning Taiwanese from visiting relatives on the mainland. The flow of investment from Taiwan increased steadily along with the stream of Taiwanese visitors to Jiangsu, the ancestral home to some 180,000 Taiwanese. Among those who moved to Taiwan with the retreating Nationalist government in the late 1940s and early 1950s, 174,703 persons were from Jiangsu, Zhejiang, and Shanghai. Many of these people later became important figures in the government and business communities in Taiwan. In addition, more than 467,000 people in Jiangsu have relatives in Taiwan.[47]

Given these rich human connections, Taipei's lifting of the ban on kinship visits to the mainland triggered a steady flow of Taiwanese visitors

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[45]Ibid., 111-12; *Touzi Zhongguo dashichang*, 56-57.

[46]Cheng, *Dongya jingji yu Jiangsu jingji bijiao yanjiu*, 109.

[47]Cui Zhiqing, *Dangdai Taiwan jingji cidian* (Contemporary Taiwan economic dictionary) (Nanjing: Nanjing daxue chubanshe, 1993); *Jiangsu nianjian 1990*, 211.

Table 7
Taiwanese Visits and Donations to Jiangsu

Year	Visits to Jiangsu	Visits to Taiwan	Donations (million *yuan*)
Nov. 1987-1990	410,000	442	22.875
1990	448,104	673	9.850
1991	236,222	972	17.395
1992	256,000	981	30.000
1993	161,200	1,112	39.880
1994	–	–	30.000
1995	75,220	–	40.000
1996	70,000	–	63.000
Total	1,656,746	10,180	253.000

Sources: Calculated from data in *Jiangsu Yearbook*, 1990-97 issues.

as well as investments to Jiangsu. By the end of 1996, Taiwanese had made more than 1.65 million trips to the province. At the same time, more than 10,180 persons from Jiangsu had been to Taiwan for kinship visits. During the same period of time, Taiwanese of Jiangsu origin donated a total of 253 million *yuan* to their home regions, setting up schools and helping the handicapped and victims of natural disasters (see table 7). Many of the visitors combined kinship visits with searches for business opportunities. For example, the US$1.6 million Kanghua Gas Company of Huaiyin in northern Jiangsu was brokered through a kinship visit to Taiwan at the end of 1990 by Wu Naiding.[48]

The number of visits by business groups has also steadily increased. With few exceptions, these trips almost always include meetings and banquets with provincial and municipal leaders. This corresponds with a structural shift in Taiwanese investment to the mainland under way since 1993 when Taiwan's large business groups began their concerted march to the mainland. Targeting mostly the mainland domestic market, the large business groups prefer to locate around major metropolitan centers. For instance, Taiwanese business groups usually open their offices in Shanghai (where land is expensive) while leaving their production operations in

[48]For more details regarding this case, see "A Home Tune Attracts Investment of Millions," *Haixia guangjiao* (Strait Wide-Angle), 1994, no. 4:40.

Table 8
Contracted Taiwanese Investment in Suzhou

Year	Number of Firms	Total Investment (US$100 million)	Taiwan Capital (US$100 million)	Average: Overall (US$10,000)	Average: Taiwan Capital, US$10,000
By 1990	68	1.54	0.72	226.66	105.80
1991	93	1.40	0.84	150.00	90.32
1992	570	18.17	11.62	318.76	203.76
1993	588	17.96	13.38	305.47	227.49
1994	257	11.50	9.89	447.38	384.93
1995	220	14.67	12.88	667.00	585.66
1996	156	5.80	4.34	371.79	278.20
1997 (Jan.-June)	105	3.28	3.01	312.38	286.67
Total	2,057	74.321	56.67	349.93	270.35

Source: Suzhou Taiwan Affairs Office.

Jiangsu—mostly in southern Jiangsu (around Suzhou, Wuxi, and Nanjing). Suzhou is home to more than 20 percent of all the Taiwanese-invested firms in Jiangsu and more than 50 percent of all Taiwanese investment in the province in terms of contracted capital (see table 8).[49]

In response to these developments, the provincial government of Jiangsu has passed a series of laws and regulations to encourage Taiwanese investment into the province since the early 1990s. After the 1986 "Provisions for Encouraging Foreign Investment," the provincial government promulgated and compiled a series of resolutions and policy guidelines regarding Taiwanese investors including "Jiangsu Investment Guide for Taiwanese Compatriots" (1990), "Introduction to the Investment Environment of Jiangsu" (1990), "Measures for Encouraging Investment from Taiwanese Compatriots" (January 7, 1991), and "Temporary Measures for Rewards for Attracting Investment from Hong Kong, Macao, and Taiwan" (January 20, 1991).[50]

[49]Sang Dengping, "Economic and Trade Cooperation between Jiangsu and Taiwan: Implications, Current Situation, and Trend" (Paper presented at the Conference on Cross-Strait Economic and Trade Relations, Nanjing, July 1997), 3.

[50]*Jiangsu nianjian 1991*, 222.

In addition, various cities also passed a series of measures to attract Taiwanese and other foreign investors. For example, in 1992 Nanjing passed its own "Measures for Encouraging Investment from Taiwanese Compatriots" and "Temporary Measures for Purchase and Construction of Houses by Taiwanese Compatriots." Through these measures, the province offered a five-year exemption from land fees and only half the standard rate for the next five. In addition, Taiwanese-invested firms are allowed to sell a certain portion of their products on the domestic market so long as they can balance their own foreign currency needs.[51]

Jiangsu province uses Taiwanese investment—a kind of special foreign investment—as a tool for restructuring the local economy. Taiwanese investment could also help local TVEs upgrade their equipment, increase exports and economies of scale, and improve management skills.

In addition to the various laws and regulations, the province and its cities began to host a series of trade shows and business festivals every year both within and outside the province in order to attract foreign investment. Most of these festivals at the local level are organized like farmers' markets. Firms looking for foreign investment line up their tables very much like individual vendors selling home-grown products. Few speak English or any other foreign language. In addition, few of the potential investors are really "foreign" in the strict sense of the word. Since there are also such events held in New York and Hong Kong, these occasions often become shopping bazaars for small investors from Taiwan and Hong Kong. These festivals usually wind up with special receptions hosted by the provincial and municipal leaders in honor of leading Taiwanese businessmen attending the events.[52]

All these strategies help facilitate the flows of Taiwanese investment to the province. Since 1992/93, Jiangsu surpassed Guangdong to become the recipient of the largest amount of Taiwanese investment. By July 1997, the total number of Taiwanese investment projects had increased to 6,084,

[51]*Jiangsu nianjian*, various issues; *Nanjing nianjian 1993* (Nanjing yearbook 1993), 123; *Touzi Zhongguo dashichang*, 120-45.

[52]Ibid.; and author's visit to the Nanjing autumn trade and investment festival, October 1, 1997.

with a total contracted capital of US$6,423 million (of which US$2,709 million has been realized). This figure comprises roughly 22 percent of the total number of Taiwanese-invested firms in the mainland and 19.8 percent of the contracted amount of Taiwanese investment capital. By mid-1997, of all the Taiwanese-invested firms in Jiangsu, 284 had an investment over US$10 million. Thirty-eight of Taiwan's top one hundred business groups have investments in Jiangsu.[53]

Of all foreign investment, the number of Taiwanese-invested firms is second only to Hong Kong and Macao. In terms of the amount of contracted investment capital, Taiwan was second only to Hong Kong and Macao up until 1994 when Taiwanese investment was surpassed by investment from the United States (see table 6).[54]

Most of the Taiwanese-invested firms are small enterprises that go to mainland China to take advantage of the low labor costs and cheap land. These firms tend to be concentrated in light industrial and consumer goods with a low capital/technology-labor ratio and in many cases use only second-hand machinery. For example, between 1987 and 1991, around 85 percent of all the Taiwanese-invested projects in Nanjing had an invest-

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[53]Jiangsu Provincial Taiwan Affairs Office, "Report on Taiwanese-Invested Firms in Jiangsu" (July 1997). According to statistics compiled by the Investment Commission of the ROC Ministry of Economic Affairs (*Monthly Statistical Report*, May 1997, 55-59), however, Jiangsu's share of the total amount of Taiwanese investment in the mainland was 32.78 percent by May 1997. Using the statistics reported by the Jiangsu Provincial Foreign Economic and Trade Commission and reports by China's State Economic and Trade Commission, Jiangsu's share of the national total by the end of 1996 becomes 15.74 percent in terms of the number of projects, 16.37 percent in terms of contracted amount of investment, and 16 percent in terms of realized Taiwanese investment.

[54]The year 1993 is also the year when Taiwan's large business groups began their concerted march to the mainland. Given government restrictions and the need for sharing investment risks, these large business groups often registered in a third country that has investment guarantees with China or simply teamed up with multinational corporations in their march to the mainland. This may reflect a declining amount of investment from Taiwan but the actual picture could be quite different, however. For example, Roma Ceramic Tile Company in Nanjing with an investment of US$45 million is registered as an American wholly-owned firm (author's interview in Nanjing, October 18, 1997). The actual investment capital, management team, and equipment all came from Taiwan. Another famous Taiwanese firm in Nanjing—Wang Wang Food Company with a total investment in mainland China of US$300 million (by 1997, its investment in Nanjing alone was over US$60 million)—is registered as a holding firm from Singapore (data from the Nanjing golden autumn trade and investment festival, October 1, 1997).

Table 9
Average Size of Taiwanese-Invested Firms in Jiangsu

Unit: US$10,000

Pre-1989	1989	1990	1991	1992	1993	1994	1995	1996	1997*
29.6	42.3	47.4	65.7	101.9	92.3	96.2	115.8	153.7	180.4

*January-July.
Sources: Calculated from data presented in table 6.

ment of less than US$1 million[55] (for the average size of Taiwanese investment projects in Jiangsu province, see table 9).

In terms of sectoral distribution, according to statistics available for Taiwanese-invested firms in Nanjing between 1987 and 1991, recreation and restaurants rank atop all other sectors, accounting for 20.7 percent of all the Taiwanese-invested firms during the period. "A taste from Taiwan" or "Taipei fashion" is advertised in most of the karaoke/night clubs, cake shops, and wedding houses in the city. The sector with the second largest Taiwanese investment was the electronic/electric industry, with 13.4 percent. In third place, the textile/apparel industry accounted for 12.2 percent while cosmetic/personal hygiene products and the chemical industry took the fourth and fifth places at 9.8 percent and 8.5 percent, respectively.[56]

In contrast to the predominance of wholly Taiwanese-owned firms in Xiamen,[57] Taiwanese-invested firms in Jiangsu province are predominantly joint ventures since they are mostly targeted at the mainland domestic market. For example, in Suzhou, until June 1997, wholly Taiwanese-owned firms accounted for only about 29.3 percent of a total of 2,057 Taiwanese-invested firms (see table 10). The rest were either joint ventures or cooperative ventures in contrast to an average 77.52 percent of wholly

[55]*Nanjing nianjian*, 1987-96 issues.

[56]Ibid.

[57]Qi Luo and Christopher Howe, "Direct Investment and Economic Integration in the Asia Pacific: The Case of Taiwanese Investment in Xiamen," *The China Quarterly*, no. 136 (December 1993): 746-69; Guo Zhemin, *Xiamen jingji tequ jianshe yu fazhan yanjiu* (A study of the development of the Xiamen special economic zone) (Xiamen: Xiamen daxue chubanshe, 1995).

Table 10
Ownership and Size of Taiwanese Investment in Suzhou

Year	Ownership Type			Investment Size (US$)			
	Wholly-owned	JVEs	CVEs	5-10 million	10-20 million	20-30 million	30 million and above
By 1990	7	61	–	3	1	–	1
1991	13	79	1	5	2	–	–
1992	52	502	16	38	28	12	7
1993	134	407	47	36	30	16	7
1994	115	126	16	17	21	9	15
1995	111	89	20	17	15	12	15
1996	94	43	19	7	5	6	2
1997 (Jan.-June)	77	24	4	5	5	6	1
Total	603	1,331	123	128	107	61	48

*JVEs: joint ventures; CVEs: cooperative ventures.
Source: Suzhou Taiwan Affairs Office.

Taiwanese-owned firms in Xiamen for the period 1983-91. Between 1989 and 1991, in Nanjing of the eighty-four Taiwanese-invested firms, only 13.1 percent were wholly Taiwanese-owned firms.[58]

In addition, Taiwanese-invested firms in Jiangsu have a lower export ratio in comparison with their counterparts in Xiamen. In 1990, Taiwanese-invested firms exporting less than half of their products accounted for only 4.37 percent of all the Taiwanese-invested firms in Xiamen. During the period 1990-91, Taiwanese-invested firms exporting less than half of their products constituted 36.49 percent of all the Taiwanese-invested firms in Nanjing.[59] All these examples show the changing nature

[58]*Nanjing nianjian*, 1989-91 issues. Across the province, the number of wholly foreign-owned firms is on the rise. For example, in 1991 there were only 91 wholly foreign-owned firms, with a contracted capital of US$94.02 million. In 1993, 814 more wholly foreign-owned firms were approved, with a total contracted capital of US$2.02 billion. In 1994, 715 more wholly foreign-owned firms were approved, with a contracted capital of US$2.05 billion. In 1995, 964 wholly foreign-owned firms were approved, with a contracted capital of US$5.67 billion. By the end of 1995, the total number of approved wholly foreign-owned firms reached 2,858, with a contracted capital of US$10.66 billion which was 25.8 percent of the total contracted foreign investment in the province. See Cheng, *Dongya jingji yu Jiangsu jingji bijiao yanjiu*, 108.

[59]*Nanjing nianjian*, 1990-91 issues; Luo and Howe, "Direct Investment and Economic Integration," 755.

of Taiwanese investment from export processing to being targeted at the mainland domestic market.

Again, TVEs have played an important role in attracting Taiwanese investors. Unlike state-run firms, TVEs are market-oriented and engaged mostly in the processing industries such as textiles, garments, footwear, the chemical industry, machinery, electronics, and food processing. In 1990, for example, 32.4 percent of the local industries in Suzhou were in textiles, 13 percent were in the chemical industry, and 7.7 percent were in construction materials. These corresponded to the industries that have been exiting Taiwan since the late 1980s as a result of heightened competitive pressures following the appreciation of the New Taiwan dollar, rising wage costs, and a strengthening labor movement.[60] By 1994, 871 Taiwanese-invested firms in Suzhou had been involved in joint ventures with TVEs—a figure which is about 65 percent of the total number of Taiwanese-invested firms in Suzhou.[61]

TVEs offer special attractions for small and medium-sized enterprises (SMEs) from Taiwan, Hong Kong, and Macao because of such structural similarities as being flexible and small in size. In 1985, rural firms in Suzhou and Wuxi employed an average of eighty-two people, with fixed assets averaging about 180,000 *yuan*. The average capitalization of the SMEs in Taiwan was around US$2-3 million. Both TVEs and SMEs were created by making use of surplus labor from rural areas, informal sources of finance, and through subcontracting relations with large firms (either state firms or large multinational corporations).

In addition to their similarities, both TVEs and SMEs also face mounting difficulties due to their unique characteristics. Since Taiwanese SMEs are export-oriented, the appreciation of the New Taiwan dollar, rising costs of labor and land, and surging labor and environmental protection movements all forced these enterprises to relocate to places where they could maintain competitiveness in the export market and find alternative market outlets.

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[60]Cheng, *Dongya jingji yu Jiangsu jingji bijiao yanjiu*, 109.
[61]*Haixia guangjiao*, 1994, no. 4:28.

For the TVEs, the increasingly onerous competition from home and abroad and declining profit margins have all pointed to the need to upgrade their technologies and improve management skills. During the period 1984-89, the technical level of two-thirds of the equipment used in the TVEs in southern Jiangsu was below the national average. Since costly research and development is simply beyond the capacity of TVEs, one shortcut is to join up with foreign investors to gain both technology and tax benefits. On both accounts, small Taiwanese investors with their equipment and management skills fill the needed technological niche. Given shared culture and a common language, Taiwanese investors are quickly adapting their technologies to the mainland, an environment similar to that at home fifteen to twenty years ago. Taiwanese investors are also able to capitalize by joining local cheap labor with Taiwanese production efficiency. Utilizing their rich OEM (original equipment manufacturer) experience and established production networks and market outlets, these investors are able to bring handsome returns to both Taiwanese investors and their local partners.

What is even more important for TVEs is the need for foreign investment capital and outlets to export markets. Increasingly affected by government macroeconomic policies since 1989, TVEs have been facing tremendous financial difficulties since the late 1980s which is reflected in their rising debt-equity ratio. For example, the equity-debt ratio of TVEs in the jurisdiction of Suzhou at the end of 1995 was around 75 to 80 percent. This means that almost all the fixed capital formation was derived from borrowing. In most of these TVEs, even operation capital was largely dependent on borrowing—with an equity-debt ratio around 60 percent. This high equity-debt ratio made TVEs increasingly vulnerable to government macroeconomic policies that, since the late 1980s, were targeted mostly at curbing inflation through tight monetary policy and raising interest rates.[62] In addition, local firms also desire the status of "joint venture" which would entitle them to the privilege of a three-year tax exemption

[62]Shi Xunru and You Jingbai, "Analysis of the Debt Problems of TVEs in Southern Jiangsu and Policy Responses," *Zhongguo nongcun jingji* (Chinese Rural Economy), January 1997, 10-16.

and two-year tax reduction, and the tariff-free imports of equipment and materials. Foreign investors can also provide trips abroad, foreign-made gifts, and hard currency.

Structural similarities and complementary individual needs have all helped make SMEs and TVEs ready partners. Shared cultural understanding and interpersonal connections between Taiwanese investors and local officials facilitate the establishment of business operations. SMEs looking for cheap labor, land, and access to mainland China's huge domestic market meet with TVEs looking for investment capital and more advanced equipment. Joint ventures often take the form of land contribution and outlets to China's domestic customers from TVEs and used equipment and access to the existing export marketing networks by the SMEs. Deals are often sealed at banquets amid heavy smoking and expensive wines. For Taiwanese SMEs, the equipment is obsolete and mostly useless in Taiwan. Through joint ventures with TVEs, they get a chance to replace their used equipment and find a market niche to increase their economies of scale and develop products with their own brand names. For example, for all the foreign-invested projects in Jiangsu, about 70 percent of foreign contribution took the form of equipment. In some areas, this figure reaches as high as 90 percent. Note that about 80 percent of this equipment has been previously used. Through joint ventures, TVEs gain tax benefits, more sophisticated equipment, the right to export, and valuable international marketing experience.

For the TVEs, in addition to cheap labor, land costs are almost zero. Also important is that in these "commercial republics," the party secretary is the boss and there is no need to wait for the approval of higher-level bureaucrats. Since often the success of investment in the mainland has come to depend largely on the relationship the investors have cultivated with local officials, the ability to make flexible deals with local officials has been a major attraction for small Taiwanese investors.

Conclusion

Through an examination of Taiwanese investment in Jiangsu province in east China, this paper has argued that the surge of Taiwanese investment into mainland China has been facilitated by the flexibility of Taiwan's unique industrial organization, shared cultural understanding, and language affinity with their local agents. While not guaranteeing the success of the investment projects, these factors certainly help lubricate the establishment of interpersonal networks and lower transaction costs in negotiating business deals. These networks are especially important for small Taiwanese investors given the rent-seeking environment in mainland China as a result of some peculiar features of reform policies, especially "particularistic contracting." Motivated by new fiscal schemes, rapid local development, foreign exchange earnings, and outright personal benefits, local officials have become the most important agents for Taiwanese investment in mainland China. These local officials tend to be more flexible than higher-level bureaucrats and more willing to accommodate overseas investor needs in terms of more favorable tax breaks, relaxed inspection of imported materials, and higher percentage of sales allowed to the mainland domestic markets.

In the absence of routinely enforced business laws, the success of business depends largely on the flexible interpretation and implementation of regulations by local officials. With illicit practices prevalent, local official cooperation and the relationship the investors have cultivated with local officials have become the most important considerations for foreign investors. Being familiar with similar experiences back in Taiwan and with little cultural and language barriers, Taiwanese investors have a clear advantage over other foreign investors in the mainland in finding opportunities and cutting deals. This is especially true at the local level where the reach of the state is stretched to the limit and irregular practices are most prevalent. While likely to come under increasing scrutiny as China becomes more and more involved in various international organizations, these informal ways of doing business are unlikely to fade away soon given their prevalence at the local level.