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**UNIVERSITY OF WARWICK
DEPARTMENT OF POLITICS AND INTERNATIONAL STUDIES**

**THE DYNAMICS OF CROSS-BORDER
MICRO-REGIONALISATION AMONG, GUANGDONG,
TAIWAN AND JAPAN**

**Sub-National Governments, Multinational Corporations and the
Emergence of Multi-Level Governance**

KATSUHIRO SASUGA

Submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

June 2002

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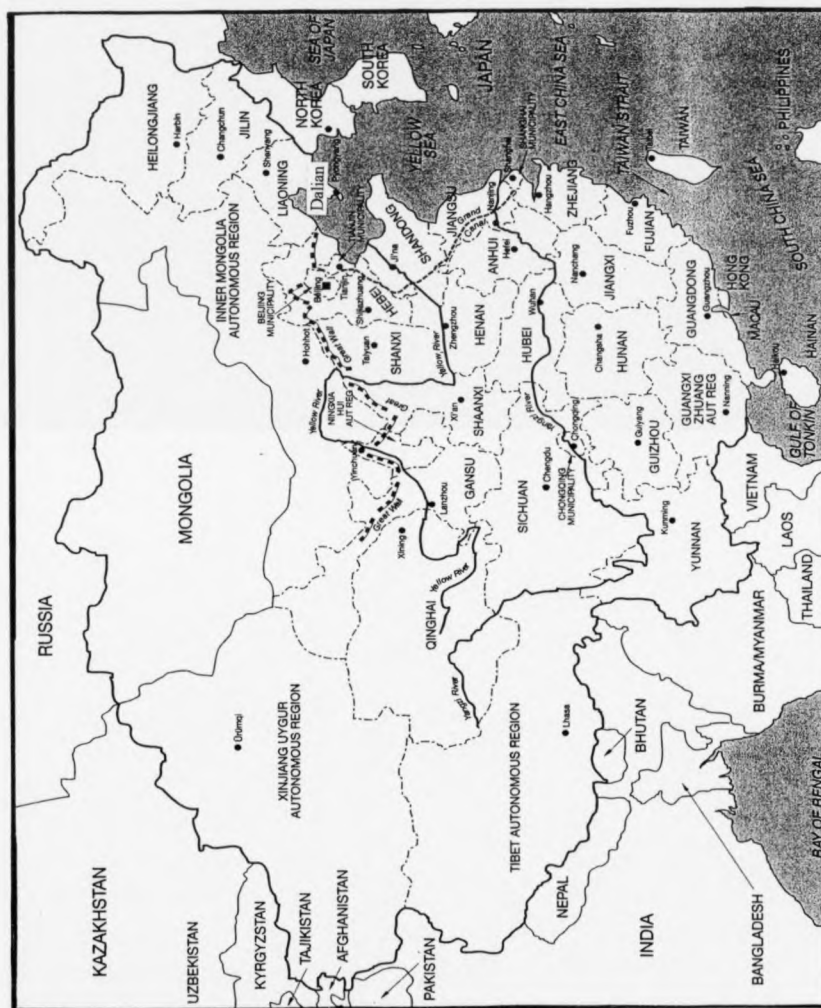
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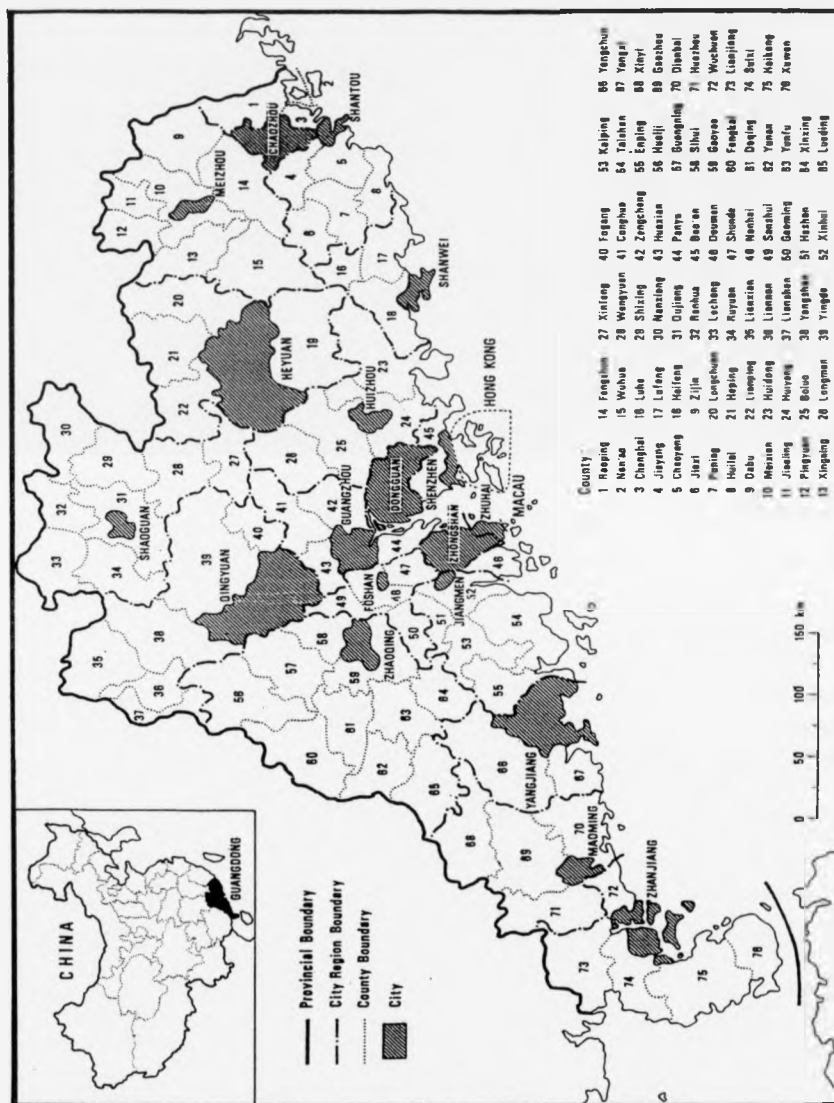
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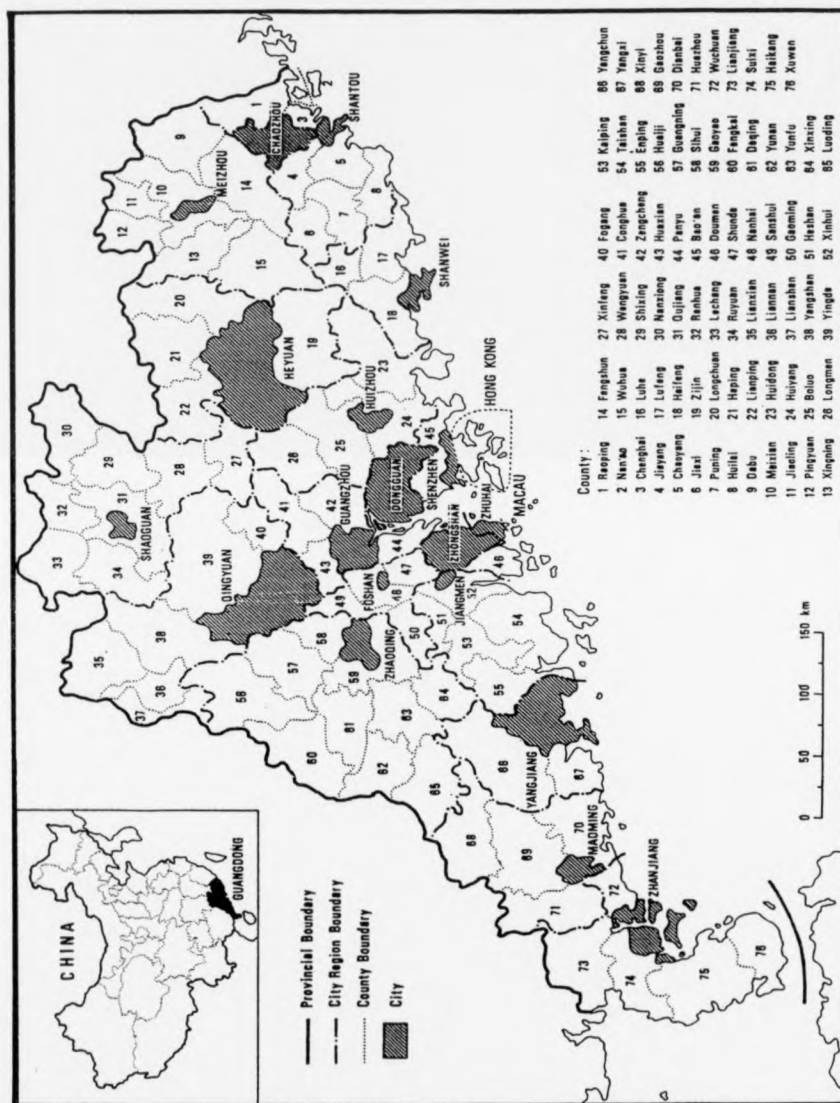
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Administrative Divisions of Guangdong

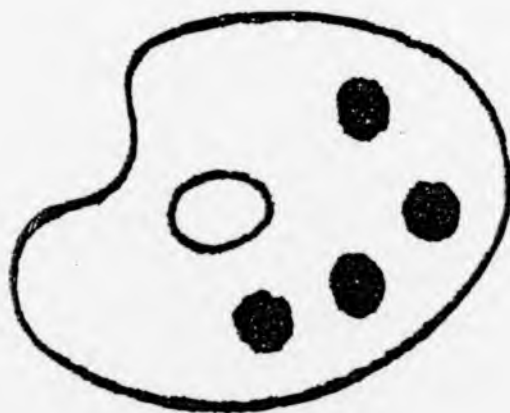
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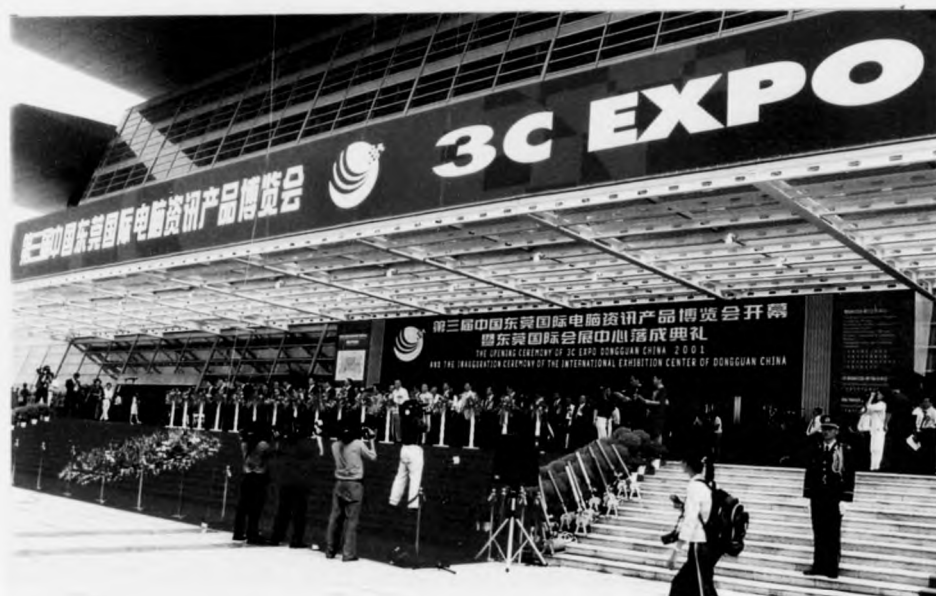


Administrative Divisions of Guangdong

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3C EXPO in Dongguan, October 2001

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ABSTRACT

This thesis applies an international political economy perspective to explore the main factors and processes involved in the development of micro-regionalisation among the Guangdong province of China, Taiwan and Japan with specific reference to the electronics industry. The emphasis is on the inter-related dynamics of multi-level governance (involving in particular the increasingly important role of Chinese sub-national governments and their network relations with multinational corporations) and the spread of cross-border production networks and international commodity chains. This is the first study to integrate an analysis of economic and political-governmental factors in the development of this particular case of micro-regionalisation. The analysis focuses on three related research questions: (1) How should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan? (2) What kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations? (3) How do networks of multi-level governance (MLG) operate to facilitate micro-regionalisation?

First, the phenomenon of micro-regionalisation among Guangdong, Taiwan and Japan is analysed in terms of three major components: the opening up of new political and economic spaces in Guangdong as a result of China's domestic reform movement and the emergence of a fluid and flexible system of multi-level governance; the strategic decisions by Japanese firms, especially in electronics, to invest in southern China; and the expansion of cross-strait production networks between southern China and Taiwan.

Secondly, the development of cross-border relations is examined from the viewpoint of the inter-relationships between key strategic actors (the state, sub-national governments and multinational firms) and the impact of a number of organisational variables, including commodity chains, network linkages, production networks, *guanxi* networks and organisational learning and conventional social factors). The analysis highlights the impact on firms' behaviour of both the home and host governance contexts.

Thirdly, the analysis shows that, with the dispersion of authoritative decision making in China, the multiple levels of local (sub-national) government have assumed more responsibility in responding directly to foreign investors. The case study of Dongguan and the electronics industry reveals the important roles of the provincial, city and sub-municipal governments in developing cross-border micro-regional network relations with multinational firms. It also highlights some of the major problems arising from an emergent, unplanned system of multi-level governance that lacks overall control and co-ordination.

TRANSLITERATION

Where there are references to Chinese names, in most cases, the system of Romanisation of Chinese characters used in this study is Mandarin (the *pin-yin* system). The only exceptions are proper names and places in Taiwan (e.g. 'Taipei') and the names of some famous people such as Lee Teng-hui. However, if the name is widely used in both versions in English publications, both versions are given in the text, as in the case of the Taiwanese Nationalist Party (Guomindang/Kuomintang). Following the Chinese convention, names in the text and notes are given with the family name first followed by the given name, e.g. Deng Xiaoping. Also, in the case of Japanese names, traditionally the family name is first, followed by the given name. However, in writings of Japanese names in English, the given name is followed by the family name (e.g. Kaname Akamatsu). Long vowels in Japanese names are indicated by macrons (e.g. 'Tsūsanshō'), except when referring to authors and works published in English and to the names of the big well-known cities and major firms such as Tokyo, Osaka and Toshiba. Thus a work written in English by a Japanese author named Ōmae appears as Ohmae in the text. A work written in Japanese by a Chinese author named Chō appears in the bibliography in the Japanese section with both versions, e.g. Chō (Zhao). In the bibliography, for all English, Japanese and Chinese authors, the family name is given first, followed by the given name after a comma (,).

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LIST OF ABBREVIATIONS

ACS	Association of Caribbean States
ADB	Asian Development Bank
ADF	Asian Development Fund
AFTA	ASEAN Free Trade Area
AICO	ASEAN Industrial Cooperation Scheme
AMF	Asian Monetary Fund
APEC	Asia-Pacific Economic Co-operation
ARATS	Association for Relations Across the Taiwan Strait (China)
ARF	ASEAN Regional Forum
ASEAN	Association of South East Asian Nations
ASEM	Asia-Europe Meeting
BSEC	Black Sea Economic Cooperation Scheme
CCP	Chinese Communist Party
CCPCC	Chinese Communist Party Central Committee
CD-ROM	Compact disc read only memory
CEA	Chinese Economic Area
CEFTA	Central European Free Trade Agreement
CJV	Contractual joint venture
COEs	Collective-owned enterprises
CPNs	Cross-Border Production Networks
CPU	Central processing unit
CRT	Cathode ray tube
CSPs	Cities with separate plans (China)
DFTEC	Dongguan Foreign Trade and Economic Cooperation bureau
DKB	Daiichi Kangyō Bank (Japan)
DPP	Democratic Progressive Party (Taiwan)
DRAM	Dynamic random access memory
DTN	<i>Dongguan Tongji Nianjian</i> (Dongguan Statistical Yearbook: China)
DVD	Digital video disc
EAEC	East Asian Economic Caucus
EAEG	East Asian Economic Group
ECOWAS	Economic Community of West African States
EJV	Equity joint venture
EMS	Electronics Manufacturing Service

EPZ	Export-processing zone
ERSO	Electronics Research Service Organisation (Taiwan)
EU	European Union
FDI	Foreign direct investment
<i>FT</i>	<i>Financial Times</i>
FTA	Free trade agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GE	Grant Element
GITIC	Guangdong International Trust and Investment Corporation
GSP	Generalised System of Preference
<i>GTN</i>	<i>Guangdong Tongji Nianjian</i> (Guangdong Statistical Yearbook: China)
HKID	Hong Kong Investment Promotion Division
HKPC	Hong Kong Productivity Council
IC	Integrated circuit
ICCs	International Commodity Chains
IMF	International Monetary Fund
IPE	International Political Economy
IPNs	International production networks
IPR	Intellectual Property Right
IT	Information Technology
ITCC	Industry and Technology Council Corporation (Hong Kong)
JETRO	Japan External Trade Organisation
KMT	Kuomintang (Chinese Nationalist Party)
LCD	Liquid crystal display
LD	Laser disc
LED	Light emitting diode
M&A	Merger and Acquisition
MAC	Mainland Affairs Council (Taiwan)
MERCOSUR	El Mercado Comun del Sur
METI	Ministry of Economy, Trade and Industry (Keisanshō: Japan)
MITI	Ministry of International Trade and Industry (Tsūsanshō: Japan)
MJSTA	Monte Jade Science and Technology Association
MLG	Multi-level governance
MNCs	Multinational corporations

MOF	Ministry of Finance (Zaimushō: Japan)
MOFA	Ministry of Foreign Affairs (Gaimushō: Japan)
MOFTEC	Ministry of Foreign Trade and Economic Cooperation (China)
NAFTA	North American Free Trade Agreement
NGOs	Non-governmental organisations
NIDL	New international division of labour
NIEs	Newly industrialising economies
<i>NKS</i>	<i>Nihon Keizai Shinbun</i>
NPC	National People's Congress (China)
NRT/A	New Regionalism Theory/Approach
OA	Office automation
OBM	Original brandname manufacturing
ODA	Official development assistance
ODM	Original development manufacturing
OECD	Organisation for Economic Cooperation and Development
OEM	Original equipment manufacturing
P&A	Processing and assembling
BOC	People's Bank of China
PECC	Pacific Economic Cooperation Conference
PKO	Peace keeping operation
PLA	People's Liberation Army (China)
PRC	People's Republic of China
PTA	Processing trade arrangement
R&D	Research and development
RCA	Radio Corporation of America
ROC	Republic of China
RTA	Regional trade agreement
SAR	Special administrative region
SEF	Strait Exchange Foundation (Taiwan)
SEI	Statutes of Encouragement of Investment (Taiwan)
SEZ	Special economic zone
SMEs	Small and medium-sized enterprises
SNGs	Sub-national governments
SOEs	State-owned enterprises
SPS	Switch power supply
TAC	Electronics Technological Advisory Committee (Taiwan)

TBA	Taiwanese Business Association
TEEMA	Taiwanese Electrical and Electronics Manufacturing Association
TFT	Thin film transistor
TJCSS	Tōkan (Dongguan)-Japan Consulting Support Service
TNCs	Transnational corporations
TOBs	Take-over bids
TSMC	Taiwan Semiconductor Manufacturing
TVEs	Township and village enterprises
UK	United Kingdom
UMC	United Microelectronics Corporation
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UPS	Uninterruptible power supply
US	United States
VTC	Vocational Training Council (Hong Kong)
VTR	Video tape recorder
WFV	Wholly foreign-owned venture
WTO	World Trade Organisation
ZTN	<i>Zhongguo Tongji Nianjian</i> (China Statistical Yearbook)

Note:

1 billion = 1,000 million

Exchange Rate: 1 US dollar = 8.2785 RMB (Chinese currency) = 107.77 Japanese Yen (2000)

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June 2002, KATSUHIRO SASUGA

CHAPTER 1

INTRODUCTION

During the 1990s, 'globalisation' and 'regionalisation' became fashionable terms in the study of international political economy (IPE). These phenomena cannot be explained by a single causal mechanism but must be seen as complex, uneven and contradictory trends that result from many different causal processes (Jessop, 2001: 27). In East Asia¹ the nature and scope of these impacts on the emerging markets of less developed countries, especially China, is a particularly difficult issue, since it raises fundamental questions about the scale of economic activity (traditionally based on the Chinese national economy). Since economic reform, China has been the largest recipient of foreign direct investment (FDI) among all developing countries. The large injection of FDI, the transfer of technology, and the abundant supply of cheap labour have led to China's success in the development of its foreign trade. Spatially, China's distinctive pattern and processes of reintegration with the world economy are most clearly visible in the rapid development of industrial agglomeration in the Pearl River Delta in the Guangdong province.²

In the Pearl River Delta, labour-intensive, low-technology and low-value-added manufacturing started with the relocation of activity from Hong Kong in the 1980s and has since grown into a massive agglomeration in the electronics industry (especially in PC-related products), which now forms the world's largest exporting base. Following investment by Hong Kong firms, Taiwanese, US and Japanese FDI has injected huge levels of foreign capital into this region. The emergence of cross-border economic dynamism has brought about a fundamental contradiction between 'pure economic space' and the economy as a territorially and/or socially embedded system of both economic and extra-economic resources and competencies. While this emerging economic space has had a favourable effect on economic development as a whole, it has also served to further fragment the national economy and create alternative foci of identity and political legitimacy (Jessop, 2001: 28).

Thus far, most popular studies of the economic relations among China, Hong Kong and Taiwan have sought to explain those relations in terms of three distinct geographical layers: 'Greater China' or 'the Chinese Economic Area' (CEA) (mainland China, Hong Kong, Taiwan and Macau); 'Greater South China' or the 'South China Economic Zone' (Guangdong, Fujian, Hong Kong and Taiwan); and 'Greater Hong Kong' (the Hong Kong-Guangdong nexus) (Drover, Johnson and Tao, 2001; Sum, 1999; Sung, 1998; Rowley and Lewis, 1996; Hsiao and So, 1997; Shambaugh, 1995; Naughton, 1997; Taylor, 1996; Khanna, 1995; Kwok and So, 1995; Jin 1995). There has been little interest in examining the processes and consequences of spatial restructuring across southern China from the perspective of the broader dynamics of East Asian regionalisation and sub-national involvement in cross-border governance.³ The three-layered pattern of China's economic relations is usually defined narrowly in terms of horizontal political and economic groupings of regions that benefit from their geographical proximity but lack formal institutional arrangements. However, the pattern of the economic interconnectedness of 'the three Chinas' is increasingly determined by a deep-rooted restructuring at the regional and firm levels as an expression of a new international, regional and hierarchical division of labour within and between regions. How can we explain the fact that a number of multinational corporations (MNCs) have selected Guangdong province (Pearl River Delta Region) as their manufacturing base in China? What are the theoretical implications of this phenomenon for the study of IPE? These are key questions that will be addressed during the present analysis.

1.1 Research Aims

This study seeks to explore and explain the key components and characteristics of the emergence of micro-regionalisation⁴ among the Guangdong province of China, Taiwan⁵ and Japan and the role of networks of governance⁶ linking Chinese sub-national governments (SNGs) and foreign firms. The focus is on the development of networks of SNGs in the context of the spread of industrial agglomeration in Guangdong with particular reference to the rescaling of Chinese political economy, the role of Japanese and Taiwanese FDI, the role of local government, and the governance of cross-border production networks (CPNs) and international commodity chains (ICCs)⁷ in the electronics industry.

The processes of economic globalisation exhibit a remarkable diversity at the regional scale. National governments remain the most important providers of responses to globalisation, but there are increasing interactions at the sub-national level between local governments and MNCs. This suggests the need to develop an in-depth understanding of the new mechanisms of multi-level governance (MLG) and the role of ICCs and CPNs. However, this is a complex task, since the forms of governance are continually evolving and changing.

It is especially important to understand the mismatch between political and economic space under the impact of globalisation. East Asian micro-regionalisation is a good example of this problem. Although this study considers only one industrial sector, the electronics sector, as a specific case study for analysis, it utilises this case study to demonstrate the broader significance of emergent networks of governance linking SNGs and MNCs, and evolving intra- and inter-firm relations through investment and production activities. The major driving forces behind the expansion of the electronics industry in Asia are pragmatic technological transfer strategies, FDI, the subsidiaries of MNCs, Japan's role in building technology bases, and overseas Chinese firms (Das, 1998: 67). These networks are complex and require innovative methods – both formal and informal – of co-ordination and management in order to ensure the achievement of mutual benefits for the parties involved.

The three key research questions underlying this study are as follows:

- How should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan?
- What kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?
- How do networks of multi-level governance (MLG) operate to facilitate micro-regionalisation?

In empirical terms the research aims to furnish data concerning the structures, functions and operations of cross-border micro-regional networks of governance. More specifically, the intention is to contribute to an understanding of the implications of these developments for MLG in China and for the pattern of China's integration with the East Asian regional

economy. The thesis argues that the new regionalism in East Asia is a manifestation of the broader impact of economic globalisation, and involves a deep-rooted restructuring at the regional and firm levels as an expression of new international, regional and hierarchical networks of governance within and between regions. At the firm level it is the emergence of CPNs of various kinds, linked to the geographical extension of ICCs, which is of primary importance and poses the most fundamental challenges for the operation of SNGs. In theoretical terms, the aim of this study is to contribute to the development of theories of micro-regional network-building and to the understanding of emerging patterns of cross-border multi-level governance.

1.2 Definitions of Key Terms

Before outlining the parameters of the research area of multi-level governance and micro-regionalisation, it is important to clarify several definitional issues concerning types of FDI and foreign trade in cross-border economic relations among Guangdong, Taiwan and Japan.

FDI

Foreign direct investment is investment in the businesses of another country. This often takes the form of the setting up of local production facilities or the purchase of existing businesses. It must be distinguished from portfolio investment, which is the acquisition of securities (Rutherford, 1992: 178). In China, the forms of foreign-invested enterprises – *sanzi qiye* – consist of four types: equity joint ventures (EJVs), contractual (or co-operative) joint ventures (CJVs), wholly foreign-owned ventures (WFOVs), and joint exploration of resources. An EJV is a limited liability company jointly operated by Chinese and foreign investors in proportion to the size of their respective investments. Any profit and loss is distributed according to the equity shares of its partners. Profit sharing in CJVs is designed by contract and not by equity proportion. A WFOV is 100%-owned by foreign investors but the duration of the investment contracts requires government approval. The fourth type -- joint exploration of resources -- is used for the joint development of natural resources. According to official Chinese statistics, foreign investment incorporates three main categories: foreign loans, FDI and other foreign investment. This thesis does not discuss foreign loans and focuses on FDI (EJVs, CJVs and WFOVs) and forms of *sanlun yihu*: processing and assembly (in other foreign investment) and compensation trade.

Processing Trade Arrangements (PTAs)

Since the economic-reform process began in the late 1970s, the forms of China's foreign trade have become diverse, and recently nearly half of China's foreign trade has been undertaken by processing trade arrangements (PTAs).⁸ The forms of processing and assembling (P&A), and of compensation trade, are types of consignment trade between Chinese firms and foreign firms, called as *sanlai yibu*. In general, the Chinese government or its partner provides plant, labour, water, electricity and other basic facilities, and foreign investors supply the machinery, equipment, materials and design of products and take responsibility for marketing. Foreign firms pay a processing fee to the Chinese side (Sit, 1998: 896). They enjoy exemption from tax on imported materials, and the finished products are then sold outside China. This is the major difference from other forms of joint venture in China. For China, as the forms of P&A, and of compensation trade do not require the introduction of high-tech machinery and the search for access to foreign markets, it is relatively easy to expand exports.

The three forms of P&A (*sanlai*) include those businesses engaged in processing with supplied materials (*lailiao jiagong*: contract processing), manufacturing with supplied samples (*laiyang jiagong*: import processing), assembling with supplied parts and design by foreign partners (*laijian zhuanpei*). In contract processing, Chinese partners receive a net fee to process supplied raw materials into finished goods according to the foreign investors' requests. This is a *de facto* form of CJV (G. Yeung, 2001a: 6). Chinese official figures for inward investment, which distinguish CJVs investment as a separate investment from processing and assembly and compensation trade, underestimate the effect of CJVs investment on China's foreign trade. In import processing, Chinese partners produce and export the finished products according to a sample supplied by foreign partners. In *laijian zhuanpei*, Chinese partners receive a net fee to assemble supplied components according to a design provided by foreign partners (ibid.: 6). Compensation trade (*buchang maoyi*) is similar to barter trade: Chinese partners import equipment and technology funded by a foreign investors' loan and repay it with products. They compensate for the fee for the introduction of machinery facilities by producing goods. Chinese firms do not need to shoulder the burden of the introduction of high-tech machinery. Those firms intending to target the domestic markets are advised to convert P&A contracts into EJVs or CJVs (ibid.: 6). However, given China's vast territory and loose management of P&A (it is allowed almost everywhere in China), it is difficult to capture the real statistical data on such

processing arrangements. In the Chinese literature, the definition of consignment trade is even more diverse. For example, Shao Xianglin, Wang Yuliang and Ren Xiaowei (2001) categorise eight forms of processing trade. Therefore, in this thesis, in order to avoid confusion, it is important to pay attention to the real processes of transactions (trade data) rather than forms of investment. Processing trade arrangements (PTAs) in this thesis are seen to include transactions in which foreign investors bring parts into China as imports and take the processed products back as Chinese exports.

Utilised and Contracted FDI

In official Chinese statistics there are two types of FDI: 'utilised FDI' (actual use) and 'approved, agreed or contracted FDI'. Utilised FDI is the actual value of investment that has already materialised in China. It includes the re-investment of foreign firms in China. On the other hand, contracted FDI is the pledged value of investment. The gap between these two sets of statistics is indeed very wide.⁹ The contracted FDI often includes aborted projects and tends to overestimate the real extent of investment flows (G. Yeung, 2001a: 7). Thus, the focus of this thesis is the actual use of FDI.

The Origins of FDI

In official Chinese statistics there is no identification of the origins of FDI. It is very difficult to capture the real amount of investment. Hong Kong is counted as a separate foreign territory. In terms of accumulated inward FDI, until 1999 (actual use) Hong Kong was the largest investor in China (50.1%), the US (8.4%) was second, Japan (8.1%) was third, and Taiwan (7.8%) was fourth (*Kōryū*, No. 617, 2000). However, these figures do not necessarily reflect the origins of FDI accurately. For example, FDI from mainland China into Hong Kong is often reinvested into China in order to enjoy preferential treatment intended exclusively for foreign investors. In 1999, FDI from mainland China into Hong Kong accounted for 25.9% of Hong Kong's total inward FDI, and 24.8% of Hong Kong's outward FDI went to mainland China.¹⁰ This includes the reinvestment activities of foreign-financed firms in China. Also, much of the Taiwanese FDI in China is by small and medium firms which do not register officially with the Taiwanese authorities (since the latter still place restrictions on Taiwanese FDI in mainland China). In fact, Taiwanese FDI has recently used Central American islands as a tax haven for reinvestment to China (initially reinvestment was mainly through Hong Kong). In 1998, the Virgin Islands became the second largest source of China's inward FDI (8.87% of total inward

FDI based on actual use) and in 1999 they were the fourth largest supplier (6.60% of total inward FDI based on actual use)(*Zhongguo Tongji Nianjian* : hereafter *ZTN*, 2000). A further complication is that some reinvestment is carried out through Hong Kong. In 1998, the Virgin Islands were the single largest investor in Hong Kong, exceeding even investment from mainland China (*Xianggang Jingji Nianjian* 2000). Furthermore, both Hong Kong and Taiwan are also used as conduits for reinvestment in mainland China by foreign firms (mainly US, European and Japanese). According to official Chinese statistics, all these investments originating outside Hong Kong have normally been counted as FDI from Hong Kong. Although Hong Kong's investment in China is not always 'pure' Hong Kong capital, in this thesis, in order to avoid further confusion, China's FDI is dealt with as foreign investment capital flow into China. However, we need to look behind the official statistics and explore the actual economic relations among Guangdong, Taiwan and Japan.

Foreign Trade

China's foreign trade statistics also classify Hong Kong as a foreign territory. Due to the various forms of PTAs between Hong Kong and China, some trade statistical problems arise. The 1999 statistics for trade between China and the US are a good example. According to the Chinese accounts, China's total trade with the US (in value) was \$US 61.47 billion and China enjoyed a trade surplus of \$US 22.41 billion. However, on the US side, the total trade with China was valued at \$US 94.91 billion, and the US trade deficit against China was \$US 68.67 billion (*Jingji Ribao*, 2 March 2000). By the same token, in 1999 China announced a \$US 1.4 billion trade deficit against Japan, while Japan announced a \$US 19.55 billion deficit against China. The gap between Chinese and Japanese trade statistics amounted to \$US 20.95 billion. One of the major reasons for this statistical gap is the impact of PTAs in China (*Jingji Ribao*, 2 March 2000). For example, in terms of US-China trade, China's trade surplus, excluding the PTAs in 1999, was estimated as \$US 21 million (*Kokusai Bōeki*, 16 May 2000). The transit trade through Hong Kong makes matters worse. Re-exported products from Hong Kong, which are not re-assembled in Hong Kong, are counted as China's exports. Thus, China's trade surplus against Hong Kong exhibits the trade deficits of the US and EU (European Union) against China (*Kokusai Bōeki*, 16 May 2000). Thus, PTAs and Hong Kong's status as a foreign territory make it more difficult to count real trade flow among the countries. In order to

avoid further complications, this thesis employs the definition that Hong Kong is a foreign territory of China.

Multinational Corporations

A multinational corporation (MNC) is defined as an international firm that produces goods or services in several countries, without being concentrated in a single country. By comparison, a transnational corporation (TNC) is a firm with substantial operations in many countries but which is controlled from its original home base (Rutherford, 1992). Thus strictly speaking, the difference between MNCs and TNCs can be seen in the difference between large Japanese MNCs (operating in several countries) and offshore production activities by SMEs (small and medium-sized enterprises, i.e. Japanese and Taiwanese firms controlled from their home country). However, this distinction does not necessarily identify the operational systems accurately due to the increasing complexity of cross-border production systems (product definition and design, supply of inputs, manufacturing, outsourcing, distribution, support services, research and development, etc.). Therefore, we use the term 'multinational corporation' to refer to firms (including TNCs) with activities across several countries.

Industrial Agglomeration

Industrial agglomeration is the spatial clustering of similar or related industrial activities in a particular place, and the co-location of firms engaged in a given line of business (Maskell et al., 1998: 9). In Japan, for example, the industrial agglomeration of the electronics industry in Ōta-ku (Tokyo), where more than 10,000 small electrical, metal and plastic processing factories agglomerate, supports the success of the Japanese electronics industry by responding to the demand for flexible processing (Itami, 1998). Industrial agglomeration can be seen as the result of the way in which key organisational variables (such as types of commodity chains, the structure of networks, organisational learning and conventions) significantly influence the performance of export-led growth.

The Electronics Industry

Throughout this thesis the consumer electronics industry receives special attention. The term 'electronics industry' here refers mainly to the production of consumer electronics goods including electronic products (especially radios, compact disc players, personal computers and televisions) and computer products as well as varieties of household

appliances such as washing machines and refrigerators. More correctly, Guerrieri (2000) distinguishes between industrial electronics products, consumer electronics and electronic components. Each sector has its own types of production network. Although this thesis focuses mainly on the production of consumer electronics, it also recognises the importance of the other two categories in terms of the complementary links between them and consumer electronics.

1.3 The Existing Literature on Chinese SNGs' Foreign Economic Relations

The literature relating to regionalisation among China, Taiwan and Japan is enormous. Accordingly, in the present study the literature on theoretical debates (Chapter 2), globalisation and regionalisation (Chapter 3), the reform of Chinese domestic governance and multi-level governance (Chapter 4), Japanese FDI and production networks (Chapter 5), Taiwanese FDI and Taiwan Strait (Chapter 6), and local corporative networks (Chapter 7) will be discussed separately in the appropriate analytical context. Here, we focus on a review of the literature on Chinese SNGs' foreign economic relations.

There is in fact only a small literature on local foreign economic relations with reference to Chinese SNGs at the sub-provincial level. Exceptionally, Vogel (1989) carried out extensive field work in Guangdong. He discusses the evolution of the open door policy and investigates reform at the provincial level (Guangdong and Hainan), in special economic zones (Shenzhen, Zhuhai, and Shantou), in the capital (Guangzhou), and at the county level. In an official publication, the Guangdong Province Planning Committee (1995) (in the references, Kantonshō Keikaku linkai) outlines the path of Guangdong's development with the aim of joining the developed world by 2010. This emphasises the importance of the provincial-level response in strengthening relations with Hong Kong and achieving a transformation of the industrial structure. In terms of the evolution of the open door policy at the provincial level, Goodman (1997) demonstrates how the provinces of Guanxi, Hainan, Liaoning, Shandong, Shanghai, Sichuan and Zhejiang have developed distinctive responses to the reform process, emphasising the dynamics of economic and social change within each province (e.g. in terms of new class formations), and the changing nature of these provinces' relations with the centre. Goodman's research group also publishes an academic journal focusing on the provinces (*Provincial China*). Hendrischke and Chongyi (1999) examine the ways in which major decision-making powers have gradually shifted to

the provincial level, and how the distinctive political and cultural identities of each province influence policy processes and outcomes. Their analysis includes studies of Guizhou, Shaanxi, Hubei, Tianjin and Jiangxi. Cheung, Chung and Lin (1998) focus on the role of provincial leadership in the initiation and implementation of economic reform. They offer four studies on resource allocation (Shanghai, Guangdong, Zhejiang, and Shaanxi) and four studies on foreign capital and investment (Shandong, Fujian, Hainan and Sichuan).

Although these four books make a significant contribution to a political economy perspective on China's new regionalism, apart from Vogel's work they all stress the role of the provinces and do not have much to say about the position of large cities and other sub-units within those provinces. Moreover, although they deal with foreign economic relations in some provinces, they do not focus on the international activities of provinces or cities -- which may be summed up in the term 'paradiplomacy' (see Dymont, in Hocking, 1993a). As Chung writes (1995):

As the de-ideologization of politics and economic interdependence are emphasized, sub-national governments have been empowered to deal directly with foreign business interests as well as, very often, with foreign government authorities. In some cases, local governments have gone so far as to bypass the central government in promoting their own parochial interests, thus introducing a thorny problem in central-local dynamics. In such cases, there are at least three different levels -- international, central, and local forces -- requiring more wide-ranging analysis of their conflicting views and interests (p.506).

Chung also notes the increasing tendency of provinces to form horizontal links among themselves, thereby creating regional blocs that present collective demands to the centre. At the same time, the various sub-provincial units (in particular, the special economic zones, coastal open cities, central economic cities) are also asserting their autonomy and in some respects are seeking to compete directly with the provinces (1995: 507). Chung (1999) demonstrates how different combinations of factors have contributed to both successes and failures in local economic development. His analysis includes studies of Guangzhou, Tianjin, Hangzhou, Wenzhou, Qingdao, Dalian, Xiamen, Fuzhou, Chengdu, Chongqing, Nantong, Zhangjiagang, Panyu and Nanhai. Chung's work makes a significant

contribution to the understanding of the multi-layered structure of Chinese political economy and the importance of the entrepreneurial role of the large cities.

In terms of East Asian regionalisation below the level of the state, there are still few studies of the role of the sub-provincial level (i.e. major cities). Chung's book is a notable exception but it focuses on bilateral economic relations, e.g. between Qingdao and South Korea. However, the relationship between economic integration and domestic politics cannot be fully understood through such a bilateral approach. In general, the literature has been dominated by a state-led framework based on a strict and unhelpful distinction between domestic and international politics. Thus, the interpenetration of the domestic and international spheres is not given sufficient attention. In the case of Chinese SNGs and their role in the development of the East Asian regional economic system, domestic and international factors are closely interwoven and cannot be dealt with separately. The bilateral perspective on SNGs can only be applied to limited cases (e.g. the study of fiscal decentralisation) and cannot be applied to the phenomena of multi-dimensional, multi-layered and complex regionalisation.

The lack of appropriate approaches to the analysis of SNGs has previously obstructed the understanding of the role of Chinese SNGs as economic actors in East Asian regionalisation. In particular, there has been a lack of network-based approaches and attention to issues of governance. Consequently, there have been few systematic attempts to compare East Asian regionalisation with regionalisation processes in other areas. Researchers invariably comment on China's uniqueness. Henry Yeung's study (2000) offers an analysis of the relations between Singaporean FDI and Chinese local government. It argues that as a result of economic reform, the activities of foreign firms in China are heavily dependent on local corporatism. Undoubtedly, the viewpoint of economic geography is helpful, and it is applied in this thesis to the study of networks of governance.

Godfrey Yeung's study (2001a) of the city of Dongguan (in Guangdong) contributes a valuable micro-geographical perspective. It gives special consideration to how the attractiveness of the region to foreign (especially Hong Kong investors) has been influenced by locational, economic, administrative and cultural factors. The analysis highlights the complex, mutual interaction between foreign firms (Hong Kong) and Dongguan's local government. Unfortunately it does not much discuss East Asian

regionalisation, especially the significant role of Japanese and Taiwanese firms in Dongguan.

The aim of this thesis is to fill the research gap that has now become apparent by taking into account the roles of SNGs in creating various networks of governance with foreign firms. In this way the present study seeks to contribute to the literature on comparative regional studies and to bridge the artificial distinction between the domestic and international levels of analysis that stems from the emphasis on the state-led perspective.

1.4 The Framework of Analysis and Research Methodology

Issues of spatiality and spatial complexity have now become important focal points of work in the social sciences. There is a formidable methodological challenge to link empirical studies and a theoretical understanding of the role of SNGs and private actors in cross-border economic relations. In this section we first present the framework of analysis for the current research, and we then explain the research methodology.

1.4.1 The Framework of Analysis

The creation of definitions, concepts and categories is necessary in order to analyse the phenomenon of economic regionalisation. Although there is an enormous literature on regionalisation, most books and articles are concerned with the development of the EU. There has been a neglect of broader comparative studies, and our understanding of the development of cross-border economic relations, especially outside the EU, remains poor. What is needed is a categorisation of different forms of regionalisation and their distinctive characteristics.

Higgott and Reich (1998) suggest that the concept of regionalisation embraces three distinct dimensions: (1) *de facto* processes of economic integration, firm-led and network-led processes, and *de jure* processes of state-led institutionalised governance; (2) emerging (vertical) meso-levels of authority between the state and the global order (trans- or supra-national regionalisation), and between the state and the local level (sub-national regionalisation); and (3) emerging (horizontal) authority across extant territorial jurisdictions. The major interest of this thesis is in the increasing interplay between *de*

facto processes of economic integration and *de jure* processes of state-led institutionalised governance at the sub-national and micro-regional level.

This thesis therefore concentrates first of all on the importance of *de facto* processes of economic integration, the organisation of production and allied activities, and the clustering of industry through the expansion of international (cross-border) production networks. The case of the electronics industry, which has played a major role in the East Asian economy, is chosen to illustrate these changing geographical patterns. In particular, the locational strategies and production system of Japanese and Taiwanese electronics firms need to be highlighted. It is important to identify the strategic differences between Japanese and Taiwanese firms. While there are various elements causing differences, to a large extent, these are derived from the characteristics of the home country's governance. The Taiwan Strait conflict remains a politically unresolved area, and thus we need to consider why Taiwanese firms have taken a risk by investing in mainland China. The desire to minimise transaction costs cannot be the only reason.

This thesis focuses on the increasing role of SNGs in co-ordinating the relations between economy and society in cross-border economic relations. In particular, it seeks to distinguish between two different *de jure* processes: vertical and horizontal regionalisation between the state and the local level. It also seeks to identify the emerging horizontal authority across extant territorial jurisdictions (i.e. national boundaries) at the sub-national level. A sub-national level of analysis in the regionalisation debate is essential in order to bridge the divide between the macro- and micro-regionalisation perspectives (see Chapter 2). In East Asia, through the development of economic relations between cross-border regions, the sub-national level has changed both qualitatively and quantitatively. Behind the rapid development of urban areas in East Asia there are fundamental changes in industrial structure. Industrialisation based on export-led strategies, and the international, regional and hierarchical division of labour, mainly in the production system, has become the foundation of the continuous upgrading of industrial structure and rapid urbanisation. The resulting quantitative economic growth has in turn led to qualitative change at the sub-national level. One problem here, however, is that in China the discretion of the sub-national level has invariably been limited by the state. Accordingly, the vertical dimensions of regionalisation (decentralisation and recentralisation) within a country are

extremely important. This restructuring leads the domestic governance structure towards multi-level in nature.

Why, then, does the rise of cross-border economic activities require new forms of governance? One of the reasons is that the state and sub-national levels have faced an increasing burden of new regulations. For example, when MNCs set up regional headquarters or local corporate bodies, they seek to establish interface functions and a new business infrastructure, e.g. in finance, telecommunications, transportation, legal services, research and development, and distribution, in selected areas. As a result, foreign and domestic business interests increasingly agglomerate at the sub-national level. A SNG seeking to attract foreign capital must ensure that the economic infrastructure is in good condition in order to support both domestic and international use. Therefore, international airports and ports, as part of the urban infrastructure, also assume the characteristics of international public goods (Imasato, 1999: 18-21). In this way, SNGs reinforce the development of firms' regional relations and in turn promote their own internationalisation. Furthermore, the programme of economic build-up and foreign economic strategies qualitatively supports the activities of cross-border firms by reducing the problems caused by national boundaries. While the main economic actors in regionalisation are firms, as the production system is incorporated in a certain local area (localisation) the sub-national area can no longer escape the influence of the internationalisation of the production system. The relations between the state and firms cannot be examined at only the state or firm level of analysis, because the impact of MNCs on the regional economy occurs mainly through the localisation processes in the production system. Localisation stresses the importance of territoriality and local political space, and the embeddedness of firms in the specific social and cultural milieu in which they operate. The effective co-ordination of inter-firm networks can thus best be achieved by local government rather than central government. Consequently, SNGs are emerging as vitally important economic actors in both the domestic political economy and the international political economy.

In becoming major economic actors, SNGs need the continuing political protection of the modern sovereign state system. However, at the same time, in this situation the power dynamics come from two seemingly opposite directions. The state is seen to be under the influence of the power of both relativism and absolutism. The forces of relativism are seen as regionalisation brings in various rules about competitiveness and complementarity,

norms, identity and organic regionness. This relativises state autonomy and monopolistic territoriality. This in turn can lead to growing political tensions within a country. On the other hand, the forces of state absolutism are seen in the way in which the state utilises regionalisation in order to strengthen its power, national interest and territoriality on the basis of rationality and nationalism. However, this study does not adopt a deterministic viewpoint, but instead seeks to reveal the empirical processes of the evolution and reform of governance taking place beneath the state level in the context of globalisation. Of crucial significance is the way in which international cross-border production networks are adjusted and institutionalised into the state system through localisation, and the way in which the internationalisation of SNGs is adjusted into the state or beyond the state's capability. This requires an investigation of the evolution of governance in both the vertical (central and local government) and horizontal (local horizontal authority) regionalisation processes.

A particularly important question concerns the interplay between the *de facto* and *de jure* regionalisation processes, and the respective roles of the central (vertical), local (horizontal) and external actors (state or firms). A related question is whether the size of the sub-national unit directly influences the unit's role in regionalisation processes. This study focuses on two levels of SNG in China: the provincial level (*sheng*) and the sub-provincial level (*shi*). It argues that under the impact of globalisation, SNGs are playing an increasingly important co-ordinating role between MNCs and the state, and are becoming economic actors in their own right, defending their own economic interests and expanding their territoriality. The analysis therefore seeks to clarify the difference between two contrasting regionalisation processes in China: from above (the national process: vertical) and from below (the sub-national process: horizontal). Decentralisation and recentralisation are seen as the primary measures of Chinese regionalisation from above, and the sub-national responses to this movement can be seen as an expression of sub-national regionalisation from below. The study seeks to show that China needs a further restructuring of the domestic developmental system and centre-periphery relations in order to adjust to globalisation. In considering the power configuration through the effects of production networks on the state system, the aim is to give an account of the roles of different levels of SNG in providing MNCs with international public goods. Thus, the analytical viewpoint of this study is the role of Chinese SNGs as economic actors in

bridging micro-regionalisation and IPE through emerging networks of cross-border governance.

The framework of analysis in this study employs concepts of *network* and *governance* as key characteristics of the emergent cross-border networking between SNGs and firms, and intra- and inter-firms relations. (These will be elaborated in more detail in Chapter 2.) The first of these concepts, *network*, denotes a 'complex of organizations connected to each other by resource dependencies and distinguished from other ... complexes by breaks in the structure of resource dependencies' (Benson, 1982: 148). Put another way, it refers to regularised interactions among independent agents, nodes of activity and sites of power (Castells, 1996). The concept of *governance* is used to indicate the ways in which networks are ordered, co-ordinated and regulated, both formally and informally. Governance is not the same as institutionalised government, although governments – in this case SNGs – play a major role in the conduct of governance. Governance suggests that a variety of actors and agencies – both public and private – are involved in order to create order. In one sense, therefore, governance denotes a complex and fragmented set of institutional and agency-based relationships in a particular field of activity. This gives rise to key issues concerning how such relationships are organised and how they function.

1.4.2 Research Methodology

The purpose of this section is to outline the research methodology employed in this study. The main challenge faced by the researcher is to link the empirical investigation of the cross-border networks of governance among Guangdong, Taiwan and Japan to the emerging theoretical understanding of the role of SNGs and private actors in cross-border economic relations, especially the growth of production networks.

Inevitably, the choice of research methodology is guided by a range of factors, including the researcher's own previous experience, academic background, specialisation and capabilities; the nature, scope and complexity of the phenomena under investigation, the specific research questions being addressed, the practical possibilities for research access, and the limitations of resources (including time) (Burnham, 1997).

1.4.2.1 Factors Influencing the Choice of Research Methodology

(a) The Nature, Scope and Complexity of the Research Area

The subject under investigation in this dissertation – micro-regionalisation and networks of multi-level governance among Guangdong (southern China), Taiwan and Japan -- is exceedingly complex. It embraces a range of phenomena of an economic, social and political nature and requires an exploration of their inter-relationships and dynamics over time. In particular, the processes being investigated do not fit neatly into formal institutional frameworks. Rather they are innovative, fluid and involve both formal and informal elements. Moreover, they cut across the territorial boundaries between states and exhibit a high degree of fragmentation. In addition, they relate to both the domestic and international spheres of economic organisation and political management.

To make matters even more complex, the existing literature in this research area is limited, and the literature that does exist (both primary and secondary) is mainly in the Chinese and Japanese languages. Since the dissertation is written in English, the researcher frequently had to deal with problems of translation among three languages. These problems were exacerbated by the researcher's need to undertake interviews in the three countries, which meant that in the cases of China (Guangdong) and Taiwan the researcher had to deal with the task of communicating in Chinese and translating the resulting information into English.

It is also not easy to arrange research interviews in China. In particular, there are still bureaucratic and cultural obstacles to foreign researchers exploring areas that are regarded by the political authorities as sensitive. This is certainly true at the level of Chinese SNGs. Often researchers in this situation have to develop contacts at a social level in order to 'open doors'. This is indeed one of the most important features of Chinese social networks, and social networks in turn often provide the basis for business and governmental networks.

For the researcher, the complexity of the area of investigation meant that he inevitably had to be selective in his research focus, and this led directly to the decision to select the electronics industry as a particular case study. One of the initial tasks, therefore, was to become familiar with how this particular sector operates from an economic and technological point of view through literature based study. Also, the researcher decided to

concentrate on one specific geographical location: Dongguan in the province of Guangdong. These deliberate choices made the research more manageable but also meant that limitations were posed on the extent of the study's comprehensiveness and generalisability.

(b) *The Key Research Questions*

As already explained above, this study employs three main research questions:

- How should we define and characterise key components of micro-regionalisation among Guangdong, Taiwan and Japan?
- What kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?
- How do networks of multi-level governance (MLG) operate to facilitate micro-regionalisation?

Each of these three questions raises methodological challenges. The first question involves an understanding of the nature of micro-regionalisation. The issue of regionalisation in East Asia is still dominated by three levels of analysis: macro, meso (sub-regional) and micro. This research question focuses on not only the level at which micro-regionalisation actually takes place but also interactions between different levels. The Chinese domestic context of micro-regionalisation involves the reform of governance through a range of measures implemented by the Chinese central government in recent years and their impact on central-local relations and the scope for local choice and autonomous decision-making. This issue has already been explored by several previous researchers (see Chapter 4). In the international and regional contexts, the empirical records of the East Asian regionalisation process, which focus more on the economic dimension (i.e. firm-led regionalisation), are readily available (see Chapters 5 and 6), so the research task here is essentially to combine an analysis of the two different streams of micro-regionalisation, i.e. the domestic and the international. Therefore, the main research methods are: literature-based research (including primary and secondary sources) and the analysis, synthesis and assessment of existing sources, supplemented by interview data.

The second research question involves a focus on the policy environment, the underlying economic rationale, and the roles of the key actors, although, as Henry Yeung (1998)

points out, political and institutional factors cannot be separated from the economic 'pull' of the host country or region in attracting inward investment. On a theoretical level there is no shortage of discussion of the rationale behind inward investment decisions, but the main need in the present research is to gather empirical material from the electronics industry in order to gain a more in-depth understanding of what has motivated Taiwanese and Japanese investors. The policy environment in the home countries (in this case, Japan and Taiwan) cannot be separated from the economic 'push' factors for MNCs. Similarly, MNCs' production networks abroad are to a great extent embedded in their country of origin's distinctive business practices and managerial styles. There is a wide-ranging existing literature on the East Asian international division of labour, Japanese FDI, and Taiwanese FDI (see Chapters 5 and 6). In this regard, therefore, literature-based research and analysis are the primary research tools and some interview data are used for supplementation.

The third question concerns the operation and structure of networks of MLG among Guangdong, Taiwan and Japan. This is a subject on which there is virtually no reliable literature at the present time. Some of the literature on Chinese SNGs is relevant in the sense that it explains their internal structures and links with central government and also considers SNG's foreign economic relations (i.e. G. Yeung, 2001a). However, the focus of the present research is on the networking linkages between SNGs and foreign firms. This is explored here through the case of Dongguan with particular reference to the electronics industry. Some information has been gathered from documentary sources, but in addition it has been necessary to rely on interviews with key persons and observations in these processes. Thus, for the final case study, interviewing and observations are the primary research source, and are combined with literature-based research.

1.4.2.2 Resource Limitations

The research for this project was completed within a limited time period: from October 1997 to December 2001. This included a comprehensive literature search, the establishment of an appropriate framework of analysis, the design of a research strategy, and the writing of various drafts of Chapters 1 to 8. Research visits to Guangdong, Hong Kong, Taiwan and Japan took place in 1998 (July to August), 1999 (July to August), 2000 (April and September to October), and 2001 (September and October).

With more time, more finance and more opportunities for research visits and interviews, it would have been possible to broaden the research base for the dissertation. This is a problem for all researchers, especially those involved in international and cross-national investigations. Inevitably, therefore, the present thesis must be seen as an initial, limited study which needs to be expanded further in the future. The emphasis throughout is on achieving a balance between the depth and breadth of research. In general, however, the aim is to achieve an intensive rather than extensive analysis of the subject matter, and to employ a corresponding 'fine-grained' rather than 'coarse-grained' methodological approach (Harrigan, 1983).

1.4.2.3 Quantitative and Qualitative Research Methods

Quantitative research is concerned mainly with measurable, statistical indicators, usually linked to the testing of 'models' and hypotheses that are formulated in terms of quantifiable relationships, whereas qualitative research focuses on attitudes, beliefs and patterns of human behaviour, i.e. the actual practices that can be identified in a particular field of activity. Economics is an example of a field in which traditionally quantitative methods have been dominant, but it is interesting to note that even here there has been a growing interest in the social, institutional and behavioural context of economic activity (North, 1990). In the present research quantitative analysis has a role, for example in terms of data concerning patterns and levels of inward investment, the geographical dispersion of firms, and business performance; but the main focus is on examining interactions between SNGs and firms across national borders. Here qualitative methods are also relevant and are more likely to produce the answers to the key questions about structure and operation of networks of governance. One purpose of the interviews and observations was to obtain essential factual information about the development of cross-border relations among Chinese SNGs (in Guangdong), Taiwanese and Japanese firms, through various cooperative meetings and forums as well as local business associations.

Unlike most quantitative research, the present research is not primarily concerned with the establishment of causal relationships between two or more variables, with 'proving' any specific hypotheses, or with generalising the research findings to other areas of research. It seeks to offer an in-depth analysis of the particular networking relationship of micro-regionalisation in one specific geographical area (micro-region) of the world. For all these reasons, the quantitative approaches are adopted where the aim is to identify patterns

of economic dynamism, and the main approach to the study of networks of multi-level governance is more qualitative.

1.4.2.4 The Four Research Studies

The dissertation's four research studies are briefly outlined in the next section. The relationship among the three key research questions, the four studies, and the main research methodologies is summarised in Table 1.1 where the four research studies are referred to as (a), (b), (c), and (d).

Table 1.1 The Research Questions and Methodology

<i>Research Question</i>	<i>Research Studies</i>	<i>Methodology</i>
(1) How should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan?	(a) Chinese domestic context (b) International (Japanese) context (c) Regional (Taiwan Strait) context	(Primary) Literature-based analysis (Secondary) Interviews
(2) What kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?	(a) Chinese domestic context (<i>host</i>) (b) International (Japanese) context (<i>home</i>) (c) Regional (Taiwan Strait) context (<i>home</i>)	(Primary) Literature-based analysis (Secondary) Interviews
(3) How do networks of multi-level governance (MLG) operate to facilitate micro-regionalisation?	(d) Development of cross-border sub-national governmental networks	(Primary) Interviews and observations (Secondary) Literature-based analysis

(a) *The Choice of China, Taiwan and Japan*

Throughout the dissertation, the geographical focus is on three territories: China, Taiwan and Japan. By 1999, Japan had become China's largest trading partner, and China had become Japan's second largest trading partner (*Guoji Shangbao*, 14 January 2000 and Tsūsanshō, 2000). By 1999, Taiwan had become China's seventh largest trading partner (*Guoji Shangbao*, 14 January 2000), and China had become Taiwan's second largest exports destination (*Higashi Ajia eno Shiten*, spring special edition 2000). Japan had become Taiwan's second largest trading partner by 1999, and Taiwan had become Japan's third largest trading partner (*Nittai Bijinesu Nyūsu*, No. 2 2000 and JETRO, www.jetro.go.jp/ec/j/trade). Despite increasing economic interconnectedness among the three territories, the national economy-based statistics overlook the deep-rooted restructuring that is occurring at the regional and firm levels (see Chapter 3). In acknowledging the

deficiencies of the existing approach to China's foreign economic relations, this thesis seeks to develop a distinctive account of micro-regionalisation.

(b) *The Choice of the Electronics Industry*

Throughout the research studies, the emphasis is on the particular case of the electronics industry in cross-border economic relations. This sector was chosen for a number of reasons. First, it is the main industrial sector in East Asian industrialisation. The share of electronics goods in the total exports in each East Asian country is very high (see Table 1.2).

Table 1.2 The Share of Electronics Goods Exports in the Total Exports of East Asian Countries (Value)

Country (year)	Share of electronics exports in total exports (%)
Taiwan (1999)	43.39
South Korea (1997)	34.63
Malaysia (1997)	50.88
Philippines (1997)	27.70
Singapore (1997)	27.76
Thailand (1997)	30.83
Indonesia (1997)	7.02
China (1999)	22.70

Source: *Higashi Ajia eno Shiten* (2000), spring special edition

Secondly, the electronics industry is forging increasing economic links among the three countries. The electronics goods exports from China operated by the PTAs accounted for 90% of China's total electronics goods exports in 1999 (*Kokusai Bōeki*, 16 May 2000). Foreign firms dominate PTAs, and Japan and Taiwan are the two major contributors. For example, in 1999, exports in electronics goods and parts accounted for 25.5% of total Japanese exports to China and 14.6% of total imports to Japan from China (Tsūsanshō, 2000: 176-8).¹¹ In the same year, 23.7% of Taiwan's total exports to mainland China and 30.9% of total exports from the mainland to Taiwan consisted of electronics goods and parts (*Kōryū*, No.618, 2000).¹² Also, exports in the electronics industry accounted for 24.5% of total Japanese exports to Taiwan, and 23.4% of total imports to Japan from Taiwan in 1999 (Tsūsanshō, 2000: 186-7).¹³ The electronics industry is already the leading industry in Japan and Taiwan and is emerging as China's most important industry in terms of imports and exports.

(c) *The Choice of Guangdong and Dongguan*

The choice of Guangdong and its one rapidly growing city, Dongguan, for special attention is related to the trade structure discussed above. Guangdong, especially the Pearl River Delta Area, is the largest site for PTAs in the electronics industry. Indeed China's exports owe much to the coastal area, especially Guangdong province, which has been in the first rank in exports for the last 15 years. For example, in 1998, Guangdong's share of trade was equivalent to 40.6% of China's total imports and exports (ZTN, 1999). In 1999, Guangdong's share of trade was 39.9% of China's total imports and exports (*Guoji Shunghao*, 20 January 2000).

In Guangdong's imports, Japan and Taiwan have been two major partners, accounting for more than 40% of the total. This relates to the trend of Guangdong's inward FDI. Manufacturing investment accounts for a large part of total FDI in Guangdong: 86.3% in 1990, 69% in 1995, 66% in 1997, and 55.7% in 1998 (*Guangdong Tongji Nianjian*: hereafter *GTN*, 1999). As far as the PTAs are concerned, in 1999 they accounted for 77.7% of the province's total exports, which is equivalent to 54.5% of China's total PTAs in exports. Thus, Guangdong is the central place for China's PTAs, which are structurally dependent on Japan and Taiwan for imports, and on the US and EU market for exports. Furthermore, electronics goods exports are the major sector; for example, half of Guangdong's exports in 1999 were in electronics goods and machinery (*Aogang Xinxi Ribao*, 14 January 2000).

Secondly, when the analysis is brought down to the sub-provincial level, inward FDI is focused on the Pearl River Delta. In 1998, the total exports from the Shenzhen and Dongguan reached 52.1% of total exports from Guangdong (Maruya, 2000: 143).¹⁴ Shenzhen has been the top city in the volume of trade for seven consecutive years, and its average annual growth rate from 1980 to 1999 was a remarkable 31.2% (*Kokusai Bōeki*, 6 December 2000). Dongguan has also emerged as the site of the highest concentration of Taiwanese electronics firms (the number is almost 3,200) on the mainland (*Sinorama*, February 2000). In particular, the role of foreign firms in the industrial output in both cities is remarkable. Their share of the total industrial output was 75.9% in Shenzhen and 86.1% in Dongguan in 1998 (Maruya, 2000: 143). Furthermore, the concentration on electronics and telecommunication equipment is especially remarkable. From 1991 to 1998, the value of the industrial output of electronics and telecommunication equipment grew from

40.65% to 58.28% of the total value of Shenzhen's industrial output (Lu, 2000: 64). In terms of Shenzhen's trade relations, Japan is the largest source of imports and Taiwan is the second. Thus, Shenzhen and Dongguan clearly exhibit the new patterns of cooperation at the micro-regional level among China, Taiwan and Japan. Economic relations among China, Taiwan and Japan are becoming exceedingly complex at the micro-regional level, and this necessitates an investigation of the links between Japanese and Taiwanese FDI and their links to changes of industrial structure in the Pearl River Delta.

(d) *Four Studies*

In the Chinese domestic context, the first case study seeks to answer the first and second research questions: *how should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan?* and *what kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?* By using previous research findings, the first case study seeks to demonstrate the key features of Chinese domestic governance reform towards a multi-level structure and the emergence of SNGs as economic actors. Specific measures include the decentralisation of economic management, regional development policies, the establishment of special economic zones and open cities, the increasing role of cities in Chinese administration, and the relations between Guangdong and the centre. This thesis argues that the centre's initiatives and strategies have induced a dramatic increase of local autonomy and helped to change the dynamics of economic scale. Micro-regionalisation in the Chinese domestic context is a state-led institutionalisation process but has created new forms of multi-level governance (MLG).

While the central government continues to exercise a decisive role in setting standards and formulating macro-organisational policies, it would be wrong to see Chinese domestic regionalisation as a purely linear process. Rather there are many variations of path development and complicated sets of interactions among actors and institutions. Therefore, the Chinese domestic context of MLG cannot be generalised. Despite the limitations of the capacity of SNGs, the increase of local autonomy in foreign economic management is a key factor in the creation of micro-regionalisation. This case study examines the increase of local power in Guangdong province and its changing relations with the centre.

From the international perspective, the second case study also seeks to answer the first and second research questions. However, the second case study focuses more on *de facto* processes of micro-regionalisation based on firm-led economic regionalisation. Japanese direct and indirect (through Hong Kong and Taiwan) investment in the electronics industry is selected for special attention. After exploring the organisational features of Japanese firms (*keiretsu*), the size of firms, managerial structures, and systems of centralisation, we then analyse the empirical path of development of the international division of labour, international commodity chains (ICCs), and cross-border production networks (CPNs) through Japanese outward FDI. We need to understand, in particular, why Japanese electronics firms have shifted their production sites to ASEAN and China, how the governance of CPNs based on *keiretsu* has been transformed into a new form, the importance of the Japanese government's role, and the significance of the major *push* factors in the policy environment for Japanese FDI. In this regard, Japanese official development assistance (ODA) and free trade agreement (FTA) policies are also examined.

The third case focuses more on the regional context of micro-regionalisation (the Taiwan Strait). It explores the development of networking linkages through the various strategic interactions between different levels of political and economic activity. Despite unresolved political conflicts, Taiwanese electronics firms have actively set up offshore production in China. The key questions here are: Why have Taiwanese electronics firms shifted their production sites to mainland China? What is the role of the Taiwanese government in the development of the electronics industry? What is the impact of the relocation of Taiwanese firms on Taiwan Strait relations? How have Taiwanese firms maintained cross-strait production networks?

The fourth case study explores the structure and operation of networks of MLG. Special consideration is given to the process of the development of networks of governance among Guangdong (Dongguan government), Japanese and Taiwanese firms. The key questions are: How are these networks constructed? How do they operate? How are they governed? The success or failure of SNGs is contingent on the extent to which they can capitalise on the policy environment and entrepreneurial leadership structure, and can effectively mobilise their resources. Although Dongguan is not a special economic zone, it has been one of the most successful Chinese cities. We need to find out why foreign firms have

chosen to invest in Dongguan. This case study seeks to examine the patterns of horizontal networking arrangements linking SNGs to MNCs.

A key methodological issue is whether the experience of the electronics industry can be taken as an acceptable basis for generalising about processes of micro-regionalisation among Guangdong, Taiwan and Japan, or whether this study must be seen as an individual case with its own unique characteristics. Because there is no cross-sector comparison in the present study, we must be very careful about any generalisation to other industries. At the same time, the evidence that the present study furnishes about the behaviour of Chinese SNGs in relation to foreign firms does have a broader significance for cross-border micro-regionalisation and the operation of networks of governance. Moreover, this study seeks to illuminate the variations among CPNs according to the specific approach of different firms and the characteristics of home governance (i.e. size of firms, networking linkages with other companies, strategies of offshore production, types of alliances). There is a huge variation in the strategic focus of firms and in managerial styles. Where appropriate, the research endeavours to identify specific factors that apply to the particular example of the electronics industry and may not apply to other industries. However, further research into other industries is needed if the findings of the present study are to be extended to those sectors.

1.5 The Structure of the Dissertation

The dissertation consists of eight chapters. Chapter 2 elaborates the theoretical justification and analytical framework which underpins the research. It addresses the key theoretical debates on the emergence of micro-region. It also seeks to develop the concepts of *network* and *governance*, and to show how they can usefully be applied to analyse the fluid governance between SNGs and firms, and in intra- and inter-firm relations. Chapter 3 presents an overview of the discussion of globalisation and regionalisation in East Asia and examines the patterns and processes of China's micro-regional reintegration with the global economy on the basis of a synthesised statistical database. It gives special attention to the emergence of regional variations (i.e. in terms of industrial agglomeration) in Guangdong (especially in the Pearl River Delta and Dongguan).

Chapters 4, 5, 6 and 7 present case studies of the emergence of micro-regionnalisation among Guangdong, Taiwan and Japan. Chapter 4 investigates *de jure* processes of China's micro-regionalisation in the context of domestic regionalisation (the rescaling of political economy), including economic reform, open door policies and regional development, all of which have been promoted in combination with vertical state-led institutionalisation. This chapter seeks to demonstrate that the features of Chinese domestic governance reform embrace a multi-level approach which has enabled the emergence of SNGs as economic actors. Although the political and economic foundations of SNGs are largely determined by the institutionalisation processes led from the centre, in addition decentralisation, regional discrimination policy, and de-ideologisation have impacted on the increasing economic autonomy of SNGs. In particular, as Guangdong has offered various types of preferential treatment to firms, it has become the most successful administration in terms of the increasing scope and scale of foreign economic relations. Therefore, institutionalisation from above has supported the policy environment and helped the SNGs to emerge as key economic actors in cross-border micro-economic relations.

Chapter 5 analyses key aspects of the international context of micro-regionalisation, the features of the production networks of Japanese electronics firms (*keiretsu*), Japanese FDI in East Asia, and evolution of the Japanese production system. The chapter argues that the actual integration processes in East Asian regionalisation are developing below the state level according to the strategies of Japanese MNCs' international, regional and hiererachical division of labour, which is in turn bound to CPNs and ICCs. Chapter 6 focuses on the regional (Taiwan Strait) context of micro-regionalisation. There is a focus on the features of the Taiwanese production system in the electronics industry (small and medium firms, complementary inter-firm relations, government support of these relations, and relations with Japanese firms located in Taiwan). Chapter 7 considers the operation and structure of micro-regionalisation. The Hong Kong-Guangdong link offers a pioneering, basic model of cross-border production relations (originally these were PTAs). The discussion seeks to show how Chinese SNGs and firms have established networking arrangements through intermediary organisations, especially in the case of Dongguan. Finally, Chapter 8 summarises the major findings of the thesis and its contribution to the understanding of how micro-regionalisation among Guangdong, Taiwan and Japan through electronics investment and production activities has developed and how it operates in the

context of globalisation. It also acknowledges the limitations of the present research and stresses the need for further research in the future.

¹ 'East Asia' in this thesis refers to Japan, the NIEs (Newly Industrialising Economies: South Korea, Taiwan, Hong Kong and Singapore), the ASEAN 4 (Thailand, Malaysia, Indonesia, and Philippines) and China.

² The definition of the area of the Pearl River Delta varies. For example, Wang Yuefu defines the Pearl River Delta as consisting of Guangzhou, Shenzhen, Zhuhai, Foshan, Jiangmen, Zhongshan, Dongguan, Huizhou, Huiyang, Boluo, Zhaoqing, Sihui and Gaoyao. See Wang (1997: 15). Johnston (1999) lists Guangzhou, Panyu, Shenzhen, Zhuhai, Huizhou, Dongguan, Zhongshan, Jiangmen, Foshan, Nanhai, and Shunde. *Dongguan Tongji Nianjian 2000* (hereafter *DTN*) defines the area of the Pearl River Delta on the basis of data for 12 cities: Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Zhaoqing, Jiangmen, Dongguan, Zhongshan, Shunde, Nanhai and Panyu. This dissertation refers to the phenomenon of industrial agglomeration, especially in Shenzhen and Dongguan. Thus the variations of definitions of the area do not obstruct the purpose of the research. However, because of the limitations of the available data, the area is here taken to include the 12 cities (as listed in *DTN* 2000).

³ Wang (2001a) discusses the governance of cross-border economic linkages between Taiwan and China, focusing on the alliance between local bureaucrats and Taiwanese firms as well as the emerging industrial networks. Kwok (1995) identifies regional transnational production networks in East Asia and Guangdong. Sum (1999) points out the emergence of central-provincial-local entrepreneurial networks in China.

⁴ The term 'micro-regionalisation' is used here to denote the scale of cross-border regional activity that depends primarily on inter-firm and intra-firm economic relations, and can be distinguished from the broader 'macro' (East Asian) and 'meso' (sub-East Asian) levels that depend more on overtly political initiatives (see Chapter 2).

⁵ 'China' refers to the People's Republic of China (PRC). Although the PRC claims that Taiwan is a part of China, in this dissertation Taiwan refers to the territories governed by the Republic of China (ROC).

⁶ See Section 1.4 in this chapter, and on the concept of 'governance' and related theoretical arguments see Chapter 2.

⁷ For further theoretical discussion of the concepts of cross-border production networks and commodity chains see Chapter 2.

⁸ For further discussion of the processing trade, see Chapter 3.

⁹ For example, in 1993 the amount of contracted FDI was \$US 111.4 billion but the utilised FDI was only \$US 27.5 billion. See Mitsubishi (2001: 506).

¹⁰ *Remin Ribao*, <http://j.people.ne.jp/2001/04/03/jp20010403-4253.html>

¹¹ The figures are based on value.

¹² The figures are based on value.

¹³ The figures are based on value.

¹⁴ The figure is based on value.

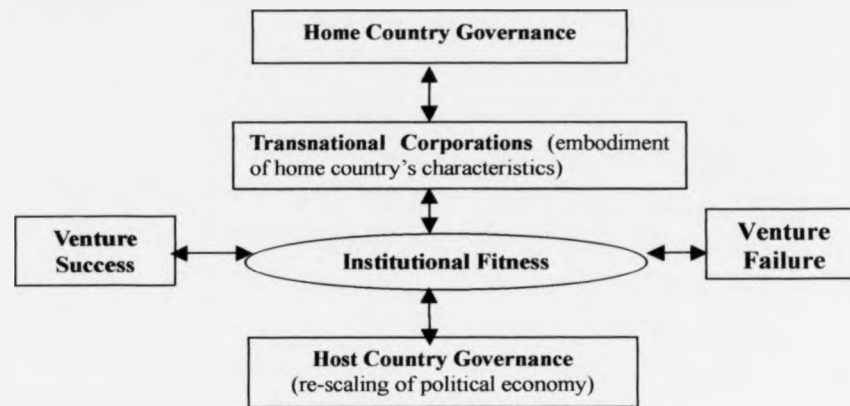
CHAPTER 2

THEORETICAL PERSPECTIVES ON MICRO-REGIONALISATION

This chapter reviews some key theoretical debates concerning the characteristics and role of regions and the dynamics of regionalisation in the contemporary international political economy. These debates form the necessary starting-point for the study of regionalisation in southern China and for the establishment of a model of micro-regionalisation that accommodates the broader context of changes that are occurring globally under the impact of the transformation of the spatial basis of political and economic organisation. Although different theoretical perspectives are evident in the literature, and there continues to be vigorous debate over the nature, scope, causes and consequences of 'the new regionalism', the literature reveals broad agreement that regions at various scales of operation (hence the use of such terms as 'regions', 'sub-regions' and 'micro-regions') are becoming increasingly important in today's global economy, and that the challenges posed by regionalisation to the territorial organisation of nation-states and the cross-border relations between nation-states are especially significant in terms of the emergence of new networks of governance linking agencies of government, business enterprises and business associations of all kinds.

The key issues are presented schematically in Figures 2.1 and 2.2 as a model of the micro-regionalisation perspective proposed in the present study, based on the approach of Henry Yeung (2000: 813-14). Although Yeung does not distinguish between sub-national government and central government, according to his model the 'institutional fit' of MNCs into the needs and requirements of local and regional states is crucial for MNCs' operational outcome. However, these firms are embedded in the home country's institutional environment, and are also influenced by the institutional setting and agenda of the host locality. These variables inevitably affect the behaviour of firms (H. Yeung, 2000: 814-15).

Figure 2.1 H. Yeung's Theoretical Framework of Scale Politics in Governing International Investments



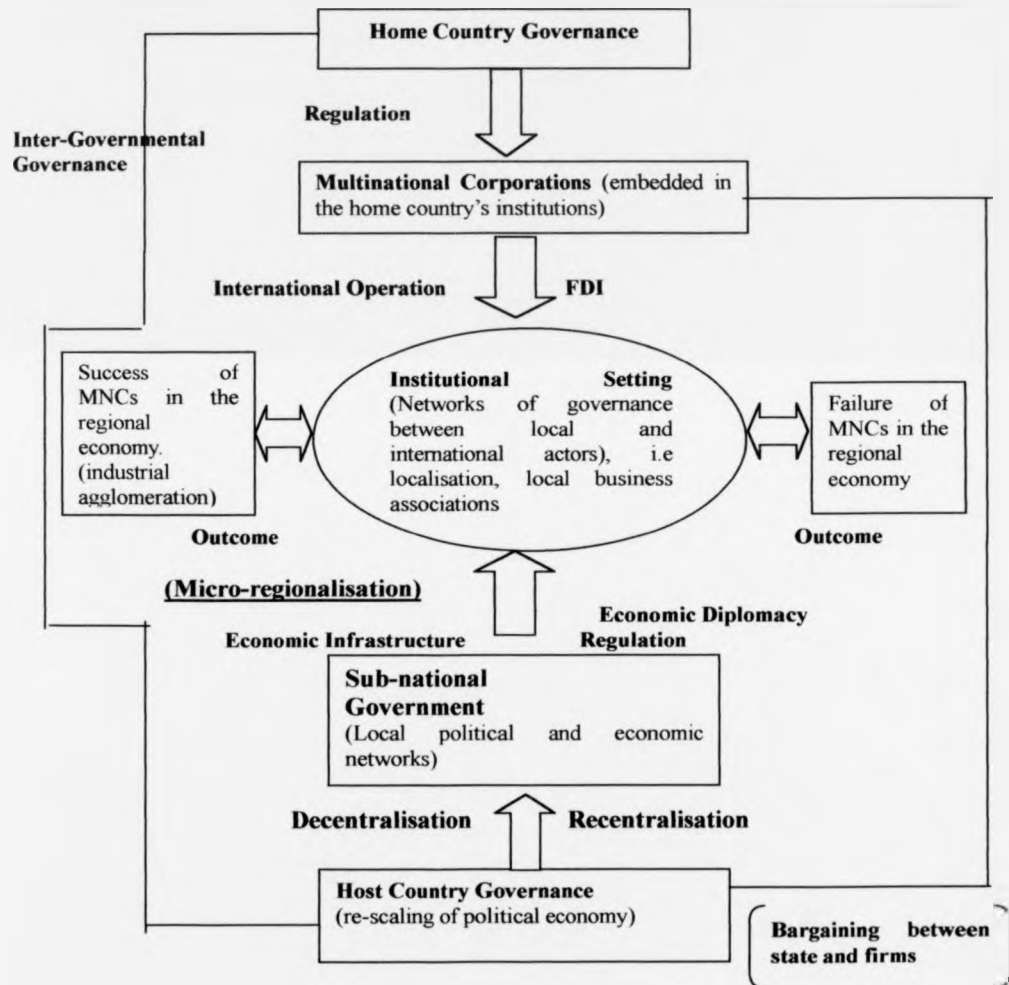
Note: Yeung uses the terms of 'TNCs' in his model

Source: H. Yeung (2000), 'Local Politics and foreign ventures in China's transitional economy: the political economy of Singaporean investments in China', *Political Geography*, Vol 19, No 7, p 814

Figure 2.2 is an elaboration of H. Yeung's model by the researcher in order to develop the theoretical framework of micro-regionalisation. Within certain environmental constraints, various actors pursue their own interests. In particular, FDI is a manifestation of the international operational networks of MNCs. The internationalisation of the production system is in turn embedded at the sub-national level within the host country. The host government and local governments provided the economic infrastructure, including the finance, telecommunications, transportation and legal system, etc., for attracting the investment of MNCs. MNCs need to adapt to the institutional setting and especially the host country's sub-national level of government-business networks. The outcome of the production system depends on the success of collaborative relations between different networks. If such relations are successful, then new economic spaces, in terms of industrial concentration or agglomeration, are likely to emerge. At the same time, the activities of those MNCs that pursue the internationalisation of production will promote the internationalisation of sub-national governments (SNGs). SNGs are themselves subject to the national governmental-institutional environment, but much will depend on the changing balance of power between central government and the SNGs. With decentralisation, the SNGs' economic power increases. Subsequently, the SNGs become key economic actors, and the sub-national axis within a host country becomes the key spatial location in an attempt to create mutual gains between SNGs and firms. The SNGs'

foreign economic diplomacy is especially decisive in determining the success of these interactions.

Figure 2.2 A Theoretical Model of Micro-Regionalisation: Cross-Border Sub-National Governance and the Network Dynamics of Multinational Corporations



Source: The researcher

This chapter therefore seeks to bring together the key issues and problems associated with this area of theorising as a basis for the application in subsequent chapters of regional analysis to the specific case of micro-regionalisation among Guangdong, Taiwan and Japan. The first matter to be dealt with (Section 2.1) is the precise meaning of 'region',

'sub-region', 'micro-region' and associated terms in the context of IPE. There is some variation in the use of these terms in the literature, and this partly reflects the varying customs and traditions of different academic disciplines. For the purpose of the present study, it is essential to clarify how these terms are to be used, and, more particularly, how 'regionalism' as a concept applies to current developments in China and East Asia more generally. Here 'micro-region' is used to denote the inter- and intra-firm dimension across the national boundaries involving SNGs, and the reasons for this choice are explained in Section 2.1.

Section 2.2 turns to the phenomenon of 'regionalisation'. The aim here is to clarify what exactly is meant by the idea that in the contemporary world there are certain processes which are leading to the economic and political resurgence of regions at different geographical scales. This discussion needs to be placed within the broader context of theories of global capitalist development, and the impact of this development on the territorial integrity of the nation-state. One of the key paradigms in this context is that of 'post-Fordism', and this framework of analysis is discussed here because it is a useful starting-point for seeking to identify those key features of the contemporary international political economy which are associated with regionalisation.

Section 2.3 deals with three distinct approaches to regionalisation, all stemming from the post-Fordist paradigm (this typology is based on Storper, 1995 and 1997). First (2.3.1), there is a school of thought which stresses the institutional basis of regional change. Secondly (2.3.2), there are those who focus on industrial organisation and transactions. Thirdly (2.3.3), there are those who emphasise the role of technological change and learning. The strengths and weaknesses of each of these approaches are then reviewed (2.3.4), and more recent efforts to formulate new explanations of regionalisation, including that of Storper himself in his theory of untraded interdependencies (*ibid.*), are examined.

Section 2.4 considers the application of models of economic change which emphasise the changing international division of labour, the emergence of distinct international commodity chains (ICCs), and the consequences for geographical patterns of industrial specialisation and agglomeration. These approaches help to illuminate the economic forces at work in particular industrial sectors as global capitalism creates complex networks of production which cross national borders. In this respect there has been considerable

interest in the patterns of geographical-industrial change in Asia, but there have been relatively few sustained attempts to apply such an approach to the specific case of China's southern provinces and their cross-border relations.

In Section 2.5 the network analysis approach is taken further to the study of business organisations, with a particular focus on their trans-national networking arrangements in cross-border production networks (CPNs). Such arrangements vary according to the particular locational contexts in which firms are embedded, thus stressing that multinational corporations are not 'placeless' but are rooted in complex spatial networks at the intra- and inter-organisational levels (see H. Yeung, 1998). This is an especially important perspective in the case of Asian business networks, because they 'have long been the fundamental nature of business structures and relationships' in that area of the world (Dicken, in H. Yeung, 1998: xv).

The approaches discussed in Sections 2.3, 2.4 and 2.5 tend to focus on the region as an *economic* space. In Section 2.6 the focus shifts to the more specifically *political* dimension of regionalisation. Here the emphasis is on the challenges which economic regionalisation poses to the territorial organisation of the nation-state. In particular, the focus is on the need to understand how economic regionalisation is leading to pressures of deterritorialisation, reterritorialisation and the emergence of new political spaces which do not fit neatly into traditional models of national sovereignty and statehood. The changing role of SNGs within the context of this emerging political spatiality is an issue of particular interest in relation to the focus of this dissertation. Increasingly, SNGs are becoming key cross-border actors in multi-level networks of governance which also include networking with foreign firms, and this involves them in assuming a much more determined external orientation towards the outside world beyond the borders of their own nation-state. Hitherto the concept of multi-level governance (MLG) has been applied mainly to the European Union, but it is presented here as an appropriate framework for the understanding of cross-border micro-regionalism among southern China, Taiwan and Japan.

Section 2.7 considers the emergence of regional blocs and regional organisations at the international level. This raises the issue of the relationship between large (macro-) regions (i.e. the European Union (EU), the North American Free Trade Association (NAFTA), and

micro-regions. A certain amount of confusion arises here because of the different usages of the term 'region' and the recognition of different regional scales in different scholarly disciplines (e.g. economics, geography, political science, and international relations). It is important, therefore, to resolve this confusion before proceeding with the analysis in subsequent chapters.

The conclusion of this chapter draws out the main lessons, issues and problems relating to the analysis of regions, regionalisation and micro-regionalisation, and presents an overall international political economy framework with a focus on the dynamics of cross-border network relationships (involving intra- and inter-firm relations, SNGs, and other key actors), which will then be applied to the specific case of the new micro-regionalisation in southern China, including cross-border relations with Taiwan and Japan. The conclusion also stressed that any understanding of regionalism in southern China must accommodate both the domestic and international dimensions of regional change, and must in particular seek to understand the changing position of southern China within the Chinese economic and political system, within the emerging East Asian regional bloc, and within the global economy. There are thus several levels of analysis which need to be integrated if a full account of the dynamics of regionalisation in southern China is to be possible; but, we argue, the network analysis approach, situated within a framework of MLG, offers a particularly fruitful perspective.

2.1 What is a Region?

The apparently simple question 'What is a region?' conceals a set of enormously complex issues relating to the significance of different scales of social, economic and political organisation and the distinctions among different types and levels of regionalisation. These issues are further complicated by the lack of an agreed, consistent terminology in the literature. Originally, the concept of a region emerged from geographical studies which emphasised the distinctive physical characteristics of a particular territorial area and, by implication, the boundaries between one such region and another. When the study of regions was extended from geography to economics (a trend which, in the Western world, began seriously in the 1950s), the emphasis was on seeking to identify, first of all, certain shared economic characteristics (e.g. rates and patterns of unemployment, population density, industrial structure) which a certain territorial area had in common, and, secondly,

regions which were based on the economic centrality of a particular place, usually a large town or city. These two perceptions led to a distinction between, respectively, 'homogeneous' and 'polarised' or 'nodal' regions. (Hallett, 1973: 3-4). Regions can also be defined in cultural terms (for example, where the population of a particular area forms a distinctive ethnic or linguistic group), and as a unit of government and administration within a nation-state. Accordingly, in view of this diversity of use of 'region' in different contexts, it has to be acknowledged that there is no single, convenient, precise definition that can be applied universally. As Hallett states, "'The region", both in theory and practice, is thus a concept of considerable ambiguity' (ibid.: 5).

This problem is exacerbated by the fact that under the impact of historical change related to the effects of technological innovation, improvements in transportation, the movement of people, new modes of communication, the transformation of economic production and trade in goods and services, and political reorganisation, the characteristics of regions are not static but 'ebb and flow' constantly and, often, unpredictably. In this respect, the historical impact of processes of industrialisation, capitalist development, and the geographical linkages between core and peripheral areas of the world has — and continues to have — far-reaching consequences for how we perceive regions. Currently, globalisation is the main focus of attention in studies of regions and regional change, since it is increasingly apparent that one of the consequences of globalisation is a distinct 'time-space compression'¹ that undermines traditional notions of territoriality, including regional territoriality (see, for example, Scott, 1998: 2), and that could even be said to mark 'the end of geography' in the conventional sense (O'Brien, 1992).

At the same time, however, there is evidence that globalisation is associated with the 'renaissance' or revitalisation of regional economies as sites of global production. It is in this respect that regions have increasingly come under scrutiny in recent years within the field of international political economy. In political sense, a region can be perceived as a distinct geographical area with a clearly defined economic relationship to global production and trade. This characterisation is captured in Scott's definition:

I will usually use the term [region] to designate a geographic area characterized by some minimal level of metropolitan development together with an associated tract of hinterland, i.e. an area that functions as the common spatial framework of daily

life for a definite group of people, and that contains a dense mix of socio-economic activities subject to centripetal or polarization forces. This new socio-economic spatiality thus assumes in its most general form the contours of a mosaic of regions scattered across the globe. This mosaic can be mapped out in terms of a network of local economies forming an integrated or quasi-integrated world-wide system of production and trade (Scott, 1998: 1-2).

Scott's emphasis on a region as a network of *local* economies is important, since it is always tempting to think of the region as a homogeneous unit and to disregard intra-regional differentiation. In fact, a typical region is bound to include within it distinct localities or sub-regions, and agglomerations of units of production, that have their own dynamics. This can lead to confusion, since a clear distinction between the local and the regional is not always easy to make. Amin and Thrift (1994), for example, tend to use the broad term 'local' to include the urban and regional dimensions of global economic activity. They base their analysis on the idea of 'the local in the global' and 'the global-local nexus':

A world of transnational flows, a world of global interconnections, a world of global-scale capitalist imperatives from which there is no escape. And yet, global economy and global society continue to be constructed in and through territorially bound communities, which, more importantly, continue to represent much more than the situation requirements of global forces. At a concrete level, metaphors such as "global village" and "one world" are complicated, perhaps even contradicted, by the presence of villages, towns, districts, cities, and regions which continue to tell their own stories of economic development and cultural or political distinctiveness (Amin and Thrift, 1994: 5).

Of particular importance in the spatial dynamics of global capitalism are a fairly small number of world or global cities (e.g. 'the big three' of New York, London, Tokyo) which are the key nodes or 'command centres' of production, trade and service provision, and the main sites of activity of MNCs (see Brenner, 1998). It is not easy to make a firm distinction in this respect between a city and a region, since, increasingly, large cities occupy a regional scale geographically and economically. Sassen, for example, prefers to

use the term 'global city-region' and to stress the role of each global city within its own particular national urban system (Sassen, 1991). Furthermore:

Each of Sassen's global cities can be viewed not only as the apex of a rapidly changing state-scale urban hierarchy, but as the major articulation point for one among three super-regional blocs of the contemporary world economy – North America, the European Union and East Asia (Brenner, 1998: 11).

A distinction between the 'super-regional' and the 'regional' is in some ways confusing, but it helps to avoid a problem which emerges in the study of international relations and international political economy, where often the concept of region is used to denote the emergence of regional blocs, such as the EU, NAFTA, and ASEAN, and less formal processes of economic integration and co-ordination (see, for example, Fawcett and Hurrell, 1995). However, if the term 'region' is used here to denote such large groupings of nation-states (e.g. the 15 member states of the EU), then it clearly raises the problem of how to designate the sub-regions within and between individual states.

In the present study the term 'micro-region' is preferred as a means of denoting the sub-national and cross-border scale of interactions, especially those based on intra- and inter-firm relations, and relations between firms and SNGs. Some of these micro-regions are the result of the actions of state elites but others are facilitated by the actions and decisions of non-state actors. Examples of such micro-regional co-operation include southern California/north-western Mexico, the south-western US/northern Mexico, Quebec/New York, America's Atlantic provinces/New England, Michigan/Ontario, Alberta/the Rocky Mountain states, British Columbia/Pacific north-west states, north-western Germany/eastern Holland, the Italian and French Rivas, and the French and Spanish Pyrenees (Holland, 1996). In East Asia, examples include the 'Growth Triangle' among Singapore, Malaysia and Indonesia (Lee, 1991; Myo et al., 1994), southern China, Hong Kong and Taiwan (Khanna, 1995), the 'Tumen River Project' among China, North Korea and Russia (Lew, 1995; Pomfret, 1996), and the Japan Sea Rim Zone (Hook, 1997). 'Micro-region', in this thesis, thus refers to the two distinctive territorial elements 'below the national level' and 'across national borders'.² Thus, in order to avoid any confusion between 'sub-region' and 'sub-national region', in this thesis 'sub-region' refers to regional groupings of small states or peripheries of the world

economy and involves mainly political processes.³ The term 'sub-national' is close to 'micro-region' but is confined within the borders of a single nation state. Thus, though ASEAN is not small in territorial terms, it can be categorised as a 'sub-region' (Table 2.1).

Table 2.1 Regional Levels in East Asia

Political Space	Regions	Basic Unit	Governance
Supra-Region (Macro-Region)	APEC	State (national economy)	Inter-governmental cooperation
Sub-Region (Meso-Region)	ASEAN, EAEC	State (national economy)	Inter-governmental cooperation
Micro-Region	Growth Triangle, Southern China	State, sub-national governments and firms (national economy, regional economy, and intra- and inter-firm relations)	Inter- and intra- regional cooperation

Source: The researcher

2.2 The Dynamics of Regionalisation

It is a common theme of recent analyses of the global economy that there has been a resurgence of regions. Indeed, in some cases writers have concluded that regions are the primary focus of global economic activity and that this signals the demise, if not the end, of the nation-state (Ohmae, 1995). Without pre-judging the validity of this argument, the purpose of this section is to consider the broad case that regionalisation has 'taken off' during the last quarter of a century or so.

'Regionalisation' must be distinguished from 'regionalism'. As Gamble and Payne (1996: 250) explain:

The concept of regionalism assumes that states and state actors are a key level of explanation in a theory of the global political economy. The calculations that state actors make of their interests and the costs and benefits of alternative courses of action are the starting point for understanding the wider context of their behaviour. This wider context is constituted by two kinds of structure – the historical residues of past social interaction and the emergent patterns of current social interaction. Together these provide both constraints and opportunities. Agents do not act within structures; rather they cannot act without reproducing structures, confirming or

modifying them through the intended and unintended consequences of their calculations and actions.

In this sense, regionalism is a state-led project to create formal regional structures. By contrast, regionalisation is promoted largely by FDI-driven processes that are dependent on the investment and locational decisions of non-state actors. (This is not the same as the view of many economists that regionalisation is a process of building a regional market without government-initiated regional trading arrangements.) The process of regionalisation emerges from the development of infrastructure and from various governmental policies such as the relaxation of barriers to trade and investment. It is characterised by a variety of participants who seek to increase economic interaction in order to minimise transaction costs, transportation costs, etc. and to gain benefits from the increased scales of economies, greater flexibility, and improved access to information, technology and know-how. This process is thus inevitably interconnected with changes in the structures of the world economy and capitalism.

There is, indeed, a general awareness that the structure and organisation of the world economy are changing. Contemporary capitalism is different in many important respects from the capitalism of the mid-twentieth century and the age of what has come to be known as Fordist mass production, which is generally seen to have reached its zenith in the 1950s and 1960s (Amin, 1994: 9). Although there are different perceptions of the precise nature, extent, causes and consequences of this change, nevertheless there seems to be agreement that in spatial terms the new global capitalism is characterised by deep-rooted restructuring at the regional level, and this is related to what has been described as a new international division of labour (see Section 2.4 below for further discussion of this concept). The latter term refers specifically to the impact of locational decisions by MNCs to move to less developed countries (usually for reasons of cost savings in the production process), thereby promoting peripheral industrialisation and the emergence of 'organisationally integrated circuits of production in different countries with each country partaking in a part of the production process but not producing the whole product' (Hoogvelt, 1997: 47). This is an especially important phenomenon from the viewpoint of current changes in the political economy of East Asia, since the rise in that area of newly industrialising countries concentrating mainly on export-oriented production reveals one of

the major shifts in the spatial distribution of production under advanced (post-Fordist) capitalism.

It is important to be clear about the main characteristics of the Fordist system of mass production, since the regional restructuring of contemporary capitalism has grown out of the decline of that system. Esser and Hirsch offer the following overview:

The Fordist phase of capitalism was marked by the imposition of Taylorist labour processes in important sectors, associated with a considerable extension of wage labour ... whilst at the same time making labour conditions relatively similar ("employee society"). The industrial mass production of consumer goods became the basis for an extensive capitalization of the sphere of reproduction, i.e. the reproduction of the work forces became the integral part of the reproduction of capital on the basis of a generalized consumer model. Great advances in productivity and the linking of mass incomes to productivity increases facilitated strong growth in the national product and the general standard of living (Esser and Hirsch, 1994: 75-6).

For Esser and Hirsch, these features amount to a distinctive process of capital accumulation. In turn, under Fordism, this process was subject to a distinctive form of regulation:

It consisted of a strong processes of concentration and the formation of new mass industries (in particular the car and electronics industries), the development of bureaucratized and centralized trade unions with a tendency for all workers to be included in the right to representation and thus to have the opportunity to conclude comprehensive pay agreements, and the expansion of the bureaucratized welfare state ... On this basis, a centralized corporatism was able to develop, based on social-contractual cooperation between commercial associations, trade unions, parties and state administrations, and a Keynesian state interventionism supported by it (ibid.: 76).

This particular analysis of Fordism, which is rooted in the approach of the regulation school⁴, is helpful in drawing our attention to the specific historical context in which

capitalist mass production rose to a position of global supremacy in the mid-twentieth century. From the point of view of Fordism's spatial foundations, the key point to stress is that the capital cities of the Western developed world were the major sites of capital accumulation and regulation, and formed the inner cores of Fordist regions. On a global scale, the countries of the Third World were essentially peripheral sources of raw materials and simple manufactured goods (ibid.: 78-9).

The clearest signs of the disintegration of Fordism are to be seen in the characteristic stagnation of the once dominant industrial cities and their surrounding regions in the Western world, and the rise of highly mobile MNCs which have shifted the locus of manufacturing to the less developed countries, including those of East Asia. These trends point to major spatial (urban and regional) transformations in the structure and organisation of global capitalism. Ironically, perhaps, formerly Fordist regions have in many situations been able to reassert themselves because they are no longer, as they were in the 1960s, 'at most a derivative category of analysis and a secondary locus of economic activity' (Sabel, 1994: 102). At the time the needs of standardised mass production meant that there was little scope for regional innovation. Sub-national units of production were subordinated in a centralised, hierarchical system of regulation. This was reflected also in the weak position of local and regional governments in Western developed countries, since the essential role of such governments was to act as the agencies of central (i.e. national) governments in the implementation of Keynesian economic policies and welfare state provision.

A global crisis of Fordism in the 1970s (for reasons which will be discussed in Section 2.3) led to a situation in which the dominant modes of capital accumulation and regulation could no longer function as they had previously done. They were incapable of dealing with the fragmentation of world markets, intensified international competition, and the rise of highly mobile MNCs. The result was a dramatic fall in profitability in all the major industrial sectors of the developed world. Standardised mass production was increasingly replaced by flexible specialisation, designed to enable producers to respond more quickly and efficiently to changing market demand and cyclical recession. In this context regions were able to reassert themselves as sources of economic dynamism. Debates continue as to whether a new post-Fordist mode of accumulation and method of regulation has fully emerged from the crisis that began in the 1970s, or whether there are still possibilities that

Fordism can be restored (neo-Fordism), albeit in a revised form. In terms of regional restructuring, one view is that regions increasingly face choices about whether to move in a Fordist or post-Fordist direction; and indeed this is linked in turn to the choices made by national governments and international agencies. The spread of neo-liberal forms of globalisation since the 1970s (and the concomitant decline of Keynesianism and welfare state provision) and the development of super-regional groupings of nation-states suggest that, whether or not we call the changes 'post-Fordist', we are indeed living through a major period of transition. For Piore and Sabel (1984), a 'second industrial divide' separates the age of mass production and the age of flexible specialisation. The regulation approach seeks to show how a new mode of capital accumulation and method of regulation are emerging, but it is hesitant to offer any firm predictions:

This is because it sees the present as a period of experimentation with various strategies to resolve the bottlenecks of Fordism, a period in which particular solutions – more or less successful – will emerge ... [T]he regulationists argue that the shape of post-Fordism will emerge from the dialectical confrontation between rival forms (Amin, 1994: 17-18).

Some commentators are more certain in their predictions. For example, Esser and Hirsch (1994), discussing the example of restructuring in Germany, identify five new tendencies in the mode of accumulation: (1) new technology-based work, with lay-offs, worker segmentation and social marginalisation; (2) a strengthened industrialisation of the service sector, including the rise of the white-collar strata and the erosion of collective solidarities and identities through the use of new technologies; (3) enforced mobility in labour markets, linked to new geographies of employment and the breakdown of family and communal ties; (4) growing social polarisation between high productivity/high consumption strata and low- or even no-wage strata; and (5) an individualisation and pluralisation of life styles. Each of these trends has potentially far-reaching consequences for the spatial organisation of production and, in particular, for the role of regional economies and regional government.

Similarly, Esser and Hirsch (1994) identify (again, taking Germany as an example) the key characteristics of a new post-Fordist mode of regulation: (1) new relationships integrating branch structure and industry on the basis of advanced production technology, with the

emergence of new small firm networks and of processes of international concentration and coordination in the hands of major firms and financial institutions; (2) a scaling down and orientation of welfare services towards the economically active groups in society; (3) a weakening of the regulatory role of trade unions; and (4) the rise of a new corporatism involving state and industry alliances in the high technology sector and select groups of privileged workers. Again, the implications of these changes for regional restructuring are profound.

It is also important to consider the impact of the crisis of Fordism and the rise of neo-liberal globalisation on the less developed countries, since there can be no doubt that current changes point to the need for what Hoogvelt (1997) calls a 'new political economy of development'. There is a particular need to consider whether regions within the so-called Third World are now in a fundamentally different position as a result of the global crisis of Fordism and the emergence of a new international division of labour. One response of Western capitalists was initially to seek to export Fordist methods of production to less developed countries, where labour costs were much lower, in an effort to restore their profitability. This 'global Fordism' solution had major spatial implications.

[I]ndustrial relocation to certain selected sites in the Third World, the so-called newly industrialising economies of south-east Asia, and Brazil and Mexico in Latin America, have been highlighted as a critical feature of this period of reconstruction in global capital accumulation.

... The unevenness of industrial progress as between Third World countries in this period, was succinctly put in the UNCTAD annual trade report 1982: "fewer than ten newly industrialising developing countries accounted in 1980 for nearly 30 per cent of developing countries' GDP and nearly half of their manufacturing output, even though their share of the population of the underdeveloped countries was no more than 10 per cent" (Hoogvelt, 1997: 47).

In particular, the newly industrialising countries of East Asia (the so-called 'tiger' economies) benefited (in terms of key economic indicators) from the crisis of Fordism by taking the opportunity to develop their industrial base. At the same time, however, in Japan new methods of flexible, customised, lean production (exhibited most clearly in the Toyota

company) were emerging to challenge the supremacy of Fordist methods. If Japanese flexible production (replacing economies of scale by economies of scope) is seen as the archetype of a new post-Fordist system, then this raises the issue – through the lens of the regulation school – as to whether it relies for its success on a characteristically Japanese system of regulation, i.e. one based on typically Japanese social, economic and political structures – including a uniquely Japanese tradition of industrial relations – which are quite different from those in the Western world (Hoogvelt, 1997: 101-2). As Western companies have sought to emulate the Japanese approach and copy its flexible production techniques, it has become clear that it is not easy simply to transplant something distinctly Japanese (or Asian) to a completely different cultural context.

Similarly, discussions of the 'East Asian development model' have focused on the reasons why seven countries – Singapore, Hong Kong, South Korea, Taiwan, Malaysia, Thailand and Indonesia – have achieved such remarkably high rates of economic growth: is it because of factors which are unique to East Asia, or can the model be reproduced in other parts of the world? (World Bank, 1993) More recently, attention has been focused on southern China, which seems to be establishing the foundations for impressive growth. Without entering into these debates at this point in our analysis, it needs to be stressed that an understanding of the specific role, structure and dynamics of East Asia as a whole and specific regions within each Asia calls for a broad view of the crisis of Fordism and efforts to resolve that crisis since the 1970s, and of the impact of new flexible production methods (especially those based on the Japanese system). This in turn points to the need to understand the problems of regulating (or governing) the particular production methods in question. For China, a country which was not previously closely integrated in the global capitalist system, the present period offers particularly difficult challenges in terms of deciding how to restructure its economy nationally, regionally and locally, and how to establish the foundations for cross-broader economic relations with neighbouring East Asian countries. The combination of recent market reforms and regionalisation in China suggests that there is a definite movement towards flexible and entrepreneurial restructuring, albeit within the framework of a broadly developmental state (Duckett, 1996).

2.3 Explaining the Resurgence of Regions

The previous section sought to lay the foundations for an understanding of the importance of regionalisation within the contemporary global economy. It introduced theories of Fordism/post-Fordism and the analysis of the crisis of global capitalism in order to show that regions occupy a particularly important, and in some ways uncertain and transitional, place in the structure of the contemporary world. In this section, the argument moves on to a more in-depth study of different perspectives on regionalisation (including those already mentioned in Section 2.2), since these perspectives raise a number of crucial issues about the complexity of regional change. The analysis follows Storper's (1995, 1997) categorisation of three major schools of thought on regionalisation, and also considers his own contribution to this debate and a possible fourth line of enquiry.

2.3.1 The Flexible Specialisation School: Institutions, Industrial Divides and Small Firms

We have already referred to Piore and Sabel's (1984) analysis of the 'second industrial divide' and its emphasis on the emergence of particular forms of flexible specialisation to replace Fordist mass production. Storper (1997) acknowledges the value of Piore and Sabel's analysis, but he is concerned that they rely rather too much on a universalisation of the experience of north-east Italy ('the third Italy') and southern Germany. In both these cases, post-Fordist production is dominated by networks of small firms, but this, Storper argues, is an untypical situation. Furthermore, the Italian and German examples cover a fairly limited sectoral area (traditional non-durables, specialised supplier industries, and, in the German case, luxury versions of mass production); and Storper remains convinced that any generalisation from such a limited basis is risky. He also stresses the deep, specific historical conditions which have led to this particular type of flexible specialisation in these two cases. More fundamentally, he asks whether the niche market specialisation of small German and Italian firms can really be taken as a guide to the kind of specialisation we might expect in larger firms (such as Toyota, for example). Furthermore, the intensely local level of production in north-east Italy and southern Germany does not seem to extend to what we could realistically call a full regional scale. Finally, Storper is not convinced that Piore and Sabel adequately explain why some firms may appear to be flexible and specialised, but are still not successful: is there a 'secret' to the success of Italian and German firms which we do not fully understand? And if so, is this 'secret' so unique to

these two examples that it cannot be generalised? Similarly, are there different forms of flexibility and specialisation? (Storper, 1995: 193-5).

Piore and Sabel (1984) observe that certain key regional and territorially embedded institutional factors have contributed to the success of the north-east Italian and south German cases. The key, they argue, is the existence of institutional networks of co-ordination. In the case of Italy, the roots of these networks are in strong family and communitarian ties, which, for Storper, are 'almost unique in Europe' (1997: 142). There are many other parts of Italy with local industrial clusters, but none is as successful as 'the third Italy':

Numerous quantitative and qualitative analyses have shown that NEC Italy is different from the other areas in that the firms partake of a local, vertical division of labor, whereas in other areas there tend to be clusters of firms that carry out similar tasks. Also, in NEC Italy, the local production system is richly endowed with commercial agents who organize the production activities and market the local products as final outputs, with a local, independent brand name, whereas in other areas, firms are frequently either subcontractors to larger external firms ... or they sell intermediate inputs on open markets (Storper, 1997: 137-8).

Following Storper's analysis, it is clear that there are some dangers in assuming that the kind of flexible specialisation that has emerged in 'the third Italy' and southern Germany is indicative of a more general movement away from Fordist mass production. This is not to deny that the analysis of Piore and Sabel is useful, but merely to point out that the distinctive social, economic and political characteristics of a region and its localities are bound to have an effect on patterns of economic organisation. Within the 'the third Italy' there is a degree of specialisation – down to individual communes and provinces – which means that the whole region consists of a very large number of networked industrial districts with an average of ten or less workers in each firm. This is clearly not a typical situation in a modern industrial society. For these reasons, we need to acknowledge that the regional economics and politics of 'the third Italy' are not necessarily a guide, and the success of this region is to a large extent socially embedded in its specific social milieu.

2.3.2 The California School: Industrial Organisation, Transactions, Agglomeration

The so-called California School approaches the emergence of flexible production and industrial agglomeration from the perspective of the factors that create a new division of labour and the transaction costs associated with inter-firm linkages. In essence, it offers an economic model of the agglomeration process, focusing on the way in which new market conditions give rise to increasing uncertainty, thereby prompting a deepening of the division of labour in order to (1) minimise the risks of overcapacity, and (2) maximise the benefits of specialisation and minimise the danger of 'technological lock-in'. At the same time, agglomeration develops because the transaction costs of traded interdependencies (input-output relations) tend to increase with the disintegration of production (since there are more transactions external to the firm and these rise with geographical distance). In other words, this approach concentrates on the economics of network forms of production (Storper, 1997: 9).

Storper himself contributed to the development of this model in the 1980s in company with many other authors such as Allen Scott. Specific industries studied included Hollywood's film and television industries, the women's clothing industry in Los Angeles, and the phenomenon of 'the Third Italy' (discussed in Section 2.3.1). The emergence of new market conditions in a particular industry can result from a variety of factors, exogenous and endogenous, so the specific dynamics are not the same in each case. (For example, regulatory and technological change was crucial in the case of Hollywood.) More recently, this approach has been further elaborated to take account of the ways in which agglomeration itself can produce new industrial dynamics (e.g. through the creation of new knowledge and technology), and the role of institutional environments in stimulating agglomeration – a perspective which brings the California School back to some of the key concerns of the flexible specialisation school.

Storper himself regards the California School's explanation of agglomeration as partial and concludes that the School's emphasis on the localisation of traded interdependencies (via input-output relations) 'is inadequate to the task of explaining the link between flexible production and the resurgence of regional economies in contemporary capitalism' (1997: 14). This is because in some cases, especially in technology-intensive sectors, 'technological agglomerations could be found without overwhelmingly dense local I-O

linkages and without the kinds of explicit institutional co-ordination found in many European industrial districts' (1997: 14).

2.3.3 Innovation, High Technology and Regional Development

The last point in Section 2.3.2 raises the specific issue of innovation in high-tech industries. What requires explanation is the uneven regional distribution of such industries. Put more simply, why are some regions more high-tech than others? In answer to this question, the American School of high technology regional development studied the development of Silicon Valley and Route 128 in the Boston area (Markusen et al., 1986), and highlighted the vital role of the university-spin off process. Other factors were also identified: a high quality of life, good infrastructure, even climate, etc. (Storper, 1997: 15). One problem here, however, is that this kind of explanation seems to be applicable mainly to those sectors of innovation which have a strong basis in formal science. Furthermore, it is not immediately clear why, given the large number of research universities, the number of dynamic high-tech regions is still fairly small.

In response, the 'regional politics' analysis suggests that the key variable is the role of regional coalitions which successfully press for the transfer of high-tech resources. Alternatively, a group of Franco-Italian-Swiss economists (the GREMI group) stress the *milieu* in which regional development takes place:

The milieu is essentially a context for development, which empowers and guides innovative agents to be able to innovate and to co-ordinate with other innovating agents ... [It is] a system of regional institutions, rules, and practices which lead to innovation. Many of the milieu theorists use the "networks" as their principal organizational metaphor. For some, the milieu is itself a network of actors: producers, researchers, politicians, and so on, in a region. For others, the network concerns the input-output system, and it is the network which is embedded in a milieu, and the milieu provides members of the network with what they need for co-ordination, adjustment, and successful innovation (Storper, 1997: 16-17).

In this model, however, it remains unclear how a distinctive milieu actually leads to innovation. This requires further exploration.

2.3.4 The Perspective of Evolutionary Economics: A Way Forward?

The theoretical contributions detailed above undoubtedly offer insights into the factors that lead to regionalisation; but they all seem to present only part of a complex picture. In the mid-1980s Storper began to apply the paradigm of evolutionary technological change, drawn from evolutionary economics, to fill these theoretical gaps. According to this paradigm, economic development is rooted in a process of learning and the search for new, more efficient forms of technological production. In this respect, what is significant about flexibility is its role in promoting such technological learning within the framework of the knowledge-based economy (Storper, 1995: 206). Increasingly, organisations cluster together in territorial space to travel along the same 'technological trajectory'. In so doing, they have interdependencies which are *untraded*, e.g. labour markets and conventions for developing, communicating and interpreting knowledge. Thus, for Storper the region is 'a nexus of untraded interdependencies' (Storper, 1995: 207).

At the same time, the traded input-output relations (I-O analysis) are, for Storper, still important. What he seeks to do is to combine an understanding of the role of traded *and* untraded interdependencies in stimulating regional agglomerations. On balance, however, he sees the resurgence of regional economies as being increasingly dependent on *untraded* interdependencies because of the growing importance of the knowledge-based economy (the 'learning economy'). This is a similar view to that of Borras, Ernst and Haggard (2000: 10), who argue that transaction costs are only one part of the equation and that other factors, including economics of scale, flexibility, access to information, and the ability to focus on core competencies, are increasingly important in shaping the territorial extent and form of industrial organisation. For Storper, the emphasis is on regions as technological-economic spaces. At the same time, however, it is clear that politics is also important: 'politics ... may decide which regions grow' (Storper, 1995: 211). Within the context of a political economy approach, a key task is to integrate an understanding of regions as political, as well as economic and technological, spaces. This is an issue to which we will return in Section 2.5.

2.4 The New International Division of Labour and Commodity Chains

2.4.1 *National Economies in East Asia*

It was only after the 1980s that the rapid industrialisation and regional development of East Asia attracted the world's attention. There was a particular interest in how the East Asian NIEs (Newly Industrialising Economies: South Korea, Taiwan, Hong Kong, Singapore), the ASEAN countries (especially Thailand, Malaysia and Indonesia) and China were able to achieve such remarkably high rates of economic growth. Explanations have often emphasised domestic political factors such as the combination of selective state intervention with neo-liberal orientations (free trade, division of labour, accumulation of capital and technologies, etc.) (World Bank 1993), institutional development (Aoki, Kim and Okuno-Fujiwara, 1997), and the role of the developmental state (on Japan see Johnson, 1982; on South Korea see Amsden, 1989; on Taiwan see Wade, 1990).

While the above studies concentrate on each country's individual economic base, there has also been a growing interest in the search for the causes of the region's broader economic dynamism, as illustrated by the revision of the so-called 'flying geese' model.⁵ In East Asia, industrial upgrading from labour-intensive to capital- and technology-intensive industries has occurred within Japan and the East Asian NIEs. The original 'flying geese' model suggests that there is a clear pattern of industrial development: (1) the diffusion of new products begins with importation from advanced countries into less industrial countries; (2) techniques and capital goods are imported and the less industrialised countries acquire their own capital goods industries; (3) there is a growth of domestic production because of the increase of domestic demand; (4) the less industrialised countries develop export capability. These processes are metaphorically named according to the pattern of 'flying geese'.

While this model focuses on the industrial development processes based on relations between national economies as the central unit, micro study (product cycle theory) suggests that productive innovation takes place in high-income countries, and that there are three stages in industrial upgrading: (1) the introductory or innovative stage; (2) the maturing or process development stage; (3) the standardised or mature stage. International production is important for firms seeking to maintain a monopolistic position and market access. This corporate strategy has become a central feature of the world economy.

However, the above models may not be applicable to the experience of the NIEs. Both expect the maturity of domestic consumption, but in the case of East Asia the stage of production for domestic consumption has often been skipped, and the starting-point has been export-led industrialisation. The production and sales activity of MNCs through FDI has accelerated both intra-industrial and intra-firm trade in East Asia, and has contributed greatly to the emergence of dynamic sub-national and cross-border micro-regions.

2.4.2 The New International Division of Labour

In effect, the emergence of micro-regions reflects the patterns of what has been called the new international division of labour (NIDL). This concept was originally based on dependency theory, as applied, for example, to the study of trade relations between Latin America and the rest of the world.⁶ It was first suggested by German scholars investigating patterns of manufactured exports from the Third World in the 1970s. Rising production costs and the intensification of competition forces firms to invest in low-cost areas. In East Asia, the role of special economic zones (SEZs) and export processing zones (EPZs) is critical in that they have been able to attract FDI and to connect with capital and advanced technology. (This is a particularly important factor in the case of southern China.) The combination seems to be sufficient to explain East Asian economic growth. However, the East Asian NIDL is by nature more of a regional division of labour, as exemplified by the cases of Hong Kong and Singapore. Furthermore, the role of foreign firms is not the same in all the East Asian NIEs. For example, as Appelbaum and Henderson (1992) observe, the NIDL applies to Singapore, where foreign firms overwhelmingly dominate; in Taiwan, foreign firms are in a minority; in South Korea, indigenous chaebols (conglomerates) dominate, and Hong Kong's economic growth was triggered by smaller local manufacturing firms. Nevertheless, the theory of the NIDL is useful in highlighting the role of FDI from advanced countries as well as the development of technology and the division of production processes.

2.4.3 International Commodity Chains

Any attempt to understand the changing patterns of the regional division of labour in the age of post-Fordism (see Section 2.2 above) requires a consideration of the organisation of production in the global manufacturing system. The concept of an international commodity chain (ICC) provides a useful insight for understanding both productive and spatial

interdependencies, and helps to explain how peripheral countries are linked to the global market (Gereffi and Korzeniewicz, 1994). The concept refers to a network of labour and production processes whose end result is a finished good (Hopkins and Wallerstein, 1994). The global commodity chains approach highlights the role of producer-driven and buyer-driven chains in creating overlapping and at times conflicting regional divisions of labour.⁷ Producer-driven and buyer-driven chains are founded on different types of production and trade networks, are driven by different kinds of lead firms, incorporate different sets of countries into their regional hierarchies, and have different consequences for industrial upgrading in East Asia's sub-regions (including sub-national regions in China).⁸ Thus, economic development through export-led industrialisation in Japan, the NIEs, the ASEAN countries and now China is part of the broader processes of globalisation. The NIDL has been modified to a more regional and hierarchical division of labour within East Asia, a division of labour which in turn is characterised by the central role of certain key geographical micro-regions. Moreover, the commodity chains approach seeks to transcend 'the increasingly sterile debate about the role of states versus markets, and to come to grips with new trends in the organization of production on a world scale' (Gereffi, 1996).

The role of exporting is very important in the commodity chains approach. According to Gereffi, there are five major export roles: (1) primary product exports, including processed 'industrial commodities' and non-traditional agricultural exports; (2) the export-oriented assembly of traditional manufactured goods, such as clothing and electronics goods, using imported components; (3) the production of components for export in relatively advanced industries, such as automobiles and computers, using substantial local inputs; (4) original equipment manufacturing (OEM), whereby contractors make goods to be sold under another firm's brandname; and (5) original brandname manufacturing (OBM), whereby manufacturers make products for export and sale under their own label.⁹ The East Asian NIEs succeeded in upgrading their industrial base from the 1960s to the 1990s, and in the 1990s they focused on components supply manufacturing, i.e. OEM and OBM.

In this context, it is important to understand the roles of NIEs in relation to the commodity chains, especially through their links with Japan. East Asian NIEs have undertaken the following roles: (1) a commodity-export role; (2) a commercial-subcontracting role, using imported components from Japan; (3) an exports-platform role, using Japanese FDI; (4) a

components supplier role, acquiring OEM from Japanese manufacturers; and (5) an independent exporter role, using original brandnames.¹⁰ Industrialisation in East Asia, therefore, is the result of an integrated system of global production and trade, supported by new forms of investment and financing, and promoted by specific government policies. Thus, the processing trade arrangements (PTAs) between China and Japan are in the phase of the export-oriented assembly of manufactured goods, using imported components.

The spatial agglomeration of industry, which is a key characteristic of the NIDL, is linked to both groups of vertically related firms (i.e. a chain of suppliers) and horizontally related firms (i.e. similar firms competing within the same industry), and according to Marshall, it has three major dimensions: (1) it provides a pooled market for workers with specialised skills; (2) it facilitates the development of specialised inputs and services; and (3) it enables firms to benefit from knowledge spill-over.¹¹ For example, in the case of southern China, there are various ways in which patterns of industrial agglomeration in the province of Guangdong are linked to the development of commodity chains: for example, through the expansion of FDI from Japan and the NIEs, the development of intra-regional trade, the transformation of industrial location structures, export-oriented strategies, and the development of market access. In turn, all of these shifts are related to the need to promote industrial organisation in order to benefit from optimal supply and output. These trends are well illustrated by the case of the electronics industry from the developed countries to the peripheral areas, and this change has been the most significant cause of East Asia's impressive regional economic development.

2.5 Cross-Border Production Networks

In recent years there has been a growing interest in the importance of network-based MNCs in the global economy. Borrus, Ernst and Haggard (2000a) discuss the significance of cross-border production networks (CPNs) as an engine of industrial integration of the Asia-Pacific region. These networks encompass 'the inter- and intra-firm relationships through which the firm organizes the entire range of its business activities: from research and development (R&D), product definition and design, to supply of inputs, manufacturing (or production of a service), distribution, and support services' (Borrus, Ernst, and Haggard, 2000a: 1). They argue that the heterogeneity of the region's technological capabilities means that firms seek to exploit the specific advantage of particular locations. This is also

a result of government industrial policies. Hence, the role of the state in fostering CPNs is vitally important.

Another key point is that CPNs vary according to the specific approach of each lead firm and also the characteristics of the home (i.e. national) system of production and innovation. Increasingly competitive success (especially in electronics) depends on the dynamics and flexibility of CPNs. This has been especially true since the Asian financial crisis. Firms in the old vertical (hierarchical) relationships are being replaced by vertically disintegrated networks of firms. Such networks often have high transaction costs, but these are compensated for by other advantages. In particular, networks can tap into locally developed technological capabilities. This is especially important in Asia because of the region's diverse and tiered levels of development. The varying patterns of governance of CPNs are also significant. These highlight the different patterns of control of CPNs exercised by headquarters or the lead networks firm -- patterns which vary according to the country of origin.

H. Yeung (1998) is particularly interested in the spatial and social embeddedness¹² of these firms, highlighting the way in which they establish roots in 'spaces of networked relations' as opposed to the much simpler 'spaces of firms' of the past (p. 76). Although he does not use the actual term 'cross-border production network', in one study he builds an analysis of Hong Kong firms in the ASEAN region on the basis of a distinction among three major types of network: intra-firm, inter-firm and extra-firm. Each of these types is characterised by its own specific profile of socio-spatial features. What is particularly fascinating in all cases is the major contribution of Chinese ethnic and family ties to the success of these various networks. In this sense, all Chinese enterprises may be regarded as 'family businesses' of one kind or another. The Chinese word *guanxi* denotes the Chinese view of good, mutual 'relationships' as the necessary basis for successful business. Yeung shows how each of the three types of network builds upon *guanxi* in various ways. Thus, intra-firm networks are rooted in the imperatives of family and entrepreneurship; inter-firm networks are based on an extended notion of friendship and partnership; and extra-firm networks stress the vital role of intermediaries and political connections.

Yeung warns against the simple generalisation of the results of his analysis of Hong Kong TNCs to other overseas Chinese businesses. Yet his analysis is extremely suggestive in its

capacity to show how different kinds of business networks emerge and take root in specific spatial contexts. In general, networking is a major feature of Asian (especially Chinese) business organisation, but it is also becoming a more prominent feature of global business all over the world. Moreover, Chinese business networks are at the same time influenced by globalising tendencies such as access to the financial resources that flow through the global financial system (Olds and Yeung, 1999). Action at the global level affects the capacity of listed Chinese firms to operate at different scales, and this has a major impact on the resources available to the many unlisted small firms. Following Yeung's approach, we can see MNCs as 'networks of governance structures' (H. Yeung, 1998: Ch. 3); and, moreover, we can add the further observation that these production networks are increasingly linked to sub-national governments and policy networks of all kinds in the remarkably fluid multi-level governance arrangements that are now emerging. Intermediate associations, such as local business associations, also play a vitally important networking role in linking government actors and firms.

In this study we argue that the network approach to understanding business organisation, an approach which is now well developed in the literature (e.g. Borras, Ernst and Haggard, 2000b), needs to be extended to incorporate the role of government (especially sub-national government) actors. Increasingly territorial *government* in the old-fashioned, hierarchical sense is being replaced by horizontal relationships of cross-border *governance*. For example, in the case of Europe, such trans-national governance is seen in terms of two key dimensions: 'below' the state in cross-border co-operation and 'above' the state in the Euro-polity (Christiansen and Jørgensen, 2000). According to Morata, between the Spanish and French sub-national governments new forms of inter-regional and inter-local co-operation are developing. The North-West Mediterranean Euroregion is seen as a regional association of cross-border co-operation, established by the Presidents of Catalonia, Languedoc-Roussillon and Midi-Pyrenees. This co-operation is associated with the development of the process of European integration. But more importantly, SNGs need to redefine their traditional functions because the transfer of some fields of national sovereignty upwards to the EU and dismantling of national borders have contributed to the transformation of established territorial boundaries (Morata, 1997: 292-3). This network behaviour of SNGs has emerged as a model of the co-operative economic growth of the micro-region.

2.6 The Political Spatiality of Regions

There is an obvious danger in 'reducing' the study of regionalisation to economic and technological factors. The role of government, political institutions, political processes, and political culture in shaping, limiting and encouraging new forms of regional activity is of vital importance. These relationships, however, are themselves becoming increasingly complex as government and politics lose their once firm territorial association with the nation-state as the primary unit of political organisation and sovereignty. No longer does the world consist simply of national economies governed by national political structures. Under the impact of globalisation and the movement towards a post-Fordist system of flexible production, the centrality of the nation-state has also declined and there has been a restructuring of political power in the direction of much greater territorial pluralism. This has involved the growing importance of regions as 'networked' political spaces within the global economy. No longer can regions (and localities within regions) simply be seen as the subordinate units of national political systems. Such a model corresponds to the old politics of Fordist mass production, but does not seem to fit the more flexible world of the politics of post-Fordism.

For example, global cities (see Section 2.1 above) now serve as the command centres of global economic networks. How these cities are governed and how they seek to resolve the political struggles and tensions that arise within them are vitally significant issues that cannot be reduced to economics and technology. Similarly, the regional spaces that surround global cities are spaces of political conflict and co-operation, both internally (within themselves) and externally in relation to other regional spaces (and their dominant urban centres) and their own national governments. For example, within any national territory, regions are competing with each other for scarce resources, financial support, economically supportive measures, and influence. This is at root a political process and involves the structuring of power relations at both the formal and informal levels. Most importantly, no longer are the Keynesian demand-management policies and redistributive welfare-state systems associated with Fordist mass production capable of providing a framework for the further development of capitalism (Brenner, 1998: 6). The territorial 'fixity' of the nation-state has dissolved in a process of what we may call 'deterritorialisation'. At the present time complex processes of spatial restructuring ('reterritorialisation') are in progress.

Globalisation and the increase of transnational interactions have eroded the division of responsibilities between states and SNGs (Keating 1999: 1). As a consequence of global economic dynamism, every major city is an important node in a global network of cities that is not subject to effective state regulation (Magnusson, 1996: 22). Territorial nation-states are no longer the key 'nodes' of the global economy (Agnew and Corbridge, 1995: 1989). Nor are they the unchallenged foundations of political identity as globalisation creates more fluid patterns of culture, religion, ethnicity and social formation. Traditional national political formations (parties, interest groups, movements, etc.) no longer command the commitment and loyalty that they used to enjoy. Increasingly, such formations are giving way to regional and local formations articulating demands for greater territorial autonomy, decentralisation, devolution and, in some cases, separation from the nation-state.

This does not mean that the territorial nation-state is unimportant. Rather, each nation-state has to decide how to adapt (restructure) if it is to increase its capacity to operate effectively in an age of globalisation, rapid technological change, and shifting political loyalties. This includes a need, at the international level, to overcome the rigidity of national boundaries, since these can often hinder the development of transnational economic, technological and social flows. Increasingly, for example, dynamic regions are emerging which actually cut across the boundaries between nation-states. Inevitably, new forms of governing these regions are required, since traditional notions of territorial state sovereignty do not allow for such a phenomenon.

New fluid patterns of MLG, based on networks of decision-making, are presently emerging throughout the world as an alternative to the rigidity of territorial state sovereignty. It is important in this situation to reconsider the concept of governance. This refers not only to formal governmental activities but also to informal, non-governmental and transnational mechanisms. The concept has been widely used to explain the micro behaviour of business organisations, as in the concept of 'corporate governance' (see OECD, 1998). In international studies, the growing interest in governance can be traced to the recognition of the shift from formal relations (state to state) to a more flexible and informal system. It also stems from dissatisfaction with the dominance of realist (anarchy) and liberal institutionalist (regime) theories in international relations. 'Governance', according to Rosenau (1992: 4-5), embraces governmental institutions but also subsumes informal,

non-governmental mechanisms. It is in fact possible to conceive of 'governance' without 'government', whereby *regulatory mechanisms* in a sphere of activity function effectively even though they are not endowed with formal authority. The Commission on Global Governance (1995: 2) defines 'governance' as 'the sum of the many ways individuals and institutions, public and private, manage their common affairs'. In this continuing process, conflicting or diverse interests are accommodated so that co-operative action can be taken. Weiss (2000) points out that there is a tension between 'governance' as a complex set of structures and processes, both public and private, and as a synonym for 'government'. Governance can be defined as a set of rules and regularised practices that together serve to bring order to the operation of a particular field of activity. The major issue of concern with governance is how the rules and practices can be coordinated effectively.

If we consider the present political economy of Europe, for example, it is possible to identify a combination of spatial relationships: supranationalism in some areas, the increasing importance of sub-national units and structures, and the spread of transnational (networked) linkages of all kinds. Local and regional authorities and actors (for example, the German Länder, the French and Italian regions, and major cities across the EU), and transnational associations and organisations of many kinds (e.g. pressure groups in a particular industry working together across national borders, associations of local authorities, and European-wide networks in health, education and other policy areas) all play a role in the new MLG. As Christiansen (1996: 14) observes, 'The way in which the process of European integration has forged new alliances – across territorial units, sectoral boundaries and the divide between public and private – is novel and perhaps unique'. He does not deny the role of the state in policy making, but stresses the increasing links between regions, and between actors on the regional and European levels, which imply new problems for the processes of democratisation and legitimisation of governance. In the case of the EU, Rosamond (2000: 98-129) refers to the obsolescence of the traditional international relations approach to the EU and emphasises the role of institutionalism and policy networks at the sub-national level to give a firm conceptual underpinning to the analysis of multi-level governance. Thus, the concept of 'governance' is also used to refer to transnational governance both below and above the state (Christiansen and Jørgensen, 2000).

At the same time, the phenomenon of MLG is actually emerging in many parts of the world, including East Asia, although in varying forms. The common denominators are greater spatial fluidity, less institutional rigidity, and the growing importance of regions and localities. It must be stressed, however, that the emergence of MLG is itself a highly political process and is both stimulated and constrained by the power relations that prevail in the geographical area in question.

The MLG approach stresses that the distinction between the domestic and the international spheres is becoming blurred as political actors across multiple levels of governance increasingly interact in multi-level policy networks (Marks et al., 1996: 41). What is also needed, however, is an understanding of how political actors at different levels interact – both formally and informally -- with private firms and other non-governmental organisations. So far, this perspective has tended to be neglected even in studies of the EU, where the MLG approach has been most extensively pursued, although there is a growing interest in the policy network approach. Studies of MLG suggest that different sectors of decision-making will exhibit their own unique characteristics in terms of patterns of governance and the interactions of governmental and non-governmental elites (Rosamond, 2000: 110). Therefore, in the present study the task is to explore the specific dynamics of decision-making in the area of foreign direct investment into southern China. This is not just a matter of applying Western (especially European) concepts of MLG, since the southern China/East Asia region is clearly very different from the EU. The fact that the Chinese political system has traditionally been very centralised and lacking in sub-national autonomy means that there are particular challenges in moving towards a system of MLG. Indeed, part of the purpose of the present study is to identify the difficulties involved in building a more pluralistic, multi-level system of governance in a political environment that has normally resisted such a transformation.

Weiss (1998) provides an interesting perspective on nation-state responses to globalisation by comparing the experience of East Asian countries (including Japan), Sweden and Germany to show that the choice of effective industrial upgrading policies is especially important in strengthening the nation-state's adaptive capacity. There is an opportunity for each nation-state to express its own institutional resourcefulness and creativity as it faces the challenge of restructuring. Weiss draws attention in particular to the reasons why Germany and Japan have demonstrated a stronger transformative capacity than Sweden

and the United States. Her answer is that the two successful cases have relied upon a strong combination of developmentalist and distributive policy orientations, while the two less successful cases have had weakly co-ordinated market economies and, in the case of Sweden, a dominant emphasis on distributive management rather than developmentalism. These examples underline the fact that not all nation-states will restructure their political economies in precisely the same way. There is a variability in state approaches to encouraging industrial development and technological innovation – a fact that has obvious implications for patterns of regionalisation.

Thus, the political context of regionalisation is of vital significance. A political economy approach to the subject needs to integrate economic and political analysis, and to demonstrate the mutual interdependence between economic and political factors. In particular, the nature, scope and extent of state power, and the relationship between state and non-state actors in the process of regionalisation must be taken into account. Also, the external role of SNGs is increasingly important: they are being called upon to direct their efforts to the cultivation of cross-border linkages, and this means that in effect they are becoming key international actors in their own right. A recent study has begun to focus on the emerging city networks in which cities exploit scales of economies (Capello, 2000). As Hocking puts it, SNGs (or, as he calls them, non-central governments), 'often acting as the mouthpiece of local economic interests, seek both to influence national external policies and, moreover, to operate in the international arena on their own behalf' (Hocking, 1993a: 1). This, Hocking suggests, is part of a broader process towards the localisation of foreign policy in the contemporary world. The traditional distinction between domestic and foreign policy is becoming blurred, and even diplomacy can no longer be viewed as a purely external or foreign activity. Increasingly, state and non-state actors – and the former include SNGs -- have to pursue strategies of 'multilayered diplomacy' in a variety of political 'theatres' (ibid.: 2-3). This challenge raises the issue of the capacity of SNGs to perform these tasks effectively. Table 2.2 offers a useful starting-point for analysing the relationship between the aims of SNGs in multilayered diplomacy, the type of involvement, the structure and resources of SNGs, and the levels of participation.

Table 2.2 suggests that a range of factors shape the pattern of involvement of SNGs in the processes of what Hocking calls multilayered diplomacy. These factors vary from one situation to another and over time. In broad terms, the structural and situational factors of a

particular SNG must be understood if the localistic action of that SNG is to be explained (Cooper, in Hocking, 1993b: 59-61). For this reason, different SNGs within the same nation-state may very well behave differently. In order to explain this variation, as Cooper suggests, both the international context and domestic politics need to be examined:

In effect, then, what is increasingly needed is a series of two-level analyses in which the non-central actor's interaction with the ipe and national politics is highlighted. By this time of exercise it seems possible to capture both the stability or the volatility of non-central foreign economic behaviour (Cooper, in Hocking, 1993b: 63).

The last point is crucial, since the behaviour of SNGs undoubtedly changes over time as domestic and international factors also change. Any analysis of the behaviour of SNGs thus needs to take account of historical fluctuations and particular critical turning-points which lead to change and innovation (see the *Involvement* dimension in Table 2.2).

Table 2.2 The Characteristics of SNGs as Actors in Multilayered Diplomacy

<i>Aims</i>	<i>Promoting regional interests; interests related to powers and responsibilities, particularly in economic area</i>
<i>Involvement</i>	<i>Continuous but likely to fluctuate in intensity; concentrated on economic agenda</i>
<i>Structure and resources</i>	<i>Sub-national government; bureaucratic and political resources; legitimacy among local population; links with national government structure</i>
<i>Levels of participation</i>	<i>Governmental and intergovernmental; closely linked to regionally based transnational actors</i>

Source: adapted from B. Hocking (1993), *Localizing Foreign Policy: Non-Central Governments and Multilayered Diplomacy*, New York: St. Martin's Press, p. 47.

2.7 Micro-Regionalism in the International Political Economy

The global economy is built upon the powerful role of major super-regional (macro-regional) blocs in Europe, North America and East Asia. In addition, similar schemes have emerged in other parts of the world. In the wake of the end of the Cold War and the decline of Fordist mass production, there is a new key role for such macro-regions in articulating the processes of capitalist development. This phase of macro-regional growth may be designated as the 'new regionalism' to distinguish it from the 'old

regionalism' of the period between the 1950s and 1970s. The 'old regionalism' can be understood only in the context of the bipolar Cold War structure of that period; whereas the 'new regionalism' has emerged out of the collapse of that structure and the impact of globalised flexible production (Marchand et al., 1999: 903).

In response to these new trends, the so-called New Regionalism Approach/Theory (NRA/T), developed by Björn Hettke and colleagues at the World Institute for Development Economics Research (United Nations University, Helsinki) and the Department of Peace and Development Research (Göteborg), has sought to develop a three-level analysis examining (1) the structure of the world system as a whole; (2), the level of inter-regional relations; and (3) the internal pattern of the single region. This is therefore quite a different perspective from that used in the period of the old regionalism, when the emphasis was on theories of regional (e.g. European) integration, as illustrated by the widespread application of functionalism and neo-functionalism (Marchand et al., 1999: 901-2).

To be more accurate, it may be better to refer to the 'new regionalisms' (in the plural), since the contemporary world exhibits a variety of patterns of regionalism (including super-regionalism). These include key micro-regions, which are geographically smaller in scale and are based on inter- and intra-firm relations, but which have nonetheless come to play a key role in the dynamics of the global economy. Underpinning all these patterns is 'the regionalised accumulation of wealth through production and commodity chains and networks', and the involvement of a wide range of formal and informal actors (Marchand et al., 1999: 905). The growth triangles of Southeast Asia, for example, are an important example of regionalisation, but they are not at the same formal, institutionalised level as, say, ASEAN. While some forms of regionalisation are clearly state-led (from above), as is the case with trade liberalisation, other forms of regionalisation proceed at the informal grassroots level, e.g. through small cross-border production networks. The importance of the informal 'second economy' in less developed countries means that regionalisation may very well be more significant in this context than at the formal level of state-led activity:

The informal second economy covers a whole range of activities from street vendors and small-scale informal cross-border trade to the warlordism of Sierra Leone and Somalia and the large and intricate cross-border smuggling of gem

stones from Angola and Senegal, and drugs from Columbia, Nigeria and Burma to products of child labour in myriad enterprises around parts of the South, including ubiquitous Special Economic Zones (SEZs) or Export Processing Zones (EPZs) (Bøås et al., 1999: 1065).

This perspective is further developed by Hettne and Söderbaum (2000), who suggest that the concept of 'regionness' embraces five elements: regional area, regional complex, regional society, regional community and region-state. These five elements correspond to increasing levels of regionness. Thus, the *regional area* is a geographical unit defined by natural physical barriers and certain ecological characteristics. When we use such terms as Europe, North America or East Asia, we have in mind initially this sense of a distinct regional area. From a social point of view, such an area is a potential region and begins to develop in that direction through increased social contacts and transactions among its constituent groups. Eventually, a *regional complex* emerges. Initially, however, the actual sense of regionness may be weak – if, for example, the area concerned is dominated by nation-states claiming rights of sovereignty and a unique identity of their own. Thus, the regional order in nineteenth-century Europe was little more than a concert of nations.

A *regional society* emerges as non-state actors develop their relations across national boundaries and form the basis for a transnational regional economy and regional civil society. At the same time, there may be a formal level of regional unity, as in the establishment and development of the EU. But this formal level is not coterminous with the informal level:

Various dimensions of regionalism and regionalizations occur at different spatial levels of regions, which to a large extent are all related to one another (and therefore must be understood within the same framework). It is particularly important therefore to explicitly integrate 'micro-regions' and micro-regionalisms into the analytical framework.

Micro-regionalism is related to macro-regionalism in the way that the larger regionalisation (and globalisation) processes create possibilities for smaller economically dynamic sub-national and transnational regions to get a direct access to the larger economic system, often bypassing the nation-state and the national

capital, and sometimes even as an alternative or opposition to the challenged state and to formal state-regionalisms (Hettne and Soderbaum, 2000: 465).

The level of regionness increases further as a *regional community* emerges:

[T]he region increasingly turns into an active subject with a distinct identity, institutionalised or informal actor capability, legitimacy, and structure of decision-making in relation with a more or less responsive regional civil society, transcending the old state borders (Hettne and Söderbaum, 2000: 466).

A regional collective identity and the structure of a genuine security community emerge to challenge the primacy of the nation-state. The dividing line between different national communities becomes weaker. At the same time, micro-regions within the regional community still have the opportunity to flourish and actually contribute to the cross-border dynamism of the regional community. The EU is at the stage of developing a regional community.

Eventually, a regional community may become a *region-state*, with a new form of political association based on a pooling of sovereignty and a recognition of the multi-cultural foundations of the association (since, by definition, cultural homogeneity in such a large area will be impossible).

By distinguishing the global, inter-regional and intra-regional levels and recognising that there are different levels of regionness, the interconnectedness of the various new regionalisms in the contemporary world becomes easier to appreciate. This also reminds us that we cannot easily generalise from one particular example of regionalism (e.g. in Europe) and extend the lessons of that example to other parts of the world (e.g. East Asia). Regionalism in all its forms depends very much on the specific historical and geographical contexts in which it takes place.

2.8 Conclusion

The theoretical analysis in this chapter sought to furnish an overall framework, rooted in a 'network' perspective in international political economy, for the subsequent investigation

of the new regionalism in Southern China and East Asia. From each section of the analysis we can draw some important conclusions that will be taken forward in subsequent chapters.

First, as Section 2.1 makes clear, the term 'region' has been used in many different ways in different academic disciplines and different professional fields. In the present study our focus is on economic regions within the global economy, and in particular on sub-national, cross-border 'micro-regions'. The latter term is preferred in order to make it clear that we are not concerned here with the larger 'macro-regions' or regional blocs, or the grouping of small states or peripheries of the world economy based on the states, although of course micro-regions do operate within these larger regions, so that, in the case of southern China we cannot ignore the broader context of the East Asian region as a whole (macro-region). The concept of micro-region alerts us to the importance of localised production systems as a crucial source of dynamism within the global economy.

Section 2.2 sought to reveal some of the complexities of the regionalisation process in the context of post-Fordist flexible production. One of the key characteristics of post-Fordism is a wide-ranging restructuring of production at the regional – including the micro-regional – level. This involves, in particular, a constantly developing new international division of labour, with specialised locational sites and agglomerations emerging under the impact of the decisions of major MNCs to move their production bases, often to the peripheral areas of the world. This process is in turn facilitated by the policy innovations of national and sub-national governments, which increasingly recognise the need to restructure their own economies to respond to the increasing flexibility demanded by global economic processes.

There is, however, considerable disagreement about the precise origins and dynamics of contemporary regionalisation, as is illustrated in Section 2.3 by the examination of three different schools of thought identified by Storper (1995, 1997) and his own contribution to the debate. The differences between these schools centre on two main issues: (1) whether the specific experience of particular localities/micro-regions (such as 'the third Italy' and southern Germany), can be universalised, or whether they reflect the impact of distinctive local cultural and institutional milieux; and (2) the relative importance of various economic, political-institutional, technological and cultural factors in shaping local/micro-regional development in particular sectors of production in particular geographical areas. Storper's

critique of these approaches and his own emphasis on technological trajectories and the role of trade and untraded interdependencies (and the cost of those interdependencies or linkages) in shaping regional industrial agglomeration is most helpful in drawing attention to the economic and technological basis of firms' locational decisions, and the relationship of those decisions to the specific institutional contexts in which they operate: 'both firms and territories are subject to temporal and spatial path dependencies that are intertwined with each other' (Storper, 1997: 291). In other words, the inter-relationship between the economic needs of firms and the territorial orders in which firms locate deserves close attention. This point is also stressed by Maskell et al. (1998: 50): 'Firms interact in markets which, whether designed or self-grown, are undoubtedly social constructions, embedded in *territorially specific* institutions which define and secure property rights and enable economic transactions'. Yet Maskell et al. also add that in empirical studies it has proved extremely difficult to demonstrate the costs and benefits of local transactions of goods and services (1998: 62). This thesis also aims to reveal the *territorially specific* factors in southern China that have an impact on the shaping of micro-regional networks.

Storper is especially interested in the role of agglomeration in facilitating the exchange of knowledge in today's learning or knowledge economy. In this respect, it may also be noted that Porter (1990) sees geographical proximity as a basis for the enhanced exchange of information among clusters of industries, and this is why, for example, industrial rivals often congregate in the same geographical area. These observations further reinforce the need to identify the specific gains that firms derive from geographical proximity in a particular territorial area, and to explain why some firms derive greater benefits than others from such proximity. If, as Maskell et al. (1998: 69) stress, 'firms are dependent on their local environment in order to retain and increase their competitiveness', then it is clearly essential to explore the nature and scope of that dependency in some depth.

Section 2.4 sought to add a more international dimension to the analysis by considering the applicability of the NIDL concept and models of commodity chains to the understanding of why and how industrial agglomerations emerge, especially in the East Asian context. This is an important issue, since on the face of it we might expect globalisation to be associated with the increased 'footloose' behaviour of firms rather than their localised 'stickiness' (Maskell et al., 1998: 69). As we have seen, there is a distinctive regional division of labour in East Asia, stimulated by processes of industrialisation, the economic power of

Japan, the geographical allocation of production for export, and the position of firms in the global network of producer- and buyer-driven commodity chains. This indicates that different industrial sectors are characterised by their own distinctive patterns of geographical specialisation, and that these patterns are constantly changing. As the micro-regions of southern China become more closely integrated with the global economy, it is increasingly important to identify their place in the NIDL and the commodity-chain patterns which shape the growth of industrial agglomerations.

Section 2.5 drew on the insights offered by CPNs approaches to the study of cross-border, trans-national organisation, as illustrated by the recent contributions of Borrus, Ernst and Haggard's edition (2000b) to the study of Asia-Pacific business and by H. Yeung's study of Asian firms to the study of Asian business (H. Yeung, 1998, 2000; Olds and Yeung, 1999). Borrus, Ernst and Haggard (2000b) emphasise the varying strategies of lead firms and the impact of national home environments. This is particularly important in the case of Japanese and Taiwanese electronics firms. Yeung's categorisation of three types of network (intra-firm, inter-firm and extra-firm) is useful in helping us to understand the variable forms of transnational business organisation. Moreover, it is important to appreciate how these variable forms are related to the specific social milieu in which they are embedded. Recently, H. Yeung (2000) has sought to extend his analysis to the networking relations between firms and government, and the dynamic inter-relationships between local politics and foreign ventures. He shows that '(T)he successful establishment of international business ventures in China is highly contingent upon an appropriate understanding and leveraging of local politics and the collusion/rivalry tendencies of local governments' (ibid.: 835). The present study seeks to develop further this perspective by focusing on Japanese direct and indirect foreign investments in southern China and the associated emergence of new cross-border network relations within an innovative process of sub-national governance.

Section 2.6 considered the political dimension of micro-regionalism. This aspect has generally been neglected in the literature, and one main purpose of the present study is to remedy this neglect. Major changes in the political organisation of nation-states, stimulated partly by the impact of global economic processes, have resulted in the increasing assertiveness of SNGs, both domestically and internationally. The old hierarchical, bureaucratic model of state decision-making is increasingly giving way to a more flexible,

network-based model in which SNGs have more responsibility for direct linkages with other regional actors, including firms. The paradigm of MLG seems to be especially appropriate as a basis for exploring the new pluralism of variegated policy networks, although care needs to be taken not to simply extend Western (European) analysis to the case of southern China, since there are clearly fundamental differences between the economic and political backgrounds of the two regions. In the case of southern China major domestic transformations in the political relationship between the central state and the provincial/sub-provincial governments have been a key part of the broader process of the emergence of cross-border micro-regionalism, but the central Chinese state has remained cautious in extending autonomy to sub-national units. Close attention will be given to these political changes and relationships in the present study.

Finally, Section 2.7 discussed the implications of the three-level New Regionalism Approach/Theory (NRA/T) in the study of international political economy. The suggestion that the global, inter-regional and intra-regional levels of change need to be considered together is reflected in the present study. Moreover, this approach recognises the importance of the micro-regional (sub-national and transnational) dimension as part of the third (intra-regional) level of analysis, and stresses the need to relate this dimension to the impact of global commodity chains and production networks. In this respect, the present study may be seen as a contribution to the NRA/T debates, and an attempt to extend the analysis to a geographical area (southern China/East Asia) which has previously been neglected in the literature.

The overall framework developed in the present study may be described as a network analysis of cross-border governance. Its aim is to reveal the fluidity and complexity of organisational linkages between governmental and non-governmental actors (especially linkages between SNGs and MNCs, and in intra- and inter-firm relations) in southern China and across the territorial borders among Southern China, Taiwan and Japan. The focus is on the emergent horizontal linkages between these actors and their embeddedness in a specific micro-regional spatial context.

¹ The term 'time-space compression' is used to capture the process of transformation of society, which is caused by the degree of interactions of goods, services and ideas globally. See further Dodgshon (1999).

² Keating and Loughlin (1997: 2).

³ For example, Hook and Kearns (1999) define 'sub-regionalism' as the middle level of regionalism between micro-regionalism and higher levels of regionalism, promoted by the weaker states in the global economy such as exemplified in the cases of ASEAN (Association of South East Asian Nations), BSEC (Black Sea Economic Cooperation Scheme), ECOWAS (Economic Community of West African States), ACS (Association of Caribbean States), CEFTA (Central European Free Trade Agreement), EAEC (East Asian Economic Caucus and 'Greater China'.

⁴ This school of thought includes a group of French economic thinkers, for example Aglietta and Lipietz. It developed as a critique of both orthodox economics and structuralism. Its central concern is the 'regime of accumulation' and the 'mode of regulation'. The former refers to the arrangements through which the accumulation of capital occurs, which involve the articulation of a system of production and consumption, and the integration of the capitalist mode with coexisting modes. The latter refers to a social framework of rules and institutions that orchestrate relations between the systems of production and consumption to ensure that they are conducive to orderly capital accumulation. See Collinge (1999:558) and Rutherford (1992).

⁵ The 'flying geese' model, which was developed by Kaname Akamatsu in the 1930s, is an attempt to describe the interactive development of a group of countries at different levels of industrialisation. See Blomquist (1996: 215-31) and Shinohara (1996: 411-19).

⁶ Frank (1967).

⁷ Gereffi (1996).

⁸ More precisely, according to Gereffi, producer-driven commodity chains are those in which large, usually multinational, manufacturers co-ordinate production networks (including their backward and forward linkages). This is characteristic of capital- and technology-intensive industries such as automobiles, aircraft, computers, semiconductors and heavy industries. For example, according to Hill's study (1989), the average Japanese auto manufacturers' production system has 170 first-tier, 4,700 second-tier, and 31,600 third-tier sub-contractors. On the other hand, buyer-driven chains are those industries in which large retailers, designers and trading companies play the vital role in setting up decentralised production networks in a variety of exporting countries. See Gereffi (1996). There are commodity chains perspectives on other East Asian industries, for example Snyder (1999) on the toys industry and Gereffi (1999) on the clothing industry.

⁹ Gereffi (1996).

¹⁰ Gereffi (1992: 106).

¹¹ A. Marshall, quoted in Maskell et al. (1998: 9).

¹² The relations between society and the market have been a primary concern of economic sociology. The classical tradition of economic sociology is found in the works of Marx, Weber, Durkheim, Schumpeter and Polanyi. Economic sociology offers a sociological perspective on personal interaction, groups, social structures (institutions), and social controls (among which sanctions, norms and values are central). See Smelser (1994). Polanyi defines a market economy as a self-regulating system of markets directed by market prices (Polanyi, 1946: 50). He also argues that the term 'economic' is a compound of two meanings, one substantive and one formal. The substantive meaning of 'economic' originates from man's dependence for his living on nature and his fellows. It relates to the interchange with his natural and social environment. The formal meaning of 'economic' implies a set of rules referring to choice and derives from logic. For Polanyi, human economy is embedded and enmeshed in institutions, both economic and non-economic. See Polanyi (1957).

CHAPTER 3

THE PROCESSES OF CHINA'S MICRO-REGIONAL INTEGRATION WITH THE WORLD ECONOMY

This chapter is divided into two parts. The first part (Sections 3.1 and 3.2) begins with a discussion of the conceptual debate on globalisation and regionalisation with particular reference to the East Asian economy (Section 3.1). It draws attention to the complexity of processes, the unevenness of forms, and the huge diversity of practices involved in globalisation and regionalisation. In particular, patterns of regional development are shaped by deepening interdependence among various actors including states, localities, foreign firms. Section 3.2 examines these actors and their roles in the processes of East Asian regionalisation, referring in particular to the emerging form of multi-level governance (MLG).

The second part of the chapter (Sections 3.3, 3.4 and 3.5) seeks to identify China's distinct pattern of integration with the world economy. Of particular importance in this respect is the 'micro-regional integration'¹ manifested by the uneven geographic spread of international economic relations in Guangdong. This illustrates the way in which China's gradual transition from relative isolationism has developed asymmetrical levels of development between different sub-national spaces. Section 3.3 focuses on China's inward FDI and the form of processing trade arrangements (PTAs). Section 3.4 focuses on the phenomenon of industrial agglomeration and the associated increase of cross-border capital movements in Guangdong. The case of industrial agglomeration in Guangdong is particularly important, as China's distinct integration processes, emphasising processing and assembly production on the basis of export-oriented strategies, have played a crucial role in the formation of new cross-border international economic relations.

The analysis of China's micro-regional integration suggests the importance of detailed disaggregate analysis. An investigation down to the sub-provincial (city) and

sub-municipal (township) levels demonstrates the huge regional differentiation in the degree of involvement of local economies in globalisation (Section 3.5). The international production system is embedded at the sub-national level within the host country (China). In the case of China's micro-regional integration with the world economy, globalisation and regionalisation come together, but the emerging new transnational economic space needs to be adapted within national political space. In this uneven impact of globalisation and regionalisation on China, Chinese SNGs, especially cities and townships, and MNCs, are directly involved in creating cross-border economic dynamism.

3.1 Globalisation and Regionalisation

3.1.1 What is Globalisation?

Globalisation and regionalisation are highly controversial issues. In the study of IPE, several different interpretations of economic globalisation and its relationship with new patterns of regionalism have been put forward. These debates are a necessary starting point for an examination of the current changes in East Asian economic relations.

Initially, globalisation can be seen as the widening, deepening and speeding up of world-wide interconnectedness in all aspects of contemporary social life, from the cultural to the criminal, the financial to the spiritual (Held et al., 1999: 2). It can be both integrative across national borders and distintegrative within these borders, while having a transforming effect on national and world society (Morrison, 2000). According to Higgott and Reich (1998: 4-11), current debates articulate four major definitions of globalisation: (a) globalisation as an historical epoch; (b) globalisation as the confluence of economic phenomena; (c) globalisation as the triumph of American values; and (d) globalisation as a sociological and technological revolution.² The movement from definition (a) to (d) represents a less state-centric and an increasingly radical understanding of the effects of globalisation on economic and social relations. In particular, Higgott and Reich point out that definition (d) corresponds to an emphasis on technological and structural determinism and does not have any sense of serious political theory.³ Although this categorisation does not provide an analytical framework for the study of globalisation and regionalisation, it is interesting to note that all of the four definitions stress the significance of the

multi-nationalisation of production and trade across borders, and the integration of capital markets.

Referring to the main characteristics of economic globalisation, Snyder (1999: 335-6) offers the following list:

the development of international production networks (IPNs), the dispersion of production facilities among different countries, the technical and functional fragmentation of production, the fragmentation of ownership, the flexibility of the production process, world wide sourcing, and increase in intra-firm trade, the interpenetration of international financial markets, the possibility of virtually instantaneous worldwide flows of information, changes in the nature of employment, and the emergence of new forms of work.

Of particular importance in terms of the present study are the changing role of the state in the global economy and the rise of new patterns of cross-border economic activities centred on the role of sub-state or sub-national activity in enhancing relations with external actors. Economic globalisation promotes more intense industrial competition among firms, and this competition is most visible at the regional scale, where specific industrial infrastructures and economic conditions shape patterns of cross-border interaction. This is illustrated by the new regionalism of East Asia, which has been greatly influenced by changes of manufacturing and trade patterns, and the emergence of cross-border production networks (CPNs). In the economic success of Japan, the East Asian NIEs (South Korea, Taiwan, Hong Kong and Singapore), the ASEAN 4 (Indonesia, Malaysia, the Philippines, Thailand) and China, the electronics industry has played a major role and will be taken as a case study for detailed analysis in the present investigation.

3.1.2 Rethinking Globalisation

Held et al. (1999) summarise three dominant tendencies (hyperglobalist, sceptical and transformationalist) in the globalisation debate. They argue that five principal issues constitute the major sources of contention among these approaches to globalisation: conceptualisation (singularity or differentiation?), causation (what is the driving force?),

periodisation (when?), impacts (on national economies and communities), and the trajectories of globalisation (Held et al., 1999: 10-14).

According to Held et al., the concept of globalisation implies four dimensions: extensity, intensity, velocity and impact (Held et al., 1999: 15-16):

(T)he concept of globalization implies, first and foremost, a *stretching* of social, political and economic activities across frontiers such that events, decisions and activities in one region of the world can come to have significance for individuals and communities in distant regions of the globe....it embodies transregional interconnectedness, the widening reach of networks of social activity and power, and the possibility of action at a distance....connections across frontiers are not just occasional or random, but rather are regularized such that there is a detectable *intensification*, or growing magnitude, of interconnectedness, pattern of interaction and flows which transcend the constituent societies and states of the world order....growing extensity and intensity of global interconnectedness may also imply a *speeding up* of global interactions and processes as the development of worldwide systems of transport and communication increases the potential velocity of the global diffusion of ideas, goods, information, capital and people...the growing extensity, intensity and velocity of global interactions may also be associated with a deepening enmeshment of the local and global such that the impact of distant events is magnified while even the most local developments may come to have enormous global consequences.

The authors define the concept of globalisation as 'a process (or set of processes) which embodies a transformation in the spatial organization of social relations and transactions – assessed in terms of their extensity, intensity, velocity and impact – generating transcontinental or interregional flows and networks of activity, interaction, and the exercise of power' (Held et al., 1999: 16). Therefore, globalisation must be understood as a process (or set of processes) rather than a singular condition or a simple linear pattern. The spatial reach and density of global and cross-border interconnectedness weave complex webs and networks of relations among societies, states, international institutions,

non-governmental organisations (NGOs) and MNCs. Together these linkages require new forms of governance based on networks.

3.1.3 Globalisation and Regionalisation

Held et al. (1999: 16) argue that their formulation helps to address the failure of existing attempts to differentiate globalisation from more spatially delimited processes such as 'regionalisation'. The latter is defined as a clustering of transactions, flows, networks and interactions between functional geographical groupings of states or societies. Globalisation and regionalisation are not necessarily a dichotomous movement; rather the process of regionalisation may create the necessary kinds of economic, social and physical infrastructures which facilitate and complement the deepening of globalisation.

Hitherto, the regionalisation debates in IPE have focused on certain levels of political institutionalisation. In particular, the emphasis has been on horizontal supra-state and institutionalised processes of economic integration in the cases of the EU, the NAFTA, MERCOSUR (El Mercado Comun del Sur) in South America, and Asia Pacific Economic Co-operation (APEC), etc. All of these groupings take the nation-state as their basic building block. Undoubtedly, states continue to play a critical co-ordinating role in international political and economic relations. As ideological conflicts have been mitigated with the end of the Cold War, the sharp expansion of cross-border economic relations has increased tension between economic actors and the state in matters of economic co-operation and economic confrontation. In the post-Cold War international order, inter-state co-operation on forms of regional association and regional economic integration have continued to be pursued for the purpose of reducing conflict, creating regional order, and managing regional economic exchanges. These trends are often referred to collectively as the 'new regionalism' or 'the second wave'⁴. By 2000, the number of regional economic organisations, as reported to the World Trade Organisation (WTO), was 214.⁵ This indicates that the attitude of the developing countries and the former socialist countries, all of which were originally suspicious of economic liberalism, has changed dramatically. The regionalisation project is now under way all over the world. At the same time, the role of the state in regionalisation is not only in the international sphere. Increasingly, vertical regionalisation processes – i.e. decentralisation and recentralisation -- in the domestic

sphere have also been promoted by the state. The contemporary wave of political regionalisation (both internationally and domestically) also involves globalisation. All these developments highlight a shift away from state-centric politics to a more complex form of MLG worldwide.

All of these debates take for granted the primacy of sovereign states and their territoriality. They also tend to focus on a singular and linear pattern of development. If we turn to the micro level of regionalisation, then it is clear that this primacy is being challenged from below. At the micro level, as people, goods, money and information have started to move beyond borders, a study of the structure and operation of macro- and meso-regional institutions on the basis of the state is often inadequate to capture the new reality. In practice, economic interconnectedness involves economic scales beneath the state, as expressed in the international, regional and hierarchical division of labour, intra-industry trade, intra- and inter-firm production and trade, capital accumulation in large cities, industrial concentration, etc. With this increased stretching across boundaries, there are growing pressures on the forms of socio-economic and political spatiality.

The operations of MNCs are central to processes of economic globalisation and regionalisation. In 1999, there were 63,459 MNCs with 689,520 foreign subsidiaries (UNCTAD, 2000).⁶ MNCs play a major role in the generation and international diffusion of technology, accounting for around 80 per cent of world trade in technology and the majority of private R&D (Held et al., 1999: 236-7). The activities of MNCs involve the extension of production networks across the world's major economic regions. The new scientific technologies have made it possible to increase production quality, and telecommunication and computer technologies have allowed firms to integrate and decentralise their production, distribution and management systems (Castells, 1986) as well as specific allied activities such as research and development, and product definition and design (Borras, Ernst and Haggard, 2000a). However, MNCs are not 'placeless'. They have identifiable home countries, which ensures that every MNC is essentially embedded within its domestic environment (Dicken, 1998: 193). There are, moreover, key differences between the structure and operation of cross-border production networks according to the country of origin of the MNC in question, e.g. in terms of the degree of organisational

centralisation/decentralisation. (Borrus, Ernst and Haggard, 2000a). MNCs have grown from national firms to global concerns by using FDI to exploit their competitive advantages and engaging in a wide range of joint ventures and strategic alliances. The rise of international commodity chains (ICCs) is especially important in this respect (see Chapter 2). The ICCs approach highlights the role of producer-driven and buyer-driven chains in creating overlapping and at times conflicting regional divisions of labour (Gereffi, 1996). The MNCs attempt to outsource production to SMEs abroad to achieve cheap high-quality production. The development of regionalisation is therefore also promoted by SMEs. In terms of long-term stability, FDI is usually bundled with various advantages for domestic society such as the transfer of technology, management skill, and the enhancement of local workers' knowledge and skill. MNCs and global production networks have thus become increasingly critical to the organisation, location and distribution of productive power, and this in turn has induced the restructuring of socio-economic and political space.

The processes of globalisation are differentiated spatially in terms of extensity, intensity, velocity and impact (Held et al., 1999: 15-16). Globalisation and regionalisation both induce the development of new forms of governance. As the MNCs (including SMEs) have become more critical to the processes of globalisation and regionalisation, the diversity of these processes has become more visibly embodied at the regional level. The actual regionalisation processes take place through the interpenetration of different levels of regionalisation, including the supra-state, national and sub-national levels, the firm and civil society. Multi-level global and regional governance incorporates the supra-national, national and sub-national levels of government, NGOs, MNCs and cultural contexts. Thus, micro-regionalisation can be seen as an expression of the impact of globalisation on a certain regional area and as a set of processes which respond to globalisation through the restructuring of forms of governance. This in effect blurs the distinctions between political and economic regionalisation. The main actors involved in creating the new forms of governance at the micro-regional scale are firms and SNGs, and their inter-relationships can be seen in terms of cross-cutting networks that require new processes of governance if they are to be co-ordinated and made effective.

3.2 East Asian Regionalisation and Multi-Level Governance

3.2.1 *The State as a Unit*

Undoubtedly, as a supra-state regional project, East Asian regionalisation has not yet achieved levels of integration comparable to those of the EU. There are various reasons for this. To begin with, East Asian regionalism is still rooted in the Pacific security framework that was established by the United States and its allies during the Cold War. Regional territorial disputes, such as those concerning the Spratly Islands and the Senkaku (Diaoyu) Islands, remain unresolved. As state-building in East Asia is still a fairly new process, there remains the possibility of military conflict as economic development proceeds. Moreover, the pace of development of regional stability and confidence-building measures is slow. As far as economic co-operation is concerned, the financial crisis of 1997 suggested that there was little capacity for a coherent regional response. Regional organisations such as APEC and ASEAN have no capability without the approval of the United States. This suggests that in East Asia there are so many variations of culture, religion, history, ideology, language, level of development, and political system that the emergence of a coherent regional identity above the state level in the foreseeable future is not very likely.

Debates on economic development in East Asia also emphasise the crucial role of state-led intervention. Thus, explanations have usually stressed domestic political factors such as the combination of selective state intervention with neo-liberal perspectives (free trade, the division of labour, the accumulation of capital and technologies, etc.) (World Bank, 1993), institutional development (Aoki, Kim and Okuno-Fujiwara, 1997), and the role of the developmental state (on Japan see Johnson, 1982; on South Korea see Amsden, 1989; on Taiwan see Wade, 1990). From the institutionalist perspective, the establishment of export-processing zones (EPZs) is seen as a kind of institutionalisation from above on the basis of an export-led strategy. In this sense, the state has attempted to secure domestic governance reform, and in so doing has often promoted domestic regionalisation (through the rescaling of political economy), usually on the basis of nationalism and the national interest. The state thus remains a major co-ordinator of the response to globalisation and regionalisation.

While most studies concentrate on each country's individual economic base, there has recently been a growing interest in the search for the cause of the region's broader economic dynamism, as illustrated by the revision of the so-called 'flying geese' model. According to the institutional perspective, in the 1990s East Asia began rapidly to promote the enlargement and institutionalisation of its regional organisations. For example, in the 1990s the number of member countries of ASEAN increased from six to ten with the entry of Vietnam, Myanmar, Cambodia and Laos. Furthermore, the establishment of the framework of ASEAN + 3 (China, South Korea and Japan) speeded up institutionalisation by regularising the ministerial meetings. In November 2000, a decision was taken to extend the free trade agreement and have regular summit meetings (*Nihon Keizai Shinbun* hereafter *NKS*, 25 November 2000).

In the development and deepening of East Asian regional cooperation, the change of attitude of the two major powers (Japan and China) is critical. Japan's attitude, which originally supported a bilateral relationship with ASEAN, changed in the 1990s. The East Asian financial crisis in 1997 deepened Japan's involvement with ASEAN in terms of economic co-operation. The framework of ASEAN + 3 has provided an opportunity for regular summit meetings among China, South Korea and Japan.⁷ In this way, ASEAN has increased the mediating role of the Northeast Asian countries. In November 2000, China, South Korea and Japan agreed to hold regular summit meetings (*Tōa*, January 2001: 65). Also, there has been mounting enthusiasm for the development of free trade. Although Japan was suspicious of the EAEC (East Asian Economic Caucus) in the early 1990s, it began to move toward the creation of a free trade area with South Korea and Singapore in the latter part of the decade. While the levels of institutionalisation and direction of these regional organisations remain weak and uncertain, the supra-state regional project is now gathering support in East Asia.

China's international relations also improved throughout the 1990s. Since economic reform, China has committed itself to various international regimes (e.g. membership of the World Bank and IMF in 1980). In 1986, China became a member of the Asian Development Bank (ADB). China also started to join the United Nations PKO (peace-keeping operation) activities in Namibia in 1989. In 1992, China became a member

of APEC. In 1994, China joined the ARF (ASEAN regional forum), which sought to improve the transparency of defence and armaments policy. China also joined the first ASEM (Asia-Europe Meeting) in Bangkok in 1996. In 2001, China was accepted as a member of the WTO. In parallel with its improvement of the international environment, in the last decade China has also strengthened relations with neighbouring countries by diplomatic normalisation (with Indonesia and Singapore in 1990, with South Korea and Vietnam in 1992). In November 2001, China proposed to establish a free trade agreement (FTA) with ASEAN. Thus, participation in multilateral organisations and the establishment of friendly relations with neighbouring countries as well as the promotion of economic cooperation have offered China important opportunities to develop economic relations with the East Asian economy.

3.2.2 The Firm and the City as Units

Corporate strategy in the production system has become a central feature of the world economy. In East Asia, the movement to MLG below the state level has also attracted attention. For example, Ohmae (1995) views East Asian regionalisation as the result of economic liberalism and stresses the key role of non-state actors, especially firms. In this context Japanese FDI has been the main vehicle of firm-led regionalisation. As far as the electronics industry is concerned, the number of overseas production sites of Japanese electronics firms increased rapidly in the 1990s. In 1999, the accumulated number of such overseas sites was 287, and the ASEAN (92 sites) and China (62) were especially important (Noda, 2000).

The process of rapid industrialisation in East Asia has been accompanied by the international movement of factors of production. However, this movement is geographically uneven, involving mainly the urban areas. This can be seen in the emergence of economic corridors or zones (e.g. the Southern China economic zone among Hong Kong, Taiwan, Guangdong and Fujian; the Growth Triangle among Singapore, Johor in Malaysia and Batan in Indonesia; the Yellow Sea Rim zone among north-east China, Korea and Japan). Thus, a region in one country has begun to promote economic co-operation with regions in foreign countries. More precisely, urban areas with shared economic interests have started to engage in direct economic co-operation. The

municipality was a part of the state's local administrative apparatus, but at the same time, every major city was an important node in a global network of cities that was not subject to effective state regulation (Magnusson, 1996: 22). For example, in February 2001, Fukuoka city (Japan's eighth largest city, located in the southern part of the country) and Singapore reached an agreement on the promotion of economic exchanges (*Asahi Shinbun*, 10 February 2001). Singapore aims to use Fukuoka as a step to expand economic ties with the northeast Asian area. Thus, globalisation is likely to increase the role of the city as an agent of cross-national cooperation based on economic linkages.

Although economic development involves a whole range of factors such as geographical relations, national policy, entrepreneurs, factories, labour, capital investment, networks and technologies, etc., the processes of East Asian regionalisation below the state show strong evidence of industrial agglomeration in urban areas, which has deepened inter-urban economic ties. As a result, the degree of industrial agglomeration in large cities is highly uneven. For example, in 1990, although the size of Japan's central economic area was only 0.18 per cent of East Asia (NIEs ASEAN, Japan and China), this area accounted for 29 per cent of total East Asian GDP (Fujita and Hisatake, 1999: 44-5). This agglomeration economy has a tendency further to widen the regional gaps within each state, especially between rural and urban areas. Industrial agglomerations are being created in large cities, and production relations connect cities across borders. Therefore, the role of SNGs in the provision of international public goods for production and in co-ordinating the economy and society is becoming vitally important. East Asian regionalisation is also being promoted below the state level, where new forms of MLG are emerging.

3.2.3 Towards Multi-Level Governance

An understanding of the different existing levels of horizontal regionalisation is only a starting-point. There is no single level which is more important than the others. Rather, there is a continuous diffusion of authority and a complex interpenetration of each level, which leads to the creation of a floating, ambiguous socio-economic and political space across borders through horizontal networks. Thus, the interpenetration processes of this multi-dimensional and multi-layered regionalisation cannot be understood only through one level of analysis. On the one hand, the supra-state (macro) perspective focuses on the

highest level of political regionalisation and dismisses the economic reality beneath the level of the state. At the meso level, the sub-state actors (local government) or small states participate in the promotion of regional arrangements. On the other hand, the firm-based (micro) perspective studies localised space but overlooks the effect on the state system and changes in international political and economic relations. While private actors have become more influential in policy decisions in the 1990s, their overall significance remains fairly limited.

In East Asia, we see the emergence of two different forms of cross-border governance below the state level which contribute to the development of regional governance. One is the so-called 'track 2' or 'second track', which aims to facilitate intellectual exchanges among member countries. Track 1 is regarded as the sphere of intergovernmental relations and track 2 provides more informal and intellectual networks including participants from government, academics and business elites. For example, the PECC (Pacific Economic Cooperation Conference established in 1980)⁸ has contributed much to the development of cross-border intellectual solidarity, and has led to the establishment of an intergovernmental forum (APEC, in 1989).⁹ It is expected that elite government officials who take part in intellectual exchanges will reflect in their contributions the discussion of policy making in their home countries. In turn this may lead to the convergence of legal systems and compensate for the immaturity of state institutions and the lack of officials' managerial capability. Thus, the existence of track 2 networks, which have some access to policy making, has supported the development of the supra-state regional project from below.

Another form of cross-border governance reflects more directly the economic interests among the parties involved. In the debates on MLG in the EU, the role of business actors is downgraded while policy networks and institutional perspective are stressed (Rosamond, 2000; Christiansen, 1996). By contrast, in East Asia, business actors have become crucial in the emergence of MLG. For example, Japanese business delegations regularly visit Beijing to exchange opinions with the Chinese central government. While the track 2 approach involves some central government initiatives in the building of the supra-state project, economic motivation is often induced by more direct interests. As discussed

above, the speeding up of economic dynamism in East Asia does not always match the processes of inter-governmental institutionalisation. In the case of China, with its inherited imperial territory, the reform of the governance structure has led to the creation of a space for MLG below the state level, and it is noteworthy that this approach has been adopted by leaders since economic reform for national economic purposes. The Chinese SNGs have been allowed to govern regional cross-border economic relations below the state. The various forms of preferential treatment offered by SNGs have played a key role in attracting inward FDI. The direct interactions between the MNCs and SNGs have become crucial for the development of MLG in East Asian regionalisation.

Cross-border economic relations beneath the state level are blurring the frontiers between the domestic socio-economic political space and the international sphere. In other words, politics, as the distribution of authority, and economics, as the distribution of wealth and resources, are both challenging the concept of stateness and its association with exclusiveness, territoriality and uniformity. This process involves the diffusion of state authority, leading ultimately to the retreat of the state (Strange, 1996). In today's world of fierce global economic competition, the state faces the challenge of deciding how best to compete in order to increase wealth and how to achieve justice. The role of the state has therefore expanded from that of conventional diplomacy and defence policy to the management of economic efficiency, regional development and social justice. The state is not always the appropriate scale for economic operations, but cannot survive as a totally self-enclosed entity. With the rapid development of cross-border economic relations, the expansion of economic space has gone far beyond political boundaries, and has consequently revitalised ecological, historical, cultural and technological communities. This points to the need for new approaches to the analysis of state-to-state relations. While the track 2 approach reinforces stateness, cooperation between SNGs and MNCs supports the development of MLG by blurring frontiers and diffusing authority.

East Asian regionalisation is continually evolving and its forms of governance are increasingly multi-level in nature. The development of various forms of MLG reflects the trend away from a purely state-centred approach to governing in today's complex globalising world. Compared to the analysis of MLG above the state, MLG below the

state, especially the role of business actors, is still neglected. This approach requires an emphasis on the interrelations between the actors constituting the multi-layered structures. Under the state system, the forms of MLG need to be adjusted and legitimised or at least be allowed to co-exist with the domestic political system. Thus, the present study seeks to demonstrate the emergence of innovative forms of MLG comprising the central government, the SNGs and foreign firms in cross-border micro-regionalisation among Guangdong, Taiwan and Japan. It seeks to discover how conflicting or diverse interests among participants are accommodated, and to identify the complementary relations among actors.

3.3 China's FDI and Foreign Trade

By the late 1990s, on the national scale the Chinese economy had become highly engaged with the world economy. In 2000 China became the seventh largest trading country in the world (*Zhongguo Duiwai Jingji Maoyi Nianjian 2001*). The first part of this section discusses the pattern and process of China's integration with the world economy, and the second section focuses on micro-regional integration with reference to Guangdong and its cities (Shenzhen and Dongguan).

3.3.1 Different Types of Enterprise

First, we will consider the changing balance among different kinds of firms in China. In China, there are four different categories of firms: state-owned enterprises (SOEs), collective-owned enterprises (COEs), foreign firms, and other types of ownership (individually owned enterprises; private enterprises). SOEs are enterprises owned by the state, and these are distinguished according to levels of jurisdiction: the nation, the province, the city, the prefecture. As a consequence of economic reform and the development of marketisation, the share of SOEs in industrial output has steadily decreased. In 1999, the industrial output of the SOEs, including enterprises with a controlling share held by the state, accounted for only 28.1% of China's total industrial output.¹⁰ COEs are collectively owned firms and include public firms owned by local governments. The largest type is the township and village enterprise (*xiangzhen qiye*:

TVEs). Many TVEs were originally based on the people's commune (*renmin gongshe*). COEs now employ nearly 70% of China's industrial workers.¹¹ Foreign firms are enterprises owned by foreigners.¹² The other firms, according to Chinese categorisation, are enterprises owned by individuals. These firms can be called 'private firms', but according to Chinese socialist ideology, they were once illegal. In 1999, these 'private firms' contributed to 20.7% of China's total industrial output.¹³ In the same year, the 'private firm' was constitutionally adopted as an important part of the socialist market economy. It can be seen, then, that non state-owned firms have significantly increased their presence in the Chinese economy.

3.3.2 China's Inward FDI

China's impressive economic performance, especially in the coastal provinces, is coincident with the growth of inward FDI. China has been the largest recipient of FDI among all developing countries. The UNCTAD (2000) estimates that at \$US 40.4 billion in 1999, inward FDI to China accounted for 19.4% of total inward FDI to the developing countries (\$US 207.6 billion). Between 1979 and the end of 1999, China absorbed a total of \$US 307.77 billion of inward FDI (actual use). Between 1985 and 1995, China's annual average inward FDI accounted for 23.4% of total inward FDI to the developing countries and 6.4% of total global FDI (UNCTAD, 2000). By 1999, there were 235,681 foreign affiliates in China, which accounted for 34% of the total number of foreign affiliates of MNCs (UNCTAD, 2000).¹⁴

Hitherto, the primary motivations for FDI in China have been: the location advantage of low-cost-labour and land, preferential government policies, and access to the rapidly growing internal market (Zhang, 2000). In addition, for Hong Kong and Taiwanese firms, there are also advantages arising from geographical, cultural and linguistic proximity, which help to reduce transaction costs. From a Chinese viewpoint, there are five advantageous factors for foreign investors: (1) political and social stability; (2) continuous economic growth; (3) the maintenance of a stable exchange rate; (4) a high level of foreign exchange reserves and a favourable balance of payments; (5) further deepening economic reform and improvement of the legal system (Hu, 1999: 38). However, of equal importance is the role of inter-organisational linkages in exploiting the scale of advantages and

flexibility. For offshore manufacturing activities based on an export-oriented strategy, low-cost factors of production are especially important. Foreign investors have been attracted by China's official adoption of an export-oriented strategy based on the principle of comparative advantage in production through the international division of labour. The proliferation of coastal special economic zones (SEZs), open cities and open areas, all of which are allowed to give preferential treatment to foreign firms, has acted as a magnet to attract FDI. Inter-organisational linkages (i.e. sub-contracting, outsourcing and production networks) are not confined to regional clusters or to the nation state but cut across national boundaries.

3.3.3 China's Regional Differentiation

In the 1990s, inward FDI in China was concentrated mainly in the coastal areas (see Table 3.1). These areas are very attractive to investors because they have better infrastructure (e.g. ports) and a better quality of labour. Among China's coastal provinces, Guangdong's dominant position is clear, but with the spread of a new open area towards the north, the gap with other coastal provinces is decreasing. For example, Jiangsu province has a steadily increasing share of inward FDI. By the end of 1998, Guangdong had the largest number of registered foreign firms (57,665) followed by Jiangsu (21,403), Fujian (18,071) and Shanghai (17,622) (Mitsubishi Sogo Kenkyūsho: hereafter Mitsubishi, 2000: 506). But the growth of inward FDI does not tell the whole story of the process of the reintegration of China with the world economy. Equally important are the growth and pattern of development of contacts with foreign economies, especially through foreign trade. According to the rate of foreign trade, foreign loans, and rate of foreign investment, there is a huge inter-provincial differentiation, and the economies of the coastal provinces have become more open, with Guangdong now being ranked as the most open economy (*Jingji Ribao*, 17 May 2001). Manufacturing exports through inward FDI are one of the key factors. Foreign firms now play a very important role in the Chinese economy, accounting for 16% of China's industrial output and nearly half of China's foreign trade.¹⁵ They employ more than 17.5 million people, equivalent to about 10% of the country's non-rural labour force (Li, 2000: 112).

Table 3.1 The Geographical Distribution of FDI in China in the National Total, 1987-2000 (Actual Use, \$US billion) (%)

Year and Total Region/ Department	1987	1991	1993	1995	1997	1999	2000
Beijing	4.1	5.61	2.42	2.88	3.52	4.90	4.1
Tianjin	5.49	3.02	1.97	4.05	5.55	4.38	2.9
Shanghai	9.25	3.32	11.48	7.71	9.34	7.03	7.8
Guangdong	26.06	41.75	27.62	27.13	25.88	28.91	27.7
Fujian	2.20	10.67	10.42	10.76	9.27	9.98	8.4
Jiangsu	2.03	4.86	10.34	13.83	12.01	15.07	15.8
Coastal Provinces (Total)	55.92	89.75	86.10	86.53	85.29	85.35	86.98
Central and Western Province	6.74	5.4	12.34	11.91	14.01	13.70	12.09
Central Department	37.38	5.51	1.56	1.57	0.7	0.95	0.93

Note: There are no clear definitions of the geographical divisions. Here the coastal provinces are Beijing, Tianjin, Hebei, Liaoning, Shanghai, Zhejiang, Fujian, Guangxi, Jiangsu, Guangdong, Hainan and Shandong. Figures are based on the researcher's calculations.

Sources: *Zhongguo Tongji Nianjian* (ZTN) 1999 and 2000 editions, *Zhongguo Duiwai Jingji Maoyi Nianjian* 2001, Mitsubishi (1996 and 2001 editions) *Chūgoku Jōhō Handobukku* (Information on China), Tokyo Sōsōsha, and Kaku, Shishi (1999) *Nihon no tai Chūgoku Chōkusetu Tōshi* (Japanese FDI in China), Tokyo: Meitoku Shuppansha.

3.3.4 China's Processing Trade

It is important to note that nearly half of China's total trade is carried out in the form of processing trade arrangements (PTAs): the Chinese government or partner provides plant, labour, water, electricity and other basic facilities, and foreign investors supply the machinery, equipment, materials and design of products and take responsibility for marketing. They also pay the processing fee for the Chinese side (Sit, 1998: 896). In terms of transactions, foreign investors bring parts into China as imports and take the processed products back as Chinese exports.¹⁶ The key for PTAs is China's abundant supply of low-cost labour. Table 3.2 confirms that processing trade has increased its proportion in China's foreign trade. In exports, the processing trade accounted for 55.2% of total exports and 41.1% of total imports in 2000.¹⁷ In terms of division by industrial sectors, in 1999 machinery and electrical equipment exports accounted for about 40% of China's total

exports. Foreign firms contributed 67% of total processing-trade arrangements exports (*Kokusai Bōeki*, 8 February 2000). In terms of bilateral trade relations, China has trade surpluses with the US (\$US 22.5 billion in 1999) and the EU (\$US 4.7 billion 1999), and a trade deficit with Taiwan (\$US 15.5 billion in 1999).¹⁸ This trend relates directly to the structure of China's PTAs. For example, in 2000, the trade surplus by the processing trade was \$US 45.1 billion but in total trade the surplus was only \$US 24.1 billion. Thus, the processing trade contributes greatly to China's trade surplus and without it China is likely to fall into a huge trade deficit.

Table 3.2 The Share of Processing Trade in China's Foreign Trade, 1986-2000 (\$US 100 million, %)

Year	China's Total Exports and Imports (A)	China's Total Processing Trade (B)	Share (B/A)
1986	738.4	123.22	16.6
1988	1028	288.51	28
1990	1,154.4	441.91	38.2
1992	1,655.3	711.56	42.9
1994	2,367.3	1,045.5	44.2
1996	2,899.0	1,465.0	50.6
1998	3,239.3	1,730.4	53.4
1999	3,606.5	1,844.6	51.1
2000	4,743.0	2,302.1	48.5

Sources: Shao Xianglin, Wang Yuliang, and Ren Xiaowei (2001) *Jiagong Maoyi: Weirai Guoji Maoyi de Zhuliu* (Processing Trade: Future Mainstream of International Trade), Beijing: Duiwai Jingji Maoyi Daxue Chubanshe, pp. 20-21 and Mitsubishi (2001) *Chūgoku Jōhō Handobukku* (Information on China), Tokyo: Sōsōsha pp. 496-7.

In 1999, 25.1% of the materials and components for the processing trade were imported from Japan.¹⁹ If we add imports from Taiwan (19.4%) and South Korea (13.5%), then a total of 58% of the materials and components for the processing trade were imported from these three countries. Furthermore, 26.9% of processing-trade exports went to the US, 14.9% went to the EU, and 21.6% went to Hong Kong, from where most of it was re-exported to the US and the EU. In total, therefore, exports of processed products from China to the US and the EU accounted for more than 60% of total exports through the processing trade. If we add exports to Japan (17%), more than 80% of exports of processed products from China were exported to the US, EU and Japan. In terms of China's integration into the world economy, the role of Japan and Taiwan is extremely important.

The pattern of China's processing trade is indeed complex, and very uneven and is structurally dependent on Japan, South Korea and Taiwan for imports, and on the US, the EU and Japan for exports. The major products in the processing trade are electrical and electronics products. In this sector exports by the processing trade arrangement accounted for 53.7% of total exports of this sector in 1999 (Shao, Wang and Ren 2001: 76). In particular, it is reported that electronics exports from China through the PTAs accounted for 90% of China's total electronics exports in 1999 (*Kokusai Bōeki*, 16 May 2000). This reflects the sectoral composition of inward FDI: FDI in China is mainly in the manufacturing sector, accounting for 62.1% of total FDI in 1997 and 56.1% in 1998 (ZTN, 1999: 600). In 2000, the share of electronics and telecommunication manufacturing FDI in China accounted for 11.3% of total inward FDI in China (*Zhongguo Duiwai Jingji Maoyi Nianjian 2001*). Thus, China's PTA is largely dominated by a few major partners (Japan, US, Hong Kong, Taiwan South Korea and the EU), and in particular electronics production has played a central role.

3.4 Industrial Agglomeration in Guangdong

3.4.1 Guangdong in the Chinese Economy

Before 1978, Guangdong province was a backward economic area in which agricultural production predominated. In 1978, Guangdong's per capita GDP was 367 RMB, which was smaller than that of Qinghai (428 RMB), Tibet (375 RMB), and Ningxia (370 RMB), and was only almost one seventh of Shanghai (2,498 RMB).²⁰ The industrialisation of Guangdong started when China's open door policy effectively transformed Guangdong into a hinterland for Hong Kong manufacturers. Guangdong's new importance gave the province increased autonomy in economic planning, fiscal policy, foreign trade and foreign inward investment. Three of China's four SEZs were established in Guangdong nearly two decades ago. As Hong Kong manufacturing firms faced increasing wage levels and higher real estate costs ('push' factors), they were attracted by the opportunity for low cost-production in Guangdong (the 'pull' factor). For similar reasons, Taiwanese, Japanese and US manufacturers also began to invest in the province.

Table 3.3 presents indicators of Guangdong's present economic position in China. The

province occupies just 1.9% of China's total land area and ranks 15th among all provinces. Its population (72.7 million in 1999) is 5.7% of the country's total population. The rate of growth of Guangdong's population in the last ten years is, however, the highest among China's provinces (37.5%), a trend which made Guangdong the third most populated province by 2000 (*Asahi Shinbun*, 4 April 2001). The main reason for this growth is the rapid pace of economic development. Guangdong's GDP was 10.3% of China's total GDP in 1999 and ranked as first among all provinces. Guangdong's foreign trade accounted for 40.6% of China's total foreign trade in 1998 and 39.9% in 1999 (*ZTN*, 1999: 577, *GTN*, 1999: 499, *Guoji Shangbao*, 20 January 2000). Guangdong is the largest recipient of FDI among China's provinces, and in 1998 its FDI accounted for 25.9% of total FDI in China (*ZTN*, 1999). In 2000, this proportion rose to 27.7%. The province has contributed almost one-seventh of all industrial and commercial taxes in China, and since 1992 it has remained the top contributor of industrial and commercial tax revenue.²¹ Guangdong's prosperity derives directly from the development of its external linkages. This is most apparent in its trade structure. In 2000, processing trade imports and exports were valued at \$US 121.15 billion, accounting 71.2% of Guangdong's total imports and exports and 58.6% of China's total exports through the processing trade (*Jingji Daobaozong*, No.2733, 2001). The province's trade relies heavily on the processing trade.

Table 3.3 Guangdong's Economic Position in the Chinese Economy, 2000 (% and Rank)

Item	China	Share (%) and Rank in China
GDP in 2000 (100 million Yuan)	9506.4	10.6(1)
Exports in 2000 (\$US 100 million)	919.2	40.45 (1)
Imports and exports in 2000 (\$US 100 million)	1701	35.86 (1)
Processing trade imports and exports in 2000 (\$US 100 million)	1,211.5	58.6 (1)
Utilised FDI in 2000 (\$US 10000 dollar)	1,128,091	27.7(1)

Sources: Ministry of Foreign Trade and Economic Cooperation (MOFTEC), <http://www2.moftec.gov.cn/official/html>; Mitsubishi (2000 and 2001 editions) *Chūgoku Jōhō Handobukku* (Information on China), Tokyo: Sōsōsha, *Xianggang Wenhui* (5 May 2001), *Jingji Daobaozong* (No 2733, 2001), and Daiichi Kangyō Bank (DKB), www.dkb.co.jp/houjin/report/china.

3.4.2 Guangdong's Foreign Relations

From the viewpoint of processing trade arrangements (PTAs), Guangdong is undoubtedly the key area for China's integration with the world economy. Half of Guangdong's exports

are electronics products. The share of FDI (actual use) from Hong Kong (67.47% in 1990; 78.31% in 1995; 72% in 1997; 67.63% in 1998; 60.14% in 1999) far exceeds that from other countries, but FDI from Taiwan, Macau, Japan, Singapore and the US is also very significant (*GTN*, 1999 and 2000). Although inward FDI from Hong Kong includes various countries of origin, e.g. the US, the EU, Japan, Taiwan as well as mainland China, Hong Kong is a key base for creating PTAs with Guangdong. Manufacturing investments account for a large part of total FDI in Guangdong: 86.3% in 1990, 69% in 1995, 66% in 1997, and 55.7% in 1998 (*GTN*, 1999). In 1998, the Virgin Islands became the second largest source of investment in Guangdong (11.87% of total inward FDI based on actual use in 1998: *GTN* 1999). In 1999, they were again the second largest supplier of inward FDI (10.77% of total inward FDI: *GTN* 2000). The ranking of Guangdong's main trading partners reflects China's distinct pattern of PTAs. Japan is the largest source of imports followed by Taiwan (see Table 3.4). More than 40% of Guangdong's imports come from Japan and Taiwan. The US and the EU are the major export destinations. A large proportion of exports to Hong Kong is re-exported to the EU and the US. As a result, more than 70% of Guangdong's exports go to the US and EU markets. Guangdong has thus materialised China's export-oriented strategy.

Table 3.4 Guangdong's Trade Relations by Country and Region, 1995-1999 (Value, \$US 100 million, and %)

Country and Region	1995		1998		1999	
	Exports	Imports	Exports	Imports	Exports	Imports
Hong Kong and Macau	39.3%	12.8%	35.9%	7.8%	34.6%	6.6%
Taiwan	2.5%	19.0%	2.3%	19.8%	2.1%	19.7%
Japan	11.5%	24.7%	9.2%	21.4%	8.7%	21.3%
ASEAN	3.8%	8.7%	4.1%	10.8%	4.1%	10.3%
United States	22.6%	7.4%	25.1%	8.3%	26.0%	8.6%
EU	11.4%	8.1%	13.2%	7.7%	14.0%	8.7%
Others	8.9%	19.3%	10.2%	24.2%	10.5%	24.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: *Guangdong Tongji Nianjian* (*GTN*, 2000 edition)

3.4.3 Industrial Agglomeration in Guangdong

Foreign investment has played a major role in the development of industrial agglomeration in Guangdong. The agglomeration of foreign firms and their assembling production

activities, as well as pre-given factors (geographical proximity with Hong Kong), have encouraged further agglomeration and have resulted in Guangdong's dominant economic position in China. Guangdong's share in telephone and stereo sets production exceeded 80% of China's total production in 1998 and 1999.²² Photocopying machines and camera production also exceeded more than 70% of China's total production in 1999.²³ The agglomeration of the electronics industry in Guangdong has affected not only the agglomeration of local firms but also the locational behaviour of foreign firms. For example, the latest information on the electronics industry (prospects for demand and supply, outsourcing and alliances) shows that Japanese electronics firms need to establish foreign branches in order to respond to international competition (Kuroda, 2001: 92).

The industrial concentration in this province has caused a regional gap in both Guangdong and China as a whole. The total GDP of Shenzhen in 2000 was \$US 20.11 billion, which exceeded the GDP of provinces such as Guizhou (\$US 11.99 billion), Tibet (\$US 1.42 billion), Hainan (\$US 6.26 billion), Gansu (\$US 11.87 billion), Qinghai (\$US 3.18 billion), Ningxia (\$US 3.2 billion) and Xingjiang (\$US 16.48 billion).²⁴ Per capita GDP in Shenzhen in 2000 reached \$US 2,870 and that of Shanghai was \$US 4,180, which far exceeded Guizhou's per capita GDP (\$US 340 in 2000).²⁵ According to a study by Hu (2001), based on a purchasing power parity (PPP),²⁶ in 1999 the level of development of China's provinces varied from a world ranking of 45th (Shanghai) to 177th (Guizhou). China's uneven development has created four different economic worlds in one nation (a high income area, a middle income area, a low income area and a very low income area) (ibid.: 6-7). Furthermore, there is also a wide gap of per capita income between urban and rural areas. The average per capita annual income in urban areas in Guangdong was \$US 1,102 in 1999. In rural areas it was \$US 438.4.²⁷ In the same year, the average income of farmers in Tibet was only \$US 70.4.²⁸

More importantly, the number of migrants seeking higher incomes has continued to increase. For example, according to Mitsubishi (2001: 76-9), by 2000 the immigrant population in Guangdong province reached 11.69 million. Furthermore, by the same year, migrant population within Guangdong reached 14.60 million. In addition, there are a large number of short-term workers in Guangdong. It is estimated that the floating population

was over 30 million in 2000, which was equivalent to 35% of the total population in Guangdong. Thus, industrial agglomeration in Guangdong has greatly contributed to the increase of the floating population.

3.5 FDI and Economic Development in the Pearl River Delta

3.5.1 FDI in the Pearl River Delta

Table 3.5 Guangdong's Inward FDI by Region, and the Share of Foreign Firms in Industrial Output and Exports, 1998 (%)

Area and City	Registered FDI by the end of 1998				Industrial Output			Amount of Exports	
	Number of Registered Enterprises	Total Investment	Registered Capital	Capital Invested by Foreign Partner	Industrial Output	Share of Foreign Firms	*Share of Hong Kong, Macau and Taiwan	Amount of Exports	Share of Foreign Firms
Eastern Pearl River Delta	33.8	27.3	31.8	79.1	29.4	83.0	55.9	56.5	53.1
Shenzhen	19.1	14.5	16.1	73.3	18.3	75.9	42.7	34.9	49.1
Dongguan	9.6	7.9	10.7	85.5	5.3	86.1	59.9	17.2	45.0
Huizhou	5.1	4.9	5.0	78.4	5.8	87.0	65.2	4.4	65.3
Central Pearl River Delta	25.8	35.8	32.0	71.1	38.7	49.4	31.7	20.7	49.5
Guangzhou	14.6	22.3	18.4	77.8	20.3	58.1	35.0	13.7	51.8
Foshan	6.3	8.0	8.3	63.5	14.0	50.9	31.6	5.8	65.3
Zhaoqing	3.3	3.4	3.4	71.3	3.7	38.4	34.6	0.7	56.9
Qingyuan	1.5	2.1	1.9	71.8	0.7	50.3	25.6	0.5	24.0
Western Pearl River Delta	14.8	12.9	14.0	68.7	19.3	57.5	41.9	10.9	54.8
Zhuhai	7.4	5.7	6.0	69.3	5.7	66.6	42.5	4.0	57.8
Zhongshan	2.6	2.7	3.0	73.7	4.9	61.7	54.9	3.6	57.7
Jiangmen	4.8	4.3	5.0	63.0	8.7	44.2	28.4	3.3	48.8
Total Pearl River Delta	74.3	76.0	77.8	73.0	87.4	63.3	43.2	88.1	52.5
Other Area	25.7	24.0	22.2	27.0	12.6	29.5	17.2	11.9	47.5
Total in Guangdong	57,665 (number of firms)	2,217 (US\$ 100 million)	1,344 (US\$ 100 million)	992 (US\$ 100 million)	9,064 (Yuan 100 million)	5219 (Yuan 100 million)	3481 (Yuan 100 million)		

Sources: Maruya, Toyojirō ed. (2000) *Ajia Kokusai Bungyō Saihen to Gaikoku Chokusetsu Tōshi no Yakuwari* (Rearrangement of the Asian International Division of Labour and the Role of FDI), Chiba: Ajia Keizai Kenkyūsho, p143 and *Guangdong Tongji Nianjian* (GTN, 1999 edition). *Share of industrial output

FDI in Guangdong is focused on the Pearl River Delta (*Zhujiang Sanjiaozhou*)²⁹. Table 3.5 shows the geographical dispersion of FDI in Guangdong and its relationship to the shares of foreign firms in industrial output and exports. In 1998, the Delta's industrial output value was equivalent to 87.4% of the total value of Guangdong's industrial output, and the Delta's exports value accounted for 88.1% of the total value of Guangdong's exports (Maruya, 2000: 143). In 1999, the total GDP in the 21 cities of the Pearl River Delta amounted to 54.3% of the total GDP of Guangdong as a whole (*GTN*, 2000: 612). The diffusion of FDI within the Delta has accelerated since 1990 owing to a surge of inward FDI, further decentralisation, and the improvement of infrastructure across the whole Delta (Shen et al., 2000). In terms of regional dispersion, the value of Shenzhen's and Dongguan's exports is very high. Foreign firms occupy a dominant position in the eastern area (the east side of the Pearl River Delta, Shenzhen, Dongguan and Huizhou) and the central area (Guangzhou, Foshan, Zhaoqing and Qingyuan). They accounted for over 80% of the total value of industrial output in the eastern delta in 1998. On the other hand, the dominant role of Guangzhou (the capital of Guangdong) in the pre-reform period has significantly declined due to the rise of cities such as Shenzhen and Dongguan. Within the Delta, regional polarisation is now emerging (Gu, et al., 2001). It is therefore important to conduct further disaggregate analysis, focusing on smaller units below the provincial level in China.

From 1991 to 1998, the value of the industrial output of electronics and telecommunication equipment jumped from 10.43% to 22.17% of the total value of Guangdong's industrial output.³⁰ Shenzhen's concentration of electronics and telecommunication equipment is especially remarkable. In the same period, the value of the industrial output of electronics and telecommunication equipment grew from 40.65% to 58.24% of the total value of Shenzhen's industrial output. Industrial agglomeration also inevitably causes rapid urbanisation.³¹ According to Sit (1998: 897), at the end of 1995, foreign firms in the Delta employed 2.738 million workers, and village collectives engaged primarily in processing-trade arrangements employed 2.462 million. Thus, the total number of employees of foreign firms in the Delta had reached nearly 5.2 million. Until the late 1970s, the regional economy of the Pearl River Delta was primarily agricultural, with over 75% of the total population engaged in agricultural production. In 1949, the urban population of

Guangdong was just 3.701 million, which accounted for only 13.3% of the total population (27.8 million). By 1978, the growth rate of the urban population was only 2% per annum, and in that year the urban population reached 6.25 million, accounting for 12.3% of the total population (50.64 million). The annual growth rate of the population between 1990 and 2000 was 37.55%, which far exceeded the national average of 11.66% (Mitsubishi, 2001: 267).

3.5.2 Shenzhen and Dongguan

Shenzhen and Dongguan have been successfully transformed into export-oriented manufacturing-based economies through processing- and assembling-induced industrialisation. Table 3.6 shows the share of Shenzhen and Dongguan in Guangdong's economy. In 1999, the total exports of Shenzhen and Dongguan exceeded 55% of Guangdong's total exports. Shenzhen contributed 35.9% of Guangdong's total imports and exports in 1999 (MOFTEC). Almost 70% of Shenzhen's imports and exports were under PTAs (*Guoji Shangbao*, 15 January 2000). In 2000, 83.7% of its exports (valued at \$US 28.96 billion) came from PTAs (*Xianggang Dagongbao*, 2 April 2001). In Shenzhen, by the end of 1999, 12,000 foreign firms had set up subsidiaries (*Jinrong Zuobao*, 17 January 2000), and accumulated inward FDI (actual use) had risen to \$US 20,045 million, which was equivalent to 6.5% of China's total inward FDI.³² The number of firms that had invested more than \$US 10 million (measured by the value of contracts) had risen to 547 by 1998.³³ In 1998, foreign firms' share in Shenzhen's total industrial output was 75.9%, and foreign firms also dominated Shenzhen's exports, accounting for 49.1% of the total (in value; see Table 3.5). In the same year, the electronics industry accounted for more than 58.24% of total industrial output in Shenzhen (*Shenzhen Tongji Xinxi Nianjian* 1999). Underlying these trends are not only economic factors but also regional policies targeting high-technology enterprises. Shenzhen's high-technology zone, which was established in 1996, has contributed to the concentration of high-tech industry. In 1999, IBM established a parts supply centre in Shenzhen, and many MNCs have chosen Shenzhen for their components supply centres. Because of Shenzhen's proximity to Hong Kong, transportation costs are relatively low, and the developed infrastructure of Hong Kong induces further agglomeration. One of the strong advantages of Shenzhen is the use of migrant workers (temporary population). In 1999, they amounted to 70% of the total

population in Shenzhen (Table 3.6).

Table 3.6 Shenzhen and Dongguan in Guangdong's Economy, 1999 (%)

Item	Shenzhen	Dongguan
GDP in 1999 (100 million Yuan)	1289.0(15.2)	355.5(4.2)
Exports in 1999 (US\$ 100 million)	264.0(34.0)	152(19.56)
Imports in 1999 (US\$ 100 million)	188.8(30.1)	133(21.21)
Utilised FDI in 1999 (US\$ 10000 dollar)	275422(19.0)	145732(10.1)
Area (square kilometers)	1948.7(1.1)	2465.0(1.4)
Registered Population in 1999 (1000)	1,198.5(1.6)	1,508.2(2.1)
Temporary Population in 1999 (1000)	2,852.9	2,448.1

Sources: *Guangdong Tongji Nianjian* (GTN, 2000 edition), and *Dongguan Tongji Nianjian* (DTN, 2000 edition)

Table 3.7 Shenzhen's Trade Relations by Main Country and Region, 1997-1999 (\$US billion, %)

	1997	1998	1999		1997	1998	1999	Balance of Trade in 1999
Total Exports	25.62	26.40	28.21	Total Imports	19.39	18.88	22.22	5.99
Hong Kong	28.2	28	30.5		6.4	6.2	5.5	7.38
Japan	12.7	11.7	9.6		28	25.8	23.8	-2.59
US	28.3	29	29.0		8.7	10.2	9.4	6.10
Taiwan	2.8	2.7	2.5		18.3	18.9	18	0.3
Singapore	2.7	3.5	3.7		6.3	6	4.1	0.1
South Korea	0.9	0.7	0.7		6.9	6.5	7.1	-1.39
UK	3.5	3.7	3.6		1.1	1	1.2	0.75
Germany	4	4	4.3		2.1	1.8	1.9	0.81
France	1.7	1.7	1.6		0.6	1.6	2.2	-0.05

Note: The figures are calculated by the researcher.

Sources: *Shenzhen Tongji Xinxi Nianjian* (1999 and 2000 editions)

Shenzhen represents the pattern of China's integration with the world economy. The high rate of Japanese FDI is especially noteworthy. Between 1986 and 1999, the average share of Japanese FDI was 17.5% in Shenzhen's total inward FDI.³⁴ Table 3.7 also shows the pattern of Shenzhen's trade relations. It reveals that Japan has been the largest source of Shenzhen's imports (23.8% of total imports in 1999). Taiwan was the second largest source of imports in 1997 and 1998. However, in 1999 Taiwan's share in Shenzhen's imports dropped dramatically. This was due partly to the shift of Taiwanese production and partly to Taiwanese firms' local procurement activities in mainland China. In exports, the US and

Hong Kong are the largest destinations for exports. Most exports to Hong Kong are re-exported to the US and EU markets. Shenzhen's trade structure clearly follows the characteristics of the East Asian trade structure: trade deficits with Japan, South Korea and Taiwan, and a trade surplus with the US and the EU.

Dongguan is now the second largest trading city in Guangdong after Shenzhen. By 2000, the average annual growth rate of Dongguan's GDP since economic reform had reached 22%.³⁵ Its success owes much to export-oriented manufacturing. By the middle of 1999, 12,356 foreign firms had established subsidiaries in Dongguan.³⁶ On a national scale, in 1998, Dongguan became the third largest exporting city after Shanghai and Shenzhen. In 1998, Dongguan's total imports and exports (\$US 23.27 billion) accounted for 17.9% of Guangdong's total imports and exports (*DTN*, 1999). In 1999, Dongguan's imports and exports were valued at \$US 28.46 billion, which was equivalent to 20.3% of Guangdong's total imports and exports³⁷ and 7.9% of China's total imports and exports (*DTN*, 2000). In 2000, Dongguan's exports of informational products accounted for 44% of total exports (*Xianggang Dagongbao*, 6 February 2001) and the city's trade surplus (\$US 2.27 billion) contributed to 9.4% of China's trade balance as a whole.³⁸ Assembling production in the electronics industry has played a central role. Trade in assembling production accounted for 94% of the city's total imports and exports in 1999.³⁹ In the same year, the share of electronics products in imports (\$US 6,120 million) was 46% of Dongguan's total imports. In exports, the share of electronics products (\$US 8,850 million) was 58.4% of Dongguan's total exports. In terms of regional relations, in 1999, 87.7% of Dongguan's imports came from Asia and 54.8% of exports (excluding Hong Kong) went to the US and EU markets (*Guoji Jingji Xinxi*, 24 January 2000).

By 1998, the value of FDI (actual use) reached \$US 9.63 billion, which was equivalent to 3.63% of the cumulative utilised FDI in China between 1979 and 1998 (\$US 265.6 billion).⁴⁰ In 1999, Dongguan's inward FDI of \$US 1.8 billion accounted for 12.41% of Guangdong's total inward FDI and for 3.42 % of China's total inward FDI (*DTN*, 2000). About 30% of Dongguan's inward FDI is in the electronics industry.⁴¹

Table 3.8 Dongguan's Inward FDI by Country and Region, 1995-1999 (Actual Use, %)

Country and Region	Data from the Statistical Bureau					Data from the Foreign Trade and Economic Cooperation Bureau
	1995	1996	1997	1998	1999	
Hong Kong	86.7	83.7	76.1	63.5	58.8	60
Taiwan	4.5	4.6	3.5	5.7	8.4	23
Japan	0.6	4.2	1.7	1.9	1.2	8
Singapore	1.2	1.1	1.9	2.5	3.8	-
South Korea	-	-	0.1	1.7	1.0	1.5
United States	4.8	0.1	7.9	1.9	2.4	2
Germany	-	-	-	0.5	1.7	-
UK	0.1	1.3	4.4	1.1	0.1	-
Others	2.0	3.7	4.4	21.3	22.4	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0

Note: The figures from the Statistical Bureau are calculated by the researcher

Sources: *Dongguan Tongji Nianjian* (DTN, 2000 edition) and *Dongguan Guide* by the Dongguan Foreign Trade and Economic Bureau. *Though *Dongguan Guide* is the latest issue (in 2001), it does not indicate the particular year

Table 3.9 Numbers of Foreign Investments in Dongguan by Type, 1978-1996 (Contract)

Type Year	EJV	CJV	WFO	Processing and Assembling (a)	Total
1980	0	0	0	415	415
1982	2	-	-	468	470
1984	43	-	-	508	551
1986	59	-	-	559	618
1988	209	-	-	1839	2048
1990	93	72	27	1075	1267
1992	524	204	130	1374	2232
1994	532	255	370	1521	2678
1996	115	56	164	1343	1678

Note: (a) In his categorisation of forms of investment, G. Yeung uses the term 'processing and assembling'. Between 1982 and 1988, the EJV category included CJV and WFO.

Source: Yeung, Godfrey (2001) *Foreign Investment and Socio-Economic Development in China: The Case of Dongguan*, Houndmills, Basingstoke and New York: Palgrave, p. 246

Table 3.8 shows the source of Dongguan's inward FDI by country and region. It reveals that there are significant differences between the statistics provided by Dongguan's Statistical Bureau and the Foreign Trade and Economic Cooperation Bureau. These are due largely to the increase of Taiwanese 'roundabout' investment through central American island countries. For example, one of the leading Taiwanese electronics firms, Kinpo

Electronics, uses the Virgin Islands as a base for roundabout investment in Dongguan. This is officially categorised as FDI from the Virgin Islands.⁴² Also, the data for firms include many foreign firms which are not yet identified by their home countries. Most of these unidentified firms are categorised as 'others' in the Statistical Bureau's data. The data from the Foreign Trade and Economic Cooperation Bureau is a better reflection of reality.⁴³ Table 3.9 confirms that the form of PTAs has been a major source of inward FDI in Dongguan.

3.5.3 Dongguan's Sub-Municipal Districts

Focusing on smaller units below the city-government level in China tells us more about the correlative relationship between local economic growth and foreign investment. Table 3.10 shows the inter-township differentiation of economic growth in Dongguan. Changan is a leading sub-municipal district in terms of the number of foreign firms, accumulated FDI, GDP and the value of exports. In terms of GDP, the combined GDP of Changan, Tangxia, Qingxi and Humen accounted for 33.8% of Dongguan's total GDP in 1999. The accumulated FDI in these four sub-municipal districts was equivalent to 32% of the total accumulated FDI in Dongguan. Also, in terms of the number of firms, these four sub-municipal districts accounted for 31.7% in 1999. Changan's GDP was almost 22 times that of Hongmei Town. In terms of exports, Changan's export value was 28 times that of Hongmei. Hongmei is ranked lowest in terms of exports, accumulated FDI and the number of foreign firms (Table 3.10). Thus, the pattern of export value at sub-municipal level is similar to the foreign investment pattern. The aggregate analysis on smaller units beneath the sub-provincial level reveals a strong pattern of micro-regionalisation, which highlights the impact of foreign investment on economic growth through export-oriented strategies.

Table 3.10 Foreign Firms, GDP and Exports in Dongguan's Sub-Municipal Districts, 1999

	No. of foreign firms in 1999	Accumulated FDI by 1999 (\$US million)	GDP in 1998 (10,000 RMB)	Value of Export (\$US million) in 1998
Changan	1,389	1,121.8	1,118,873	1,992.1
Changping	613	531.8	515,342	765.1
Chashan	274	349.8	102,698	190.0
Dalang	439	311.8	163,746	289.4
Dalingshan	280	410.5	252,240	471.2
Daohao	155	180.7	116,357	172.2
Dongkeng	186	196.8	210,399	240.7
Fenggang	954	657.6	299,665	699.1
Fucheng	489	408.5	396,795	729.8
Gaobu	111	96.3	67,246	208.7
Guangcheng	78	183.3	121,932	112.8
Hengli	236	119.5	83,326	144.3
Hongmei	38	68.3	50,962	71.0
Houjie	662	601.0	510,618	1,354.8
Huangcun	197	369.3	255,576	479.8
Humen	1,118	1,056.5	758,587	1,202.0
Liaobu	341	252.5	362,701	687.64
Mayong	67	102.7	75,844	209.5
Qiaotou	330	242.7	127,660	265.6
Qingxi	653	788.1	757,665	1,332.7
Qishi	205	119.6	61,488	141.3
Shatian	126	169.8	132,439	266.0
Shijie	403	361.2	499,310	809.5
Shilong	88	102.3	129,224	359.0
Shipai	315	118.4	83,295	156.9
Tangxia	757	854.9	903,676	1,193.5
Wangniudun	84	116.9	59,647	92.5
Wangjiang	144	81.7	49,204	171.3
Xiegang	190	112.8	60,364	83.6
Zhangmutou	317	278.3	269,415	286.2
Zhongtang	104	184.0	76,742	100.1
Huangjiang	408	226.2	134,435	219.5
City Total	12,356	11,899.05	10,480,208	147,744

Note: Data on the number of foreign firms and accumulated FDI relate to the end of June 1999

Source: *Dongguanshi Waishang Touzi Qiye ji Quanbu Gongye Ziliao Huibian 2000*.

3.6 Conclusion

This chapter has sought to demonstrate the contested debates over globalisation and regionalisation, and has examined the pattern of China's micro-regional integration with

the world economy. The dual processes of globalisation and regionalisation are complex, uneven and contradictory. In various domains we see the development of strategic horizontal actions (mostly taken by the state). At the same time, at the sub-national and firm levels, the significance of extensive cross-border capital movement is evident. The states, SNGs and MNCs have become facilitators for promoting regionalisation. East Asian regionalisation is continually evolving and its forms of governance are increasingly multi-level in nature. The development of various forms of MLG in East Asia (Section 3.2) reflects the trend away from a purely state-centred approach to governing a complex, globalising world.

China's micro-regional integration with the world economy has not been spread evenly across the entire economy. Consequently no single approach can offer a sufficient explanation. Though the state is still the key actor in the process of regionalisation in many respects, the sub-units of the state and firms have emerged as critically important actors in their own right. The huge inflow of foreign investment since economic reform has played a substantial role in China's rapid economic growth. It has greatly assisted China's reform process and also developed a distinct pattern of China's foreign economic relations on the basis of the East Asian regional economic structure. One of the most notable results is the development of PTAs in Guangdong, which is contingent on wider processes of globalisation and regionalisation. China's abundant supply of low-cost labour comprises the core part of the structure of PTAs. The combinations of regional and global processes of production are most clearly visible in the case of industrial agglomeration in the Pearl River Delta in Guangdong (especially in Shenzhen and Dongguan), particularly in the electronics industry. The structure of the East Asian regional economy, in particular the role of Taiwan and Japan as major sources of imports, is of great importance. At the same time, the US and the EU are major destinations for exports of finished products. The emerging transnational economic space of Shenzhen and Dongguan is built upon the wider processes of East Asian regionalisation.

The organisation of production in China and the regional division of labour between China and the world economy have resulted in *de facto* processes of micro-regionalisation linked to the globalisation of CPNs. With the rise of global competition, firms have revised their

production systems and relocated to achieve more efficient production and procurement. An international division of labour based largely on national economies is partly being replaced by a division of labour rooted in regional intra- and inter-firm networks which induce the industrial transformation of particular areas. Firms have become more important actors in deciding the location of production and leading the pattern of development of micro-regionalisation. The in-depth investigation of Shenzhen's and Dongguan's patterns of inward FDI and foreign trade reveals that both cities are heavily integrated with the world economy through PTAs practices and export-oriented strategies.

Although this micro-regionalisation has undoubtedly accelerated China's integration processes, it is also associated with increasing regional differentiation among regions. Further disaggregate analysis beneath the provincial level (i.e. at the sub-provincial and sub-municipal levels) illustrates the considerable differentiation of economic development and correlates with the direct impact of FDI on the local economy. The best example is the huge gap of GDP (22:1 in 1998) between a successful sub-municipality (Changan) and a less developed sub-municipality (Hongmei) in Dongguan. The success and/or failure of economic development at local level is largely due to the degree of engagement of foreign firms. China's pattern of micro-regionalisation thus highlights the uneven engagement of sub-national territories with the world economy. The challenge for the government is to build new frameworks for effective cross-border economic governance. In the processes of China's micro-regionalisation, the relationships between SNGs and MNCs at the local levels provide China's national politics with further complex multi-layered economic dynamism. It is thus important to understand the relationship between emerging cross-border economic space and the restructuring of China's domestic governance.

¹ The term 'micro-regional integration' is used by Breslin (2000) to apply to China. He stresses the role of local government and the structure of the East Asian regional economy in micro-regional integration in the cases of north East Asian integration and Southern China-Hong Kong links.

² (A) regards globalisation as a specific period of history rather than as a sociological phenomenon or a theoretical framework. (B) characterises globalisation more functionally and considers related series of economic phenomena including the liberalisation and deregulation of markets, the privatisation of assets, the retreat of state functions, the diffusion of technology, the cross-national distribution of manufacturing production (foreign direct investment), and the integration of capital markets. (C) sees globalisation as the hegemony of American values characterised by the triumph of modernisation and democracy. (D) views

globalisation as a new form of activity in which a decisive shift from industrial capitalism to a post-industrial conception of economic relations is taking place. See Higgott and Reich (1998).

³ Higgott and Reich (1998: 11).

⁴ Palmer (1991) distinguishes two waves of regionalism by *time*: 'old regionalism' in the 1950s and 1960s, and 'new regionalism' from the late 1970s. Bhagwati (1993) uses 'second wave' in order to distinguish later period from the regional integration movement in the 1950s and 1960s in Europe, and to stress its spread to Latin America and Africa. According to Hettne and Soderbaum (2000), the 'new regionalism' began to rise in the mid-1980s in the context of the comprehensive structural transformation of the global system.

⁵ Yamazawa (2001: 3).

⁶ There is no clear distinction between MNCs and TNCs in this figure.

⁷ On the transformation of Japan's ASEAN policy, see Yamakage (2001).

⁸ By 2000, the number of member countries was 24. See JIIA Newsletter (No.102 December 2000).

⁹ On the processes of the institutional development of the PECC and the APEC, see Kikuchi (1995).

¹⁰ The figure is taken from Kuroda (2001: 21).

¹¹ The figure is taken from Kuroda (2001: 21).

¹² 'Foreign firms in China' refers to *sanzai* firms including equity joint ventures, contractual joint ventures and wholly foreign owned firms.

¹³ The figure is taken from Kuroda (2001: 21).

¹⁴ According to the latest Chinese sources, by 2000 there were 364,345 foreign firms in China and the accumulated inward FDI (utilised base) was US\$ 34.8624 billion. See <http://j-people.ne.jp/2001/01/18/jp20010118-1660.html>.

¹⁵ The figure is taken from Dai-Ichi Kangyō Bank (DKB), www.dkb.co.jp/houjin/report/china/200007/.

¹⁶ See Yabuki and Harner (1999).

¹⁷ The figure is calculated by the researcher using Mitsubishi (2001: 496-7).

¹⁸ The figures are based on Chinese data (*Guoji Shangbao*, 14 January 2000).

¹⁹ The figures (%) for Japan, Taiwan, South Korea, Hong Kong, EU and the United States are based on *Chigoku Toshō* (July 2000).

²⁰ The figure is taken from Hu (2001: 324).

²¹ In 1999, Guangdong's industrial and commercial tax was 1,480 yi yuan (100 million yuan). DKB <http://www.dkb.co.jp/houjin/report/china/200002/>.

²² The figures are taken from Kuroda (2001: 91).

²³ Guangdong's share of photocopying machine production in China was 59.3% in 1998, and the share of camera production in 1998 was 83.9% in China. See Kuroda (2001: 91).

²⁴ The figure is calculated by the researcher by using Mitsubishi (2001). The exchange rate of RMB per US dollar in 1999 was 8.2783 RMB per dollar.

²⁵ The figure is taken from Mitsubishi (2001).

²⁶ Purchasing Power Parity (PPP) compares international living standards by the prices of goods and service rather than by market exchanges rates.

²⁷ The figure is the researcher's calculation based on Mitsubishi (2001). The exchange rate of RMB per US dollar in 1999 was 8.2783 RMB per dollar.

²⁸ The figure is the researcher's calculation using Hu (2001: 292). The exchange rate of RMB per US dollar in 1999 was 8.2783 RMB per dollar.

²⁹ The definition of the area of the Pearl River Delta varies. Here it refers to Guangzhou, Foshan, Zhaoqing, Qingyuan, Shenzhen, Dongguan, Huizhou, Zhuhai, Zhongshan and Jingmen.

³⁰ The figures are from Lu (2000).

³¹ The figures are from Lu (2000).

³² China's total inward FDI between 1979 and 2000 was \$US 346.63 billion. Based on Mitsubishi (2001).

³³ *Shenzhen Tongji Xinxi Nianjian 1999*.

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- ³⁴ The figure is the researcher's calculation based on *Shenzhen Tongji Xinxin Nianjian* (1999 and 2000).
- ³⁵ *Dongguan Guide* by DFTEC
- ³⁶ The figure is taken from *Dongguan shi Waishang Touzi Qiye Ji Quanbu Gongye Ziliao Huibian 2000*.
- ³⁷ DKB, <http://www.dkb.co.jp/houjin/report/china/200003/200003-2.html>
- ³⁸ The figure is the researcher's calculation using Mitsubishi (2001) and *Dongguan Guide* by DFTEC
- ³⁹ The figures are from DKB, www.dkb.co.jp/houjin/report/china/200003/
- ⁴⁰ The researcher's calculation is based on *DTN*, (1999) and Mitsubishi (1999)
- ⁴¹ DFTEC
- ⁴² *Dongguan shi Waishang Touzi Qiye Ji Quanbu Gongye Ziliao Huibian 2000*.
- ⁴³ These problems are largely due to the lack of inter-departmental communication in the Dongguan City Government. (The researcher's interview with officials at DFTEC, 12 October 2001)

CHAPTER 4

GUANGDONG AND CHINESE MULTI-LEVEL GOVERNANCE

The present chapter and the following two chapters (5 and 6) investigate the relationships between changes in China's domestic political economy and the changing structure of East Asian regional economy in order to answer the first two research questions: (1) *how should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan?* and (2) *what kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?*

This chapter starts with the analysis of *de jure* processes of China's micro-regionalisation in the context of domestic regionalisation. One of the crucial features of the reform process is that formal authority has been dispersed from central government down to sub-national governments (SNGs). While economic reform may be seen as the expression of a struggle to overcome the inefficiency of centrally planned economic management, the increasing role of SNGs in decision-making and the implementation of economic policy has major implications for the broader process of radical change in political and economic regulation. China's decentralisation does not simply mean the expansion of local autonomy based on the relative independence of the legislature, the executive and the judiciary, as is the case in Western countries. Given China's concentration of political authority in the Chinese Communist Party (CCP or Party), the devolution of power to SNGs is of much more fundamental political significance. The divergence and contradictions between administrative (political) regions and economic regions have become more and more acute, and this has undermined the integration of the national economy (Zhou, 1998). Guangdong province is the undisputed leading economic region within the Chinese economy, especially in foreign economic relations. In this respect, in Guangdong both the provincial and sub-provincial levels of government have been given increased opportunity to exploit their locational advantages.

This chapter applies the concept of multi-level governance (MLG) to the case of China in order to explain the processes and patterns of change of China's domestic governance. Although the term 'multi-level governance' has hitherto been applied mainly to the study of changing patterns of governance in the European Union to denote a system of 'overlapping competencies among multiple levels of governments and the interaction of political actors across those levels' (Marks et al., 1996: 41), it has recently started to gain currency in other non-European contexts.¹ It is applied here to describe the emerging system of economic governance in China with particular reference to the reallocation of authority in regional economic management and planning. Thus it focuses particularly on the so-called Open Door policy and the processes of decentralisation of economic management, both of which have had a huge impact on the behaviour of SNGs. The result is an enormous diversity in the forms of governance, reflecting the variation of local political factors and the changing national constitutional and political context. Guangdong's innovative governance structure provides an opportunity to explore the factors shaping the changing role of SNGs in managing regional economic development.

Section 4.1 considers in general terms the applicability of the MLG approach to the case of China. It argues the need to extend the analysis from different levels of formal government to the various components of economic governance. Following a brief theoretical discussion, Section 4.2 focuses on the background of China's reform of domestic governance in terms of administrative (state) reorganisation. Against the background of the CCP's organisational structure, Section 4.3 argues that the networks of the Communist Party still constrain the actual practice of authority in many respects, but the recent restructuring of the Party has resulted in a greater diffusion of authority. Section 4.4 considers the Open Door policy and its impact on Guangdong's governance structure in terms of the new patterns of central-local relationships. In Section 4.5 the discussion of institutional innovations focuses in particular on fiscal relations, enterprise reform, and legislative decentralisation. The consequence of reform raises the question of Beijing's capacity to control the localities, and the ability of Guangdong to circumvent that control. In Section 4.6 the case of the GITIC (Guangdong International Trust and Investment Corporation) and the significance of IPR (intellectual property rights) issues are taken as examples of this tension. Section 4.7 summarises the main arguments and offers an overall

perspective on the innovative form of China's MLG system.

4.1 Multi-Level Governance in China

Hitherto, the paradigm of MLG has been applied mainly to the analysis of European Union governance. As Rosamond (2000: 110) explains, 'MLG analysis amounts to the claim that the EU has become a polity where there are significant sectoral variations in governance patterns'. Christiansen (1996: 13) stresses that MLG involves a shift from a hierarchical (vertical) to a non-hierarchical (horizontal) system of political negotiation, with sub-national regions within the EU – and the horizontal links among these regions – becoming particularly important in this negotiation process. The multi-level governance of EU policy-making involves complex 'interweavings' among the supranational, national and sub-national levels, and close links between governmental and non-governmental agencies, a picture which is represented by the image of a 'networked polity' (Ansell, 2000). This image draws heavily on the developing theory of policy networks and policy communities as a basis for understanding the intricacies of contemporary governance. For Ansell, the networked polity is characterised by functional and territorial disaggregation, and also by strong inter-organisational and inter-governmental network relationships (Ansell, 2000: 303). Moreover, these network relationships are underpinned by strong inter-personal social networks (Ansell, 2000: 318). These new patterns are stronger in some sectoral areas of EU policy than others, and are especially prominent in EU cohesion policy and regional policy (see, for example, Hooghe, 1996; *Regional and Federal Studies*, 2000). Put another way, the EU's policy networks are 'of varying density and depth' (Risse-Kappen, 1996: 74).

Although the MLG paradigm has not been applied to China, many authors have recognised the emerging spatial complexity of the new market economy in China and the increasingly important role within that economy of other actors besides the central government and Party institutions. There is widespread agreement that a focus on formal 'government' needs to be replaced by a focus on the various components of economic 'governance', which must include a consideration of the role of states, hierarchies, clans or networks, and associations (Wang, 2001a: 113). Francis (2001) stresses four key features of China's

market economy: (1) the proliferation of paragonmental organisations (as the state takes on new regulatory functions but does so by delegating authority to private and quasi-governmental agencies; (2) the integration of non-governmental entities into state structures (so that the boundaries between the public and private sectors become blurred); (3) corporatist trends; and (4) the commercialisation of the state (as state entities – including those at the sub-national levels – become market entrepreneurs). Although she does not use the specific term, it would appear that Francis is putting forward a model which is remarkably close to that of multi-level governance. However, she wishes to stress that the Chinese case involves some unique features, especially the combination of quasi-public and quasi-private responsibilities. If MLG means the spreading of authority and policy-making influence across multiple levels of government and across the private/public boundary, then there is clear evidence of the emergence of such a system in China, although undoubtedly the Chinese state and party remain crucial 'gatekeepers' of the process (just as national governments still do in many areas of EU policy).

Zheng (1997) suggests that the old hierarchical Party-state in China is gradually being replaced by a 'segmented state', characterised by the emergence of *multiple centres of power* among the state legislative, judicial and administrative institutions vis-à-vis the Party organisation (Zheng, 1997: 264). This is very close to the idea of MLG, although the author does not use this exact term. Zheng observes: 'China has today become more decentralized than it used to be. On many occasions, the center pretends to command provinces whereas provinces don't even recognize the center. In reality, many regions and provinces are on their own ... If economic modernization continues to be the top priority for the post-Deng regime, we are going to see more divergent interests between the center and localities and among various regions' (ibid.: 264). Zheng therefore predicts that increasingly China will move towards a federal model of decision-making. However, this conclusion ignores the possibility of a more flexible model of MLG, which would in many ways be more capable of meeting the needs of China's future modernisation.

In the case of China the unique characteristics of business networks and their roots in close social networks, including those across the public/private divide, add a particularly important dimension to the nature and scope of MLG. Thus, Castells (1996: 188)

emphasises the importance of 'linkage between supportive government and family-based business networks ... in the process of export-oriented industrialization in Southern China in the 1990s'. He then describes how, for example, manufacturers in Hong Kong and Taiwan take advantage of the regional networks based in their villages of origin in Guangdong and Fujian to create subsidiaries and establish subcontracting relationships 'in order to offshore the low end of their manufacturing production (for example, in shoes, plastics, or consumer electronics)' (ibid.: 188). At the same time, as Castells stresses, these production networks can only emerge because they are supported by provincial and local (especially city) governments. Thus, Chinese MLG has its own unique features, and these become especially evident in the cross-border relations which constitute the so-called 'Greater South China Economic Region' among Southern China (Guangdong and Fujian), Taiwan and Hong Kong (Chen, 1994). Most importantly, the combination of strong social networks and supportive governance arrangements makes the Southern Chinese form of micro-regionalisation worthy of attention as a particular case of MLG which is different in key respects from the European 'model'.

It is important to understand the distinction between the processes of formal intergovernmental relations and the emergence of overlapping jurisdictions in the case of China's MLG. The administrative (state) system is mutually exclusive in terms of territoriality and is bound to a limited number of jurisdictions. The Party networks are extended along with the levels of formal government. On the other hand, the 'overlapping competencies among multiple levels of governments and the interaction of political actors across those levels' (Marks et al., 1996: 41) suggests the lack of any limitation on the number of jurisdictional levels. The number of actors in the latter case is unlimited and relations among them are more flexible than in the formal and intergovernmental type of MLG. This facilitates the coordination of the spatial economy and thereby involves economic governance by firms (see the discussion in Chapters 5 and 6).

4.2 The State System and Its Reform

With the increase of local autonomy through economic reform, the presence of local authorities in China's system of economic governance has also become important. The

country is divided into four kinds of provincial-level administrative regions (22 provinces; five autonomous regions; four municipalities; and two special administrative regions, excluding Taiwan).² These divisions are designed to accommodate the differentiation of China historically, politically, economically, racially and culturally. Vertically, each administrative region has three tiers (the provincial, sub-provincial and local levels). The provincial and sub-provincial units are especially important actors among China's administrative divisions. The average size of population of Chinese provinces, including municipalities and autonomous regions, is about 40 million, and the average land area is 300,000 square kilometres. For example, in 2000 the population of Henan province was 92.56 million, that of Shandong province was 90.79 million, and that of Sichuan province was 83.29 million (Mitsubishi, 2001). In terms of land area, four provinces (Xinjiang, Tibet, Inner Mongolia, Qinghai) are larger than France (551,500 square kilometres), and eight provinces (the above four plus Heilongjiang, Sichuan, Yunnan, Gansu) are larger than Germany (356,733 square kilometres). Furthermore, the cities (as sub-provincial units) also have large populations. For example, Shanghai had 16.74 million people and Beijing 13.82 million in 2000.³ Given China's enormous size, for ordinary residents regional identity is linked to the county (*xian*) or middle-size cities (local level), with populations of about 0.8 million (Nakai, 1999).

Since the establishment of the People's Republic of China (PRC), many changes of administrative structure have taken place through mergers, division and abolition⁴. These have been undertaken for the purpose of national defence, ethnic minority management, regional projects, and the promotion of economic reform. After 1979, for example, Hainan Island was separated from Guangdong province and became a province with the status of a special economic zone (SEZ). In 1997, Chongqing, which had a crucial role in the Three Gorges Dam Project, was upgraded to a fourth municipality. In 1997, Hong Kong reverted to China and was given a new status as a Special Administrative Region (SAR). In December 1999, Macau followed the same pattern and also became a SAR. Thus reform processes have added further complications to China's administrative divisions by establishing a variety of special zones.

Among sub-provincial units, economic reform has greatly increased the status of cities in

China's administration. In the pre-reform period, the province was the highest sub-national unit of administration that supervised sub-provincial units. Reform processes have stimulated the creation of new cities. The status of cities has become more flexible than that of other divisions in China's hierarchical administrative system. Setting up new special zones is a new regulatory function. By 1999, there were 5 SEZs, 14 coastal open cities, 5 coastal open areas, 39 economic and technology zones, 15 coastal bonded zones, and 14 border economic areas. Some cities, given the status of SEZs, coastal open cities and Cities with Separate Plans (CSPs)⁵, were elevated by reform to almost the semi-provincial level. As a result, the total number of cities increased from 194 to 667 between 1979 and 1997 (Tang and Hao, 1997: 17).

Since 1999, 39 coastal cities have been given the status of 'economic and technological development zones' (*jingji jishu kaifa qu*) and have received similar preferential treatment to that given to the SEZs. They differ from SEZs in that they originally had economic foundations as ports or coastal industrial cities. In 1991, the centre approved the establishment of 27 'high-technology development zones', where cooperative relations with universities and research institutes are emphasised. By 1997, the number of such zones had increased to 58. Finally, in order to promote processing trade and entrepot trade in priority areas, the centre adopted the establishment of bonded zones in 1990.⁶ By 1999, 15 bonded zones had been established in China. Following the establishment of special zones, the further expansion of such zones in terms of scale was carried out through the designation of 'open economic areas' (*jingji kaifungqu*). In 1985, the counties and cities located in the Yangtze Delta, Pearl River Delta and southern Fujian triangle were given this new status. By 1999, China had established five coastal open economic areas (the Yangtze Delta, the Pearl River Delta, the southern Fujian triangle, the Liaodong peninsula, and the Shandong peninsula).

Thus, sub-provincial units, especially cities, have functionally increased their economic role and have been able to engage in direct communication with the centre, by-passing the provinces. This is a particularly important example of the dynamics of MLG in the state system. At the same time, the centre has also increased its territorial domain without the interference of the provincial governments. However, China's regional administrative

divisions embrace both the remaining old structures and the birth of new administrations with their enhanced economic and entrepreneurial status. The diversification of administrative divisions and the mixture of the new and old vertical divisions continue, and the situation is further complicated by the dominant role of the CCP. Finally, decentralisation in China has produced a variety of responses at the local (provincial and sub-provincial) levels. Some local governments have been more assertive and less compliant than others in their behaviour vis-à-vis the centre, and this variation reflects the influence of a number of factors, both internal to the local unit and external (in terms of central-local relations). (See Chung, 2000 for a detailed study of local variation.) This is another reason for suggesting that the model of MLG is applicable to the current stage of governance reform in China. As Solinger (1996: 33) observes, decentralisation in China is not a uniform national policy but has affected localities in different ways: the 'enhanced comparative differentials *horizontally* – among localities – have had a profound impact on the shape of the overall, national *vertical* balance of power'.

4.3 Party Governance and Its Reform

4.3.1 Party Governance

The CCP is the highest political authority in China and its position is monopolistic. The function of the state system is mediated through the Party's networks. The organisational principles of the Party are based on the idea of democratic centralism, but in fact democratic decision-making from below has never been achieved in practice. The Party has sought to extend its hierarchical authority into almost all aspects of life, including education, industry, commerce and the military (Hunter and Sexton, 1999: 101). The state institutions, such as legislative bodies, courts of justice, prosecutors' offices, and various levels of government, have been used to materialise the Party's dominant leadership.⁷

The Party's governance structure was originally based on the CCP's organisational system at the revolutionary base and was combined with the Soviet administrative system⁸. The legitimacy of the CCP's rule is expressed in its leading role (*lingdao*), which is based on two preconditions: (1) the CCP's leading role over all parties; (2) the absolute control over military power (Wang, 1995: 314). Thus, China's authoritative structure gives the CCP the leading role as the highest authority, the military power (subordinate to the CCP) as the

second highest authority, and the state system as the third highest authority.⁹ The CCP was established in 1921 with some 50 members, but by 1999 it had about 63 million members and was the world's largest political party (Yabuki, 2000). The CCP is declared to be China's only ruling party in the preface to the Chinese Constitution. The leadership role has three elements: leadership over the activities of state politics; leadership over the state organisations through the CCP's grasp of the leading position of the state institutions; and leadership over the fundamental idea for state activities through education and guidance (Xie, Yang and Yan, 1999: 183). The CCP seeks to exercise political leadership and state authority by itself, reflecting the principle of the 'inseparable relation' between Party and Government (*dang-zheng hufen*) (Tō, 1997: 1).

The Party Committee System (*dangweiyuanhuizhi*) exists in parallel with the hierarchy of administrative levels from the centre down to the basic unit. This system is intended to guarantee the leadership of the CCP over the authority of state institutions and society (Wang, 1995: 330). The Party's command system has two features. One is the horizontal concentration on the Party Committee at each level (horizontal unified leadership). There is a vertical command system between the centre and local Party organisations (vertical unified leadership). The Party's leadership role in terms of its command system is based on horizontal concentration at the same level and vertical concentration between the different levels. Thus, in contrast to the former Soviet system, in the Chinese system authority is horizontally centralised to the Party Committee at each level (Chō, 1998: 211). The concentration of local power is evident in the fact that provincial Party leaders are concurrently provincial governors as well as members of the People's Congress and the Central Party Committee. The local Party leaders at all levels have absolute authority in local politics. Thus, if they manage the regional economy well, this guarantees them promotion in the Party's hierarchy.

4.3.2 The Restructuring of Party Governance

The formal system of CCP authority has been subject to frequent modification. Zheng contrasts the earlier decentralisation of 1958-60, when power was transferred from central to provincial Party committees, with the decentralisation of the 1980s and 1990s, when power was transferred from the Party committees to the provincial governments. 'As a result, provincial Party committees no longer have as much power to control the local

economy' (Zheng, 1997: 220). In 1980, at a Politburo meeting, Deng Xiaoping complained that the excessive concentration of power in the hands of Party committees was the main obstacle to the creation of a modern leadership system (Chang, 1995: 75). Yet at the same time the Party leaders in Beijing continue to influence the composition of provincial and sub-provincial governments through the so-called *nomenklatura* system. There are, for example, frequent transfers of Party and government officials across regions and between Beijing and the provinces (Zheng, 1997: 221). Yabuki (2000) points out that provincial First Party Secretaries are transferred across provinces more often than the Governors.¹⁰ The Party Secretaries are expected to exercise a leading role in line with the decisions of the centre (vertical unified leadership), while Governors are expected to carry out policies while taking into account local needs (local initiative) (Yabuki, 2000: 135).

The process of economic reform has exacerbated the diffusion of authority, since it has given various economic powers to the localities. The integrated Party-state has promoted the commercialisation of the Party organisation. The relationship between the central and sub-central levels can no longer be seen simply in terms of the old 'command and control' model typical of traditional state socialism. Indeed, Song (2000: 122-3) argues that the old hierarchical system has been 'undermined': 'China is gradually but inexorably becoming a state where there is considerable diffusion of power'. As the market economy has developed, it has required the centre to allow 'lower' levels to assume more autonomy and, in many cases, to assume functions of an entrepreneurial nature which are beyond the administrative capacity of the centre. Since a strong entrepreneurial class in the private sector has been slow to develop in mainland China, and since the authorities have sought to regulate the transition to a market economy as much as possible, then the entrepreneurial (quasi-public/quasi-private) role of the lower levels of administration has been of crucial importance. In this respect, a key issue is how far the growing autonomy of the lower levels of government in China has been matched by the growing autonomy of local cadres, and whether the increasing entrepreneurial role of provincial and sub-provincial governments has involved the growing influence of non-Party personnel. Furthermore, some local Party cadres have lost interest in promotion within the hierarchical Party system. As they are involved directly in efforts to maximise economic incentives, it is natural that some will be more interested in economic profit than personal promotion.

The reform of state-owned enterprises (SOEs) has further accelerated the diffusion of authority. Until 1992, the reform of SOEs mainly involved the expansion of the decision-making capacity of enterprises. The contracted management responsibility system was implemented between 1987 and 1991, but this did not diminish the interference of the government in the management of firms. Since 1992, the further reform of SOEs has focused on the transformation of enterprises into stock companies. In 1995, there were about 120,000 state-owned enterprises in China, each of which was under the control of the governments (at the central, provincial and sub-provincial levels). The sharp growth of township and village enterprises (TVEs), which are owned by local governments (towns and villages), exacerbated the difficulties of small and medium SOEs. The privatisation of the latter then began in 1995. In 1998, private firms were constitutionally admitted as an important part of the socialist market economy. By 1999, private firms, including individual small firms, already employed about 80 million workers (*NKS*, 5 July 2000). Between 1990 and 1999, the total number of absorptive takeovers by private firms of state-owned firms was 5,600 (*NKS*, 5 July 2000). Accordingly, there has been a steady transfer of Party cadres into private firms since the late 1990s, and this is expected to promote the further diffusion of authority and accelerate the blurring of the public/private distinction. Thus, the attraction of promotion within the Party's hierarchical system is now subject to more economic incentives.

The overheating of regional self-interest has raised some serious problems for the future system of Chinese governance. One negative feature of the processes of reform is that China has had to face a serious problem of corruption. It is estimated that almost 90% of all collected levies are either unauthorised or illegal (Pei, 1999: 101). Another investigation in 1998 uncovered more than 3,400 different fees illegally levied by local governments and their agencies (*ibid.*: 101). In April 1995, the Deputy Mayor of Beijing (Wang Baosen) committed suicide as he was about to be charged with embezzling the equivalent of 37 million dollars, and the Beijing Party boss (and CCP Politburo member) – Chen Xitong – was also forced to resign (Zheng, 1997: 209). This is just one example of a growing trend of corruption within the CCP, suggesting that the Party has lost the capacity to control its members. Accordingly, there is a growing recognition that effective economic development requires the talents of non-Party entrepreneurs and skilled business personnel

who are not associated with Party corruption. As, gradually, China's entrepreneurial middle class grows in size, it will undoubtedly seek more influence in the process of policy-making, and this will almost certainly further undermine the role of Party cadres.¹¹

4.4 Guangdong Province and the Open Door Policy

The Open Door policy, implemented in 1979, granted special treatment and flexible measures to Guangdong and Fujian provinces. The policy itself aimed to expand international contacts by connecting selected domestic markets with foreign markets. The primary direction of economic reform was the expansion of the economic autonomy of firms and SNGs, and the introduction of a market mechanism. By using this market mechanism and foreign resources (foreign capital and technology), China sought to speed up the modernisation of its economy. Guangdong was assigned the role of pioneer. It was granted greater autonomy over economic policies, including budgeting, planning, material allocation, pricing, investment, labour management and foreign economic relations including the establishment of SEZs. The primary aim of the SEZs is to promote the acquisition of inward FDI and, by using FDI and advanced technology, to expand foreign trade. This is thought to compensate for the shortcomings of capital, technology, and managerial know-how, and to contribute to employment, exports and the increase of tax revenue. The SEZs are thus regarded as an experimental site for an export-oriented strategy. Since then, Guangdong has been a primary vehicle for leading China's economic development. In 1999, more than one seventh of China's national commercial tax revenue came from Guangdong.¹²

4.4.1 The Open Door Policy and the Change of Central Leaders

In the pre-reform period, there was little space for SNGs to participate directly in foreign trade under the mandatory planning system. The third Plenary Session of the Eleventh Central Committee of the CCP, held in December 1978, was a critical turning point. Deng Xiaoping successfully achieved dominance in the Working Conference of the CCP in November 1978, which was held prior to the Eleventh Central Committee. Under Deng's leadership, the third Plenary Session of this Committee announced the rejection of the previous Maoist definition of economic modernisation through class struggle, and declared

its intentions to reform the central planning system for the purpose of economic development. Deng Xiaoping and the new leaders (Hu Yaobang and Zhao Zhiyang) then successfully deprived Mao's successor, Hua Guofeng, of his power. Hu replaced Hua as Chairman of the CCPCC (Chinese Communist Party Central Committee) in 1981. Deng, Hu and Zhao were reformists and proposed the introduction of a new economic policy using foreign capital and technology. However, this new policy, especially in its emphasis on the introduction of the SEZs, was faced with criticism within the Party. Chen Yun, a representative of the conservative camp, often criticised the rapid introduction of economic reform in the early 1980s. The reformists needed to defend the Open Door policy. Thus, Hu Yaobang visited Shenzhen in February 1983, and Deng Xiaoping visited Shenzhen, Zhuhai and Xiamen in order to get across the positive experience of the SEZs.

4.4.2 Leadership in Guangdong

The introduction of SEZs in Guangdong and its success owes much to the effort of Guangdong's leaders. The most crucial actors were Party Secretaries and Governors (see Table 4.1). Cheung (1998a: 93) describes how, in the pre-reform period, several provincial leaders already thought of developing economic links with Hong Kong in order to gain foreign exchange, but none of these proposals was enacted because of the dominance of the centre in decision making. The basis of economic reform in Guangdong was introduced by Zhao Ziyang (Guangdong's First Party Secretary in 1974, later General Secretary of the CCP, 1987-1989), but his wide-ranging reform strategies were actually carried out in Sichuan, to where he was transferred in 1975. The next leader, Wei Guoqing (Guangdong's first Party Secretary, 1975-1979) was an elite soldier and did not have a pioneering spirit. Xu Zhongxun, a veteran Party cadre, did not have enough experience in the management of local government. Then, Ren Zhongyi, who had spent his entire career in the northeast, became Guangdong's first Party Secretary in 1980. His reformist credentials and strong leadership in Liaoning province were the key consideration for his appointment. In order to promote innovative reform, it was important for leaders in Guangdong to cultivate the confidence of the centre. Guangdong's long distance from Beijing (more than 2,300 kilometres) and its southern culture, dialects and lifestyle inevitably aroused doubts about its capacity for compliance.

Table 4.1 Guangdong's Party Secretaries and Governors since 1978

Provincial Party Secretaries	Governors
Xi Zhongxun (1978.12-1980.11)	Xi Zhongxun (1978.12-1981.2)
Ren Zhongyi (1980.11-1985.7)	Liu Tianfu (1981.3-1983.4)
Lin Ruo (1985.7-1991.1)	Liang Lingguang (1983.5-1985.7)
Xie Fei (1991.1-1998.2)	Ye Xuanping (1985.8-1991.5)
Li Changchun (1998.3-	Zhu Senlin (1991.5-1996.2)
	Lui Ruihua (1996.2-)

Sources: Cheung (1998a: 94) and *Tōa* No 373 (July 1998)

The political roles of provincial leaders are especially important in negotiating with the centre for special treatment, encouraging local reform by the sub-provincial units, and defending against conservative critics of reform. First, in Guangdong's case, the skill to negotiate with the centre was critical. The special policies granted to Guangdong were indeed pioneering, because they enabled the province to enjoy a great deal of autonomy over a wide range of economic policies (Cheung, 1998a: 101). The provincial leaders thus needed to articulate local demands and to persuade the central leaders by lobbying. By taking advantage of their close relationship, Xi Zhongxun and Yang Shangkun were able to lobby Deng Xiaoping directly and secure his personal approval of Guangdong's special policies (Cheung, 1998a: 102). Ren was also able to exploit his close relationship with one of the key reformist leaders at the centre, Hu Yaobang (General Secretary of the CCP: February 1980 to January 1987) (Nakai, 2000: 106). During Lin's tenure, he managed to make a bold request to the centre and this resulted in Zhao Ziyang's coastal development strategy. Indeed, Lin and Ye personally met Zhao Ziyang in October 1987, and Zhao proposed to turn Guangdong into a 'comprehensive reform experimental area' (Cheung, 1998a: 102).

Secondly, the political role of provincial leaders was to encourage reform within the provinces. This was seen as a decisive factor for the success of Guangdong's economy. Ren Zhongyi's role was particularly important in emphasising the decentralisation of provincial economic authority to sub-provincial units, thereby encouraging the spontaneous behaviour of local officials. Ren explained the central policy toward Guangdong with a flexible interpretation. According to Cheung (1998a: 103),

(C)adres should first look for whatever policies that could be applied to a particular

situation rather than do nothing; second, if there was a certain latitude within central policy, cadres should implement the policy flexibly in order to stimulate economic production; third, should there be some reforms that were conducive to the interests of the people and the nation, test sites for such reforms should be allowed even if no provisions could be found in existing policy documents and such test sites might go beyond the limits of existing policies.

Ren succeeded in earning popularity among local cadres. In addition, when the centre raised the levels of direct appointment of local officials in 1984, Ren's power to appoint in Guangdong was strengthened. Finally, the political role of provincial leaders was to defend reform against criticism, mainly from the conservative groups. For example, Governor Ye Xuanping allegedly confronted Premier Li Peng over economic policy at a meeting of Governors held in the autumn of 1990 (Cheung, 1998b: 48). If the leaders had not defended reform in the province, this would have caused the retreat of local cadres from supporting the reform strategies.

4.4.3 The Emergence of New Economic Governance

The establishment of the SEZs as an innovative administrative unit is of great significance in the change of economic governance at sub-provincial levels. The SEZs themselves are under the formal authority of the State Council and not the provincial government. They offer various kinds of benefits to foreign investors through relaxed entry and exit regulations, business regulations, labour and wage regulations, land regulations, and preferential tax treatment. In 1979, the centre allowed Guangdong to establish the two export processing zones of Zhuhai and Shenzhen, and in 1980 Shantou (Guangdong) and Xiamen (Fujian) were added. These SEZs were expected to serve as the testing grounds for bold, experimental economic and social reform. In the case of China, the original four SEZs also serve as a window for national reunification by strengthening the economic relations with overseas Chinese, especially in Hong Kong, Macau and Taiwan. Shenzhen is next to Hong Kong, Zhuhai is next to Macau, Xiamen is opposite Taiwan, and Shantou links with southeast Asian Chinese communities. Through economic cooperation, the SEZs were expected to deepen the links between mainland China and overseas Chinese.

Shenzhen, adjacent to Hong Kong, is economically the most important and the largest SEZ in geographical terms: its area of 327.5 square kilometers is about one-third of that of Hong Kong. When the SEZ was established in Shenzhen in 1979, it was only a small town with a population of about 20,000 surrounded by agricultural land. The introduction of the Open Door policy profoundly transformed Shenzhen. Its remarkable economic growth (31.2% per annum from 1980 to 1999) is due not only to the impact of foreign economic relations but also to political factors. Shenzhen's development is very experimental. There has been an effort to design an innovative administrative system that meets its specific requirements. Though the executive is elected by the local People's Congress and approved by the centre, the local Shenzhen officials have lobbied regularly for greater autonomy for the SEZ and have achieved considerable success (Roberts and Ng, 1996: 41). In July 1991, the Shenzhen securities market was opened following the opening of the market in Shanghai. Shenzhen still leads the innovative, experimental path of China's economic reform.

The establishment of 'coastal open cities' (*yanhai kaifang chengshi*) in 1984 extended the concept of SEZ to 14 coastal cities including two cities in Guangdong (Guangzhou and Zhanjiang). These cities also established 'economic and technological zones' (*jingji jishu kaifu qu*) with a similar status to that of the original SEZs. They were selected because they originally had strong economic foundations such as ports or coastal industrial areas. For example, Zhanjiang has good natural ports and 23 berths for ships of 10,000 tons. Huizhou and Panyu are also designed as 'economic and technological zones'. Guangzhou was selected as one of the cities listed independently in the state plan (*jihua danlie chengshi*) in the 1980s, which granted the provincial level new powers in economic planning. In Guangdong, by 1999, there were six high technology zones (Zhongshan, Guangzhou and Shenzhen were approved in 1991, and Foshan, Huizhou and Zhuhai were approved in 1992). By 1999, six bonded zones had been established in Guangdong (three in Shenzhen, one in each of Guangzhou, Zhuhai and Shantou). In 1985, the 16 counties and cities located in the Pearl River Delta were designed as 'open economic areas' (with a total land area of 21,500 square kilometers). In the Pearl River Delta, Dongguan, Jiangmen, Zhongshan and Foshan were included. In 1988 and 1992, the open coastal areas in the Pearl River Delta were extended to include Huizhou and Meizhou, etc. They now extend to the southern part

of Guangdong province and occupy a total area of more than half of the province.

Following the devolution of economic authority to the Guangdong provincial government, the sub-provincial and local governments also enjoyed a devolution of power from Guangdong. Since reform the Guangdong provincial government has approved the creation of 56 'economic and developmental experimental zones'. The government has played the same role in relation to the sub-provincial levels as that of the central government toward the provincial government. The local governments in the Pearl River Delta have undertaken decentralisation and reform, and have made an effort to establish a simplified administrative structure. In the 1980s, Dongguan, which is located between Shenzhen and Guangzhou, adopted a radical developmental strategy to create an export-oriented manufacturing economy through processing and assembly industrialisation and outward-oriented commercial agriculture (G. Yeung, 2001a: 93). In the 1990s, it sought to attract foreign investment in high-value added and high-technology sectors and to improve the efficiency and competitiveness of locally-financed industry (*ibid.*: 95). With the success of economic development, the administrative position of Dongguan was upgraded. In 1985, it became a county-level city, and in 1988 it became a prefecture-level city under the Guangdong provincial government. In Guangdong province as a whole, the number of cities rapidly increased during the reform period: from 16 in 1984 to 54 in 1998. Thus, the sharp economic growth initiated by the Open Door policy in Guangdong has been of vital significance for changes in Guangdong's governance structure.

4.5 Changes in Inter-Governmental Relations

When considering the forms of China's MLG, inter-governmental relations in the field of economic policy are especially important. Some studies of central-local relations in China focus on historical continuity and the centrifugal tendencies arising from decentralisation (Chang, 1992; Waldron, 1990; Montinola, Qian and Weingast 1995). Others focus on the effect of fiscal and planning arrangements on central-local relations (Donnithorne, 1976; Lardy, 1975 and 1976; Wang, 1994; D. Yang, 1994; Wong, 1991; Oksenberg and Tong, 1991; Y. Yang, 1996). Most authors stress the growing importance of SNGs in decision-making and the implementation of economic policy. The process of change was

initiated by the adoption of Central Document No.50 (July 1979), which redefined the relations of the centre and Guangdong through a number of *ad hoc* contracts and by decentralising economic powers, rather than by granting new funds or resources (Cheung, 1998b: 30). Since then, Guangdong has been a leading site for the evolution of China's MLG. In particular, its economic power and close relations with Hong Kong have been especially significant. This section focuses on the interaction between the centre and Guangdong in economic policy since 1979 and assesses Guangdong's economic authority.

4.5.1 The Fiscal Dimension

Fiscal decentralisation is one of the fundamental factors that have affected central-local economic power relations. Under the mandatory planned economic system, the centre exercised predominant control over the various fiscal management systems, adopted a unified budget, and presided over the budgetary system, including the budgets of the central government, the provinces and the sub-provincial units. The centre held four sets of controls over provincial revenues and expenditure (Oksenbergh and Tong, 1991: 3): it (1) assigned revenue sources to provinces and stipulated the revenue-sharing rate; (2) stipulated the level of local expenditure by issuing targets; (3) regulated provincial receipts and spending through revenue collection and spending schedules, financial operations and accounting procedures; and (4) enacted fiscal measures such as requisitioning provincial surpluses by forced borrowing and the purchase of treasury bonds, and freezing local bank accounts.

In 1980, under the slogan of 'cooking in separate kitchens' (*fenzao chifan*), the centre attempted to increase the incentives of SNGs in fiscal management. It introduced a new institutional environment and expanded the fiscal power of Guangdong and Fujian provinces.¹³ The provinces were allowed to retain a certain amount of revenue to use for their expenditure and acquired the authority to determine their fiscal arrangements with the sub-provincial levels. For example, the introduction of a five-year fiscal contract for Guangdong set the province's obligation to transfer a lump sum of RMB 1.2 billion (later reduced to 1 billion) of revenue to the central government. Tax laws and tax policy were set by the central government, but the collection of tax was carried out by local governments, and revenues were shared upward with the central government according to

the revenue-sharing agreement or contract. This became the foundation of Guangdong's reform in the 1980s, because it enabled the province to gain more resources in subsidising reform and enjoy greater autonomy in setting its own surplus or shortfall after remitting the lump sum (Cheung, 1998b: 31).

However, the problem with such a contract system between the centre and the provinces is that it relies on *ad hoc* measures and bargaining power. According to Takaya (1996), provincial governments have lobbied to obtain the concession of lower contributions to central finance and to gain approval for extra revenue for local finance. Secondly, the tax system linking the centre and the provinces has given the provinces dominance over taxation. Thirdly, the decline of central finance became obvious in the early 1990s. The share of central government in total revenue remained low until 1990. Until then, the contribution of local governments to state finance was more than 65% of total revenue.¹⁴

In the early 1990s, the centre began to emphasise central co-ordination and management rather than local initiative and experimentation. For example, Premier Li Peng attempted to abolish the lump-sum transfer in order to raise central revenue in late 1990. Behind this initiative was the fact that the central government faced considerable economic hardship unless it could increase its income. Thus, it asked Guangdong to issue several billion RMBs worth of state bonds in the 1980s, and the extra contribution from Guangdong amounted to 1 billion RMB in 1990 (Cheung, 1998b: 46). The centre thus needed to introduce new measures to acquire central revenue without the intervention of the provinces. In 1994, the new taxation system, using a new classification of channels for the collection of tax revenue (*fenshuizhi*) (it classified central and local tax revenue by tax items), was implemented. In the 1990s, the central government's share of revenue steadily increased, but at the same time local governments' share of expenditure also increased, accounting for more than 70% of total expenditure in the 1990s (ZTN, 1999). Thus, despite the centre's increasing power over tax collection, it made concessions to the spending power of local government.

Under the provincial level, local governments undertake the management of local firms usually through the establishment of a corporate body. For local governments under the

county level, the revenue from local collective firms constitutes the main source of local finance. For example, almost 30% of provincial, city and county levels of local government finance depend on budgetary compensation from central finance. On the other hand, township and village finance contributes directly to the upper levels of governments.¹⁵ In turn, this finance depends on the revenue of local firms, especially TVEs, and the revenue of the provincial, city and county levels of government depends on the SOEs. Thus, local governments tend to have incentives to support local firms in order to increase revenue. Such budgetary restraint inevitably affects local developmental strategies and encourages governments to focus on local interests.

4.5.2 Enterprise Reform

Firms were allowed to retain a part of their profits if they adopted economic reform measures. In 1980, 6,600 SOEs were selected for an experimental scheme for profit retention. The bonus system was introduced to provide incentives for workers. In Guangdong, enterprise reform began in 1979 by giving more autonomy to management in decision making, and by paying a bonus scheme from retained excessive profits in 179 large and medium-sized enterprises. In 1981, the contracted management responsibility system was widely adopted in the province. This meant that profits in excess of the remitted profit target were to be distributed among the enterprise, the government and the control unit. Taking into account Guangdong's success, the centre introduced this system more widely from 1987 to 1991. However, the contracted management responsibility system was not able to exclude the intervention of the administrative organs because the target profit was agreed through negotiations with the government and control unit. In 1992, the 'Regulations on the Shift of the Management Mechanism for the State-Owned Enterprises' were issued to expand managerial authority in order to emphasise the separation of ownership and management. Furthermore, in the 1990s, a stock company system was introduced. The abolition of price controls on industrial reform was also facilitated, and most controls have now been removed.¹⁶

In rural areas, the promotion of TVEs was the main focus of enterprise reform. The introduction of the contracted responsibility system, which allowed enterprises to retain surplus profit, encouraged the growth of TVEs and also helped to absorb surplus labour in

rural areas. By 1998, Guangdong had 1,333,600 TVEs (Nihon Kokusai Bōeki Sokushin Kyōkai, 1999). As township and village finance depends on the revenue of TVEs, the situation of local finance is subject to the achievement of those enterprises. Guangdong's TVEs enjoy a number of locational advantages: in particular, they are close to Hong Kong and many of them undertake production for foreign markets. In 1998, 31,436 TVEs were export-oriented and their total earnings of foreign exchange accounted for \$US 17,300 million (ibid.). Thus, by making it possible to gain resources for profit independently, enterprise reform has strengthened the fiscal autonomy of SNGs.

4.5.3 Legislative Decentralisation

The third policy component involves the decentralisation of legislative power to protect the economic management role of local governments. In the pre-reform period, as China's Constitution was designed after the model of the Soviet Union, the localities were not given legislative power even on regional matters. In 1979, the second session of the Fifth National People's Congress (NPC) issued two important laws. These introduced two-level legislation (*liangji lifa*) in place of one-level legislation (at the centre) by granting the provincial People's Congresses legislative power as long as their status did not contravene the Constitution, laws, policies, and orders of the state (Gong and Chen, 1994: 77). Later these new measures were incorporated in the 1982 Constitution, which contains the additional stipulation that provincial governments are permitted to formulate their own rules and regulations in line with state laws and the administrative regulations of the State Council. These changes in the structure and functions of provincial governments and local People's Congresses have given more autonomy to localities. In 1992, the Shenzhen's People's Congress was granted legislative power, a privileged treatment usually reserved for the provincial level (Cheung, 1994: 222). Legislative decentralisation is a process that aims to establish a multi-layered legislative authority including the central, provincial and sub-provincial levels. It has helped greatly to guarantee local autonomy from a legal point of view.

4.6 Beijing's Control and Its Circumvention by Guangdong

Provincial leaders are appointed by the centre and are required to keep in line with the

centre. However, at the same time, they have their own responsibility for economic development. Thus, it is natural to expect that when a common goal is pursued by the centre and the localities, conflicts will be less likely to occur than when each side pursues its own interests. This section considers whether the centre effectively controls Guangdong or whether the province is able to circumvent such control. In particular, it refers to the examples of GITIC (the Guangdong International Trust and Investment Corporation) and Intellectual Property Rights (IPR) issues.

4.6.1 Beijing's Control over Guangdong

Constitutionally China is a centralised state system and Guangdong is only a province, subordinate to central policies. However, Guangdong's distinctive sub-culture, its history as a trading centre, its distance from Beijing and its proximity to Hong Kong and Macau have aroused suspicion among the central leaders. Traditionally, the centre's interest has focused on the way in which localities maintain their own culture and languages, and regionalism has been seen as an expression of local egoism or separatism, and therefore as a potential threat to the centre. The centre has been very cautious about separatism and regionalism. Following the establishment of the PRC, during the next three decades Beijing sent leaders to control Guangdong. Except for Ye Jianying (Guangdong Party Secretary from August 1949 to May 1955) and Chen Yu (Guangdong Governor from August 1957 to the Cultural Revolution), none of Guangdong's Party Secretaries and Governors were Cantonese. Even after Deng Xiaoping came to power in the late 1970s, Guangdong natives were not appointed to these top positions until 1985 when Ye Xuanping became Guangdong Governor. However, Guangdong is also seen as a power base for leaders. In the 1950s, Tao Zhu, provincial Party Leader (Guangdong Party Secretary from June 1955 to February 1965, born in Hunan province, later Vice Premier), used the province as a springboard to establish himself as a powerful regional leader by closely following central policies (Cheung, 1998b: 25). Following Tao Zhu, Zhao Zhiyang (Guangdong Party Secretary: from February 1965 to the Cultural Revolution, later Prime Minister), who was Tao's close associate, was put in charge of Guangdong. However, after Ye Xuanping, Guangdong held back from appointing native Cantonese as leaders. Xie Fei, born in Guangdong and a close associate of Ye Xuanping, became Guangdong Party Secretary (1991-98). Zhu Senlin (a Shanghainese who built his career in Guangdong and a

former mayor of Guangzhou), was nominated as Guangdong Governor (May 1991 to February 1996). Following him, Lui Ruihua, born in Guangdong and a former Guangdong Vice Governor, was promoted to become Guangdong Governor (February 1996 - present). In the late 1990s, the centre reasserted its power of appointment by sending Li Changchun (former Henan Party Secretary, born in Dalian) to become Guangdong Party Secretary in 1998. At the same time, Huang Liman was transferred from the post of Jiang Zemin's Secretary to the Vice Party Secretary, and the Vice Governor (Wang Qishan) was transferred from the post of chief executive of the Construction Bank of China (*Zhongguo Jianshe Yinhang*).

4.6.2 Guangdong in the Politics of the Centre

According to the Constitution, the National People's Congress (*quanguo renmin daibiao dahui*, NPC) is the highest authority in China (Article 2). In the case of the ninth People's Congress (1998-2003), 2,979 representatives of provincial-level administrations and the People's Liberation Army (PLA) have been selected. The NPC is constitutionally allocated legislative power, decision-making power, the right to select government personnel, and the right to supervise the administrative and juridical organs. The composition of the NPC indicates how regional interests are represented at the centre. Despite the superiority of minority regions in terms of voting power per person, Guangdong province sends 166 representatives to the ninth NPC (1998-2003), which accounts for 5.6% of the total number of NPC members. The provinces with large populations send a large number of delegates. Shandong province (population 88.83 million in 1999) sends 185 representatives and Henan province (population 93.87 million in 1999) sends 163. Among the leaders of the State Council, the leaders (Ministers or Chiefs) of departments and committees from Guangdong province are very few in number. In the ninth tenure period (1998-2003), only one person comes from Guangdong among 37 major positions. Jiangsu province sends nine persons to leading positions in the State Council, which is more than Beijing (2), Tianjin (1) and Shanghai (2) (Takahashi, 2001).

Politically, Guangdong is subject to the CCP's ideological and organisational discipline. The CCP's power is concentrated in the Political Bureau and the Central Committee, which are the highest authorities. Among the members of the 15th CCP Political Bureau

(1997-2002: 22 members and 2 candidate members), almost half are selected from the most powerful provinces.¹⁷ From Guangdong, Party Secretary Li Changchun was selected as a member of the 15th CCP Political Bureau.¹⁸ However, for the Standing Committee of the Political Bureau, no leader from Guangdong has been selected since Ye Jianying (10th, 11th and 12th CCP Political Bureaux). Jiangsu province sends Jiang Zemin (General Secretary, President of the PRC) and Li Liangqing (Vice Premier) to the Standing Committee of the 15th Political Bureau, and Shandong province sends five members. Thus, Guangdong's presence in central political space is not very significant compared with that of other powerful provinces. Guangdong's political power owes much to its economic power.

4.6.3 Guangdong and the Bankruptcy of GITIC

In October 1998, Guangdong's largest non-bank financial institution, GITIC (the Guangdong International Trust and Investment Corporation), was suddenly declared bankrupt by the order of the People's Bank of China (*Zhongguo Renmin Yinhang*: PBOC). GITIC was established in December 1980 and expanded its operations with the strong support of the Guangdong provincial government until 1998. In 1999, GITIC's liabilities exceeding assets amounted to \$US 1.8 billion, and the major loan providers and levels of debt were publicised: Japan (\$US 443.17 million), South Korea (\$US 206.75 million), Hong Kong (\$US 169.02 million), France (\$US 144.77 million), Germany (\$US 124.84 million) and China (\$US 103.65 million) (Mitsubishi, 1999: 166). The bankruptcy of GITIC soon gave rise to widespread international concern about China's creditworthiness.

In the first stage, the PBOC announced repayments to foreign-loan providers, and the Chairman of the PBOC, Dai Xianglong, confirmed this plan in November 1998. He was clearly concerned about the impact of the bankruptcy on foreign-loan providers and on inward FDI in China. However, in January 1999, Dai Xianglong withdrew his previous promise and stated that the bankrupt GITIC would be dealt with according to the 1986 law of bankruptcy. At the same time, he announced that the central government had no responsibility for debts to foreign-loan providers. This shift of policy revealed that the centre had finally decided to deal with this problem as one of financial structure, and to emphasise the importance of law and the market mechanism at the cost of foreign credit

for China. The centre was concerned that Guangdong's economic management was too flexible and had undesirable side effects such as corruption and smuggling. For example, in November 1998, the Supreme Court of Justice announced that RMB 440 million worth of smuggling had been undertaken by conspiracy among the Party Secretary at county level, the Chief of Public Security, the Chief of the Industrial and Commercial Bureau, and the Chief of the Crackdown on Smuggling Bureau in Huidong county in Guangdong (Mitsubishi, 1999: 200). In addition, in November 1998, the Guangdong provincial government revealed a case of smuggling in Zhanjiang, centred on the Chief Customs House. Thus, the centre began seriously to concern itself with the damage caused by illegal trading activities to state finance and the country's development. The processes of dealing with the bankruptcy of GITIC can be seen as a determined effort by the centre to hold back its control capability over Guangdong.

4.6.4 Intellectual Property Rights and Guangdong

The issue of Intellectual Property Rights (IPRs) has given rise to conflict between China and the United States (US) since the late 1980s. Despite the adoption of several laws on trademarks (1983, amended in 1993), copyright (1991) and patents (1985, amended in 1993), the US has criticised the practical effects of IPRs in China and has identified Guangdong province as the worst violator of IPRs in China (Isobe, 2000: 129). According to Isobe (2000), Guangdong province finally began to tackle the problem of violation of IPRs in the province in September 1995. The Guangdong Party Vice Secretary (Huang Huahua) was selected to head a leading taskforce to expose the level and scope of violation. Despite evidence of large-scale production of pirated versions of CDs, LDs and computer soft-wares, Huang acknowledged the possibility that production of pirated versions could be repeated and criticised the local support given in some areas to illegal production. Guangdong province also began to introduce laws to prevent pirated versions. However, finding the pirate production sites was extremely difficult because they frequently moved to underground factories. In addition, at the level of local governments (county, township and basic units), local leaders offered protection to the production and sales of pirated copies, and hence the behaviour of these leaders towards the exposure of violation was negative.

This example shows that decisions at the centre cannot always be carried out properly in localities. One of the main problems in this case is that of local protectionism, especially at the sub-provincial levels. As the local governments (under the county level) manage local firms (i.e. TVEs) and depend on the revenue of those firms, they are unlikely to accuse the producers of pirated versions who contribute to local finance. Moreover, producers of pirated goods are likely to offer bribes in order to gain tacit permission for the production and sales of pirated versions. As the public security sector belongs to local government, central orders cannot be carried out immediately. More fundamentally, China's unique residence register system (*hukou*), restricting the movement of people between rural and urban areas, tends to encourage local leaders to act in the interests of localities (Hang, 1994). Thus, at the basic level, these factors create major obstacles to the resolution of the problem of IPRs. The centre's control can reach the provincial-level government, but the centre does not have direct measures to control leaders at the basic level. The excessive concentration of power to local Party committees also makes it impossible for the state authorities (prosecutors) to intervene in local protectionism. Thus, at the level of local government (under the county level), the overwhelming dependence on the CCP's political leadership cannot itself help to enforce IPRs, and local protectionism often results in efforts to circumvent central control.

4.7 Conclusion

The reform of China's domestic governance along multi-level lines is the key mechanism through which the centre and SNGs have struggled to regain enforcement capacity and institutional legitimacy. The movement over the last two decades towards new forms of MLG in China has created a complex system of governance. From the state regulatory viewpoint, the establishment of various special zones has made it more difficult to identify intergovernmental relationships. In addition, there is now a much greater understanding and recognition of the political constraints on the reform of the constitutional state system. The CCP networks are extended along with the state institutions and still heavily constrain the functions of those institutions. This is very different from the way in which decentralisation is used to enhance local autonomy within a democratic state system. Stemming from China's traditional Party-state integration, and developed through

marketisation, the CCP itself is under pressure to commercialise, and the Party has already lost its constraining power over local cadres. Although the centre is the initial promoter and provider of reform processes, the forms of governance are being continuously reproduced and reshaped according to the practices of the key participant actors (the centre and localities in both state and Party organisations).

Perspectives drawn from the Open Door Policy and the changing structure and role of Guangdong province help us to understand the political dynamics of the emergence of new patterns of economic governance. The centre's adoption of the Open Door policy towards Guangdong was based on *ad hoc* measures without adequate funds and resources. The role of Guangdong's leadership (Party Secretaries and Governors) is thus vital in lobbying and gaining further concessions from the centre and representing Guangdong's economic interests. Through the implementation of the Open Door Policy, central-local relations have been greatly influenced by the rapid increase of economic power of Guangdong, especially in bargaining with the centre. Guangdong's growing fiscal power vis-a-vis the centre is remarkable, and enterprise reform and legal decentralisation also help to create a legitimate environment for the autonomous activities of SNGs. Guangdong succeeded in sending Cantonese leaders to the top ranks of provincial political authorities between the mid-1980s and late 1990s.

However, at the level of sub-provincial and sub-municipal-levels of governments, the influence of local factors has been more apparent than that of national constitutional factors. Indeed, the establishment of SEZs and open economic areas, and decentralisation within Guangdong have further accelerated the deepening of the Open Door Policy down to local governments. The result is the increasing assertiveness and often circumventing behaviour of localities. The two exemplary cases (GITIC and IPRs) examined above tell different stories of central control and the circumventing behaviour of localities in Guangdong. In the case of GITIC, the centre succeeded in taking back its control capability over the Guangdong provincial-level government, but in the case of IPRs the centre is faced with the difficulty of controlling local governments (especially under the county level). In terms of economic governance, the Party is functionally almost redundant at the basic levels of government. This reveals that the sub-provincial and sub-municipal

governments are less constrained by central control than by the control of the Guangdong provincial government. Another challenge to the central control capability over localities comes from the increasing gap between economic reality and national planning.

There is particular concern that 'the institutional foundation underpinning a secure market system in China is far from rationalized and secure' (Montinola, Yingyi Qian and Weingast, 1995: 81). Thus, the transition to MLG involves both problems and opportunities for further development. As long as the ultimate aim of Chinese leaders has been development, diverse forms of MLG as political processes have been able to evolve. However, full-scale marketisation is not yet a reality and local protectionism remains a major obstacle. Thus, the main need is to co-ordinate the political and economic dimensions of MLG, and to 'thoroughly settle the relationships between the state and enterprises and between the central and local governments' (Zhao and Zhang, 1999: 277). This is proving to be a difficult and complex process. No one can be certain what the future will bring. There are interesting debates concerning the possibility of a federal China emerging in the future and even suggestions that China already exhibits federalism in practice (Montinola, Qian and Weingast, 1995), but from the perspective of the present study a formal federal system might not be capable of accommodating the fluid and asymmetrical nature of MLG, and, moreover, even in a federal system (based perhaps on territorial provinces) there would have to be scope for the crucial role of cities and provincial sub-units. What makes it even more complicated is that the actors constituting China's MLG now include foreign firms, which are not restricted by territorial governmental jurisdictions and levels of government. These firms, especially in Guangdong, have emerged as key actors in breaking down territorial jurisdictions through the creation of CPNs. The result is an increasing fluidity, complexity and diffusion of authority that does not fit neatly into the formal territorial patterns of China's 'official' political and administrative structure. The overall impact of China's new forms of MLG on micro-regionalisation across Guangdong, Taiwan and Japan, will emerge out of the continuous interactions of Guangdong's political context, national constitutional circumstances and changing external economic forces.

¹ For example, the Multilevel Governance Conference at the University of Sheffield, June 2001, discussed the wider applicability of the MLG concept.

² Prybyla (1996) schematically presents China's administrative and hierarchical relations.

³ The figures are based on China's Fifth Census (October 2000). See Mitsubishi (2001).

⁴ At the end of 1949, there were 50 provincial-level units. In 1959, the provinces were reduced to 29 in number. In 1967, provincial units numbered 30. See Hu, Shao, and Li (1989).

⁵ After 1983, 14 cities were designated central economic cities (*jihuanlian chengshi*): Chongqing, Wuhan, Shenyang, Harbin, Ningbo, Dalian, Guangzhou, Xian, Qingdao, Shenzhen, Chendu, Changchun, Nanjing, Xiamen. In 1999, Shenzhen, Qingdao, Ningbo, Dalian and Xiamen became CSPs. However, other cities and capital cities have retained most of their administrative authority.

⁶ This provides exemption from tariffs on imports in order to encourage production by foreign firms.

⁷ For example, Chō (1998: 69) schematically explains how the Party's leading role extends into the state institutions and how vertical and horizontal state institutions interact.

⁸ The main characteristics of the Soviet administrative system were: (1) the number of levels varied from region to region; (2) local governments were subordinate to the organ of power at the same level and also to the level of government immediately above them; and (3) the local governments had many departments dealing with different kinds of work. See Chang (1995).

⁹ For example, under Deng Xiaoping's leadership, the presidents of the PRC (Li Xiannian 1983-88, Yang Shangkun 1988-93) were not even ranked in the top three CCP's hierarchical authorities. Deng Xiaoping held the top rank only at the military level and not at the level of the Party or state system.

¹⁰ According to the lists of provincial Party Secretaries and Governors in 2000, almost 60% of provincial First Party Secretaries were transferred from other provinces and 60% of Governors were promoted from local elites. See Yabuki (2000: 130-32).

¹¹ Jiang Zemin stressed the need to establish the Party's leading system among private firms in May 2000 (NKS, 5 July 2000).

¹² Since 1992, Guangdong has been the top-ranking province in China. See DKB, <http://www.dkb.co.jp/houjin/report/china/200002/>

¹³ Beijing, Shanghai and Tianjin were allowed more restrictive variation in 'sharing total revenue'.

¹⁴ The figure is from (ZTN, 1999).

¹⁵ For example, the rate of self-reliance of local finance at the provincial, city and county levels of government in 1999 was 72.3%. Central government finance transferred RMB 213.8 billion to local government finance (provincial, city and county levels). The rate of township and village finance was 101.8% and these levels transferred RMB 2.6 billion to the provincial, city and county levels of government. See Imai Kenichi (2000).

¹⁶ In terms of the proportion of price controls in total sales between 1978 and 1992, production goods declined from 100% to 18%, consumption goods declined from 97% to 6%, and agricultural goods declined from 94% to 13%. See Amako et al. (1999: 109).

¹⁷ The Party Secretaries in Shanghai, Beijing, Shandong and Guangdong were selected as members of the Political Bureau.

¹⁸ Xie Fei, a former Guangdong Party Governor, was selected as a member of the CCP Political Bureau but died in 1999.

CHAPTER 5

JAPANESE FOREIGN DIRECT INVESTMENT AND EAST ASIAN MICRO-REGIONALISATION

This chapter and the following chapter examine the international context of micro-regionalisation among Guangdong, Taiwan and Japan. The focus of this chapter is on the pattern and strategies of the Japanese manufacturing sector with particular reference to the electronics industry. In the world consumer electronics industry, the presence of Japanese firms is very strong. For example, Japanese firms dominate the following products (where the Japanese share of world production is more than 50%): VTRs, portable MDs, DVD players, car audios, fax machines, digital cameras, and many PC-related products (DVD-ROMs, etc.) (*Jetoro Sensā*, July 2001). Hitherto there has been little interest in examining the processes and consequences of spatial restructuring across southern China centred on the electronics industry from the perspective of the evolution of Japanese production networks in East Asia. In fact, Japanese firms have been the major contributors to the formation of innovative mechanisms and coordination among economic actors across boundaries.¹

This chapter offers a micro-level focus on the organisation of production across national boundaries and employs the analytical concept of 'cross-border production network' (CPN) to refer to 'the inter- and intra-firm relationships through which the firm organizes the entire range of its business activities, from research and development (R&D) and product definition and design, to the supply of inputs, manufacturing (or production of a service), distribution and support services' (Borras, Ernst and Haggard, 2000a: 1). Section 5.1 discusses the role of the government in Japanese FDI, and the characteristics of home economic governance are discussed, especially in relation to Japanese ODA (official development assistance) and FTA (free trade agreement) policy. Section 5.2 offers an historical perspective on Japanese outward FDI. Japanese FDI in East Asia has continued to grow since the late 1980s, and, despite Japan's recession in the 1990s, this trend

continues to accelerate. Section 5.3 presents the key characteristics of Japanese manufacturing FDI. The present analysis seeks to show that the expansion of Japanese FDI, especially manufacturing FDI, has had a huge impact on the development of a new hierarchical international and regional division of labour. Section 5.4 examines the processes of Japanese FDI in Hong Kong and China. Section 5.5 analyses the evolving governance of the CPNs led by Japanese electronics firms. Finally, Section 5.6 summarises the main arguments of this chapter.

5.1 The Political Economy of Japan's East Asian Policy

The relations between business and government are a crucial variable bearing upon economic performance (MacIntyre, 1994:1). Japan's foreign economic policy has contributed to Japan's re-entry into East Asia. However, despite the sharp increase of Japanese FDI in East Asia since the late 1980s, until the late 1990s the Japanese government did not give official support for regional preferential trade arrangements. Less formally, Japanese ODA has been focused particularly on East Asia (see Table 5.1). Moreover, Japanese ODA has been the largest national source of overseas aid in the world since 1989. Japan has sought to use ODA to deepen political and economic links with the East Asian region and to support its overall political strategy.

Table 5.1 Destination of Japanese Bilateral ODA, 1980-1999 (%)

Region and Year	1980	1990	1997	1998	1999
Total (\$US million)	1,961	6,941	6,613	8,606	10,498
Asia	70.5%	59.3%	46.5%	62.4%	63.2%
Middle East	10.4%	10.2%	7.8%	4.6%	5.2%
Africa	11.4%	11.4%	12.1%	11.0%	9.5%
Central and Southern America	6.0%	8.1%	10.8%	6.4%	7.8%
Oceania	0.6%	1.6%	2.4%	1.7%	1.3%
Europe	-	2.3%	2.0%	1.7%	1.4%
Other (a)	1.2%	7.1%	18.3%	12.2%	11.7%

Note (a) includes items that cannot be categorised by region.

Source: (MOFA) <http://www.mofa.go.jp/mofaj/gaiko/oda/>

5.1.1 The Implementation of Japanese ODA

While Japanese ODA is still the largest national source of overseas aid in the world, the

specific characteristics of Japanese ODA are not well known. This is mainly because of the fragmentary implementation system of Japanese ODA and the ambiguous processes of ODA decision-making. Despite the lack of coordination across ministries (the Ministry of Foreign Affairs, the Ministry of Finance, the Ministry of Economy, Trade and Industry and many economic agencies), it can be said that the provision of Japanese ODA has a clear strategic, political and economic purpose based on the shared belief in the 'flying geese' model of development (Hook, G., 1996: 176). Japanese ODA has thus supported the expansion of Japanese firms in East Asia (Söderberg, 1996). This is especially the case with MITI (the Ministry of International Trade and Industry became METI, the Ministry of Economy, Trade and Industry in January 2001), which seeks to enhance the vertical integration of the region's economies into Japan's own economic system on the basis of a regional division of labour (Shiraishi, 1997: 189-90). Nester (1989) argues that Japan gave its manufacturers a tremendous export subsidy which enabled them to capture markets from their foreign competitors. In the case of the electronics industry, in the 1980s MITI stressed the need for a shift to a knowledge-intensive industrial structure and used various measures to assist the Japanese computer firms to become global leaders (Matthews and Ravenhill, 1994: 50-58). Thus, Japanese ODA has a complicated purpose and various implementation institutions are involved.

Table 5.2 The Share of Japanese ODA in Total Aid to East Asian Countries, 1988-1998 (%)

Country	1988	1990	1992	1994	1995	1996	1997	1998
China	56.3	51.0	50.6	61.8	54.5	51.6	47.0	66.0
Indonesia	65.8	57.2	68.8	56.9	68.5	90.9	62.9	66.6
Philippine	67.7	53.3	67.0	62.8	55.6	55.4	56.2	56.4
Thailand	70.2	57.2	59.5	70.4	80.7	82.7	77.9	62.6
Malaysia	-	81.3	80.6	-	60.7	-	-	90.4
Singapore	54.3	--	83.1	91.0	97.1	-	-	-
South Korea	-	92.1	--	-	-	-	-	-

Note: blank does not necessarily mean zero

Sources: Gaimushō (1994) *Wagakuni no Seifu Kaihatsu Enjo* (Japan's ODA White Paper), Tokyo: Kokusai Kyōryoku Suishin Iinkai, and MOFA, <http://www.mofa.go.jp/mofaj/gaiko/oda/>

With the increase of Japanese ODA, the recipient countries have also enjoyed significant benefits. Indonesia has been the primary destination of Japanese ODA because of its natural resources and strategic location for shipping routes. China has emerged as another

primary recipient of Japanese ODA since the 1980s. In 1998, all the top ten recipient countries were in Asia (MOFA). Thus, in these countries, the share of Japanese ODA in total aid is very high (see Table 5.2). However, as East Asian countries have large populations, the level of per capita assistance is small. For example, in Indonesia, the per capita level of Japanese ODA in 1994 was US\$5, and in the case of China the figure was much smaller: only US\$1.²

Japanese development assistance is now undertaken not only by the national government and ministries but also by NGOs and SNGs. While Japanese ODA led by the national government is seen to be inseparable from the country's economic interests, the idea of ODA as an international contribution has gradually gained acceptance among Japanese citizens. Japanese NGOs and SNGs have emerged as key actors to supplement the role of the national government. The number of Japanese NGOs undertaking foreign assistance projects reached 351 in 1995 (Saotome, 1997). The activities of NGOs target grass-roots social and development projects such as the improvement of the medical environment, job training, and environmental protection. Moreover, the foreign relations of Japanese SNGs are often developed through 'sister city' relations. By 1998, 26.6% of Japanese local governments had entered into such links (Ichioka, 2000: 4). For example, Japanese prefectures -- the largest unit of local government -- had been involved in 30 'sister city' programmes with China's provincial governments by 2000.³ Despite the absence of formal diplomatic relations between Japan and Taiwan, nine Japanese local governments (cities, towns and villages) had such relations with Taiwan.⁴ Also, with the rise of Japan's conception of aid as an international contribution, the activities of Japanese SNGs in development assistance projects have increased. For example, Kitakyushu city has entered into environmental cooperation with its 'sister city', Dalian (China) (Saotome, 1997: 43). Thus, Japanese ODA has become diversified in terms of forms and processes, and has begun to contribute to the building of links with East Asia at various levels.

Japanese ODA has come under the pressure of budgetary restraint and domestic concern over the inefficiency of aid. In 1998, it actually declined for the first time, due partly to the impact of the Japanese economic recession since the early 1990s, and partly to the emergence of a more inward-looking outlook among the Japanese population. There is

anxiety, for example, that Japanese ODA does not necessarily lead to the development of friendly relations. The uncertainty over the role of Japanese ODA has raised the question of the effectiveness of aid to China. Despite the relinquishment of China's war reparations claims in the Japan-China Joint Communiqué of 1972, Chinese officials often claim that Japanese ODA (reaching a total of 6,000 billion yen -- including yen loans, donations and other types of assistance -- between 1979 and 1999) has still not compensated for the damage in China caused by Japan's invasion during the war.⁵ Japanese ODA toward China is clearly not intended as war reparations, but the negative attitude towards ODA on both sides has cast doubts on future relations between the two countries (Watanabe, 2001). Moreover, according to MOFA's plan for Japanese ODA in 2002 (NKS, 29 July 2001), as a result of a sharp increase of inward FDI in China, (especially in manufacturing), MOFA insists that China is now able to collect capital from the private sector and no longer suffers from a shortage of capital inflow compared with other developing countries like Indonesia.⁶ It also stresses the need for better inter-ministerial communication and the avoidance of duplicated aid programmes. Furthermore, in the summer of 2001 MOFA began a series of town meetings to enable public debate over the efficient use of Japanese ODA. Now there is a need for much greater transparency of ODA. The decision-making processes through informal communication among business leaders, politicians and officials, which have been able to promote Japanese offshore businesses, need to be changed.

5.1.2 Japan's Developmental Norms

Japan's developmental state model, originally offered as an explanation of Japan's own economic success, was subsequently applied to explain the pattern of development of East Asia under the name of the 'flying geese' model (see Chapter 2). The argument is that under Japan's leading role as a supplier of high technology, the East Asian countries are following in second- and third-tier positions. Japan itself has made constant progress in the shift of industrial production, moving from textiles, shipbuilding, steel and chemicals in the late 1950s and 1960s to consumer electronics and automobiles in the 1970s and 1980s, and then to high technology and computer and information industries in the 1990s (Hook et al., 2001: 199). The geographical shift from low-tech manufacture to more sophisticated products has continued in East Asia, as is illustrated by the cases of the shipping industry

and electronics industry in South Korea. In the case of the electronics industry, portable cassettes, CD players, FDDs, and CD-ROMs were once produced in Japan, but during the 1980s and 1990s they were produced increasingly in Taiwan and ASEAN. In ASEAN, the first production site was in Singapore and new sites such as Malaysia and Thailand were added (Kuroda, 2001: 192). In the technology-transfer processes, leading Japanese firms have played a major role. For example, when Samsung (one of the largest electrical goods firms in South Korea) shifted its primary products from textiles to electronics in the 1970s, the establishment of joint ventures with leading Japanese firms (Samsung-Sanyo in 1969 and Samsung-NEC in 1970) was helpful in acquiring a number of different technologies in the production of electrical goods. These partners provided essential training for Samsung's employees (Kim, 2000: 144-5).

The apparent success of the developmental state model in the 1980s influenced the Japanese policy-makers such as MITI and other economic ministries. The close cooperative relations between government and the private sector in Japan have been called the 'developmental state' (Johnson, 1982). According to Moon and Prasada (1994), the developmental state is 'a state structure characterized by executive dominance, bureaucratic unity, and the technical competence of bureaucrats; a large pool of policy instruments, selective and strategic use of resources and instruments; and the political capability to insulate economic decision-making and implementation from contending political and social interest'. Bello (1998: 437) describes the East Asian model as an activist, interventionist state with strong government discipline of the market and the private sector, preferential access by domestic companies to the local market, and industrial targeting. In the case of the Japanese model of state intervention, MITI (or METI) has played a vital role, for example through government-business consensus-building, tax incentives, credit allocation through the Bank of Japan, financial intermediation, import and foreign investment controls, the licensing of foreign-technology imports, and direct subsidies to research and development projects (Kuznets, 2000: 50). Japan's developmental model has since been transferred to East Asia because of its effectiveness in bringing the state and the private sector together to achieve economic growth.⁷

However, Porter and Takeuchi (2000) conclude that the Japanese ministerial elite model has resulted in excessive intervention in industry, thereby hindering productivity and prosperity. They identify 12 interventionist policy factors in this model.⁸ Successful cases of state intervention include the electronics industry (IC, VTR, facsimile machines, home audio visuals, car-audios, type-writers, and satellite communication machines). However, the authors point out that this model is more applicable to cases of unsuccessful industries such as securities, aircraft, chemicals, software, detergents, clothing, and the chocolate industry (Porter and Takeuchi, 2000: 61). MITI's intervention has often failed. When Honda (one of the leading Japanese automobile makers) sought to participate in the automobile industry in the 1960s, MITI obstructed Honda's entry because it had a reform plan to reduce the number of car producers into two or three major groups (ibid.: 59).

While the Japanese 'developmental state' model and its ODA strategies have traditionally been closely associated with the concept of Japan as a leader in East Asia, its conceptual foundation was increasingly challenged in the 1990s. With the collapse of the bubble economy and an ensuing long-term recession, Japan became an example of confusion and paralysis (Funabashi, 2000-2001: 77). Japan's 'developmental state' model has not promoted a new leading exporting industry after the electronics industry. Its leading role has also been challenged by the emergence of new economic realities, including China's remarkable economic growth and the rapid development of information and communication technologies in East Asian countries (Singapore, South Korea and Taiwan). The rise of global competition has had a fundamental impact on the traditional role of the government. Japan's conventional governmental-led projects are now being replaced by private-sector initiatives, especially in FDI.

5.1.3 Japan and East Asian Regionalism

Though Japanese ODA has been linked to the norm of Japan as a leader in East Asia, the actual strategies of Japan's formal foreign trade policy have not necessarily been consistent with this norm. Japan has followed the line with the GATT and WTO system as a pillar of trade liberalisation. While Japan acknowledges the positive effects of FTAs (free trade agreements) and RTA (regional trade agreements), it has been more concerned with the potential risk of protectionism. Thus Japan exhibited a negative attitude towards FTAs until

the late 1990s except for its engagement with APEC, which stressed openness toward outsiders.

By 2000, the number of FTAs reported to the WTO reached 214.⁹ However, Japan, China, South Korea, Hong Kong and Taiwan -- all East Asian countries -- are major economies that do not participate in FTAs. The Asian Financial Crisis revealed the defects of existing regional institutions (especially APEC) as a defense against the recurrence of economic crisis. Also, in the enforcement plan for liberalisation, APEC has not yet had any visible effect (Yamazawa, 2001: 12). Thus, FTAs are increasingly seen to be a more pragmatic means of promoting liberalisation. MITI's *White Paper* in 1999 acknowledged the importance of FTAs as a step toward the development of a multilateral trading system. It highlighted the positive effects of regional agreements on the expansion of trade and investment, the harmonisation of the domestic institutional environment, and the strengthening of the system of multilateral trading functions. FTAs can be seen as a supplementary, pragmatic approach that can contribute to the development of a multilateral trading system. The *White Paper 1999* proposed that Japan actively needed to offer a model of regional cooperation and integration (Ehashi, 2001). While the major strategies still stress the role of a multilateral trading system, Japan has started to act more positively toward FTAs and RTAs as key strategies for promoting foreign trade.

In June 1998, Japan received an offer from Mexico to form a new FTA, and co-research began in February 1999. Similar offers followed from South Korea in December 1998, Chile in November 1999, and Singapore in March 2000, following the agreement between the two prime ministers in December 1999.¹⁰ Among them, the most advanced project is that with Singapore, and there is hope for a formal FTA agreement in early 2002.¹¹ Because Singapore does not have an agricultural sector, there are fewer obstacles. However, the proposed FTA will have only a limited effect on the two economies, since Singapore's customs duty rate is almost zero and Japan's customs duty on industrial products is only 1.5% (Ehashi, 2001). What is important is that Japan and Singapore see the FTA as a useful measure against China (Kikuchi, 2001).

Secondly, Japan's foreign policy toward RTAs in terms of relations with the ASEAN+3 has

revealed internal inconsistency, ministerial confusion and lack of strategy. In 1990, Malaysia's Prime Minister proposed the establishment of an EAEG (East Asian Economic Group). The US and Japan opposed this idea because it might damage the position of the US in East Asia. In 1991, the EAEG proposal was adopted by ASEAN under a new name -- EAEC (East Asian Economic Caucus) -- as a sub-organisation of APEC under US pressure. In 1994, MOFA decided that Japan's participation in EAEC needed the support of Australia and the US. Japan was asked by Australia to accept Australia's participation in EAEC. This was rejected by ASEAN. In March 1996, Japan announced its non-participation in EAEC at an ASEM meeting in Bangkok. Japan's invitation to the Mekong Development Ministerial Meeting (June 1996), organised by the ASEAN, was then cancelled. That meeting was held between ASEAN and China. Japan then announced its participation in the ASEAN+3 meeting (July 1996). At the first ASEAN+3 Summit (December 1997), the Japanese Prime Minister, Hashimoto, opposed the proposal to establish this summit as a regular event. At the second ASEAN+3 Summit (December, 1998), the Japanese Prime Minister, Obuchi, was more positive than Hashimoto about getting involved in EAEC. However, as far as the ASEAN+3 Finance Ministers Meeting was concerned, Japan was requested to oppose it by the US (through MOFA), and thus Obuchi had no choice but to do so. At the same time, MOF was a strong supporter of the Finance Ministers Meeting. When the Asian Financial Crisis (1997) occurred, regional organisations, such as APEC, were not able to respond. This time MOF's plan for setting up an Asian Monetary Fund (AMF) was opposed by the US, but MOF continued to insist on the need to achieve close financial cooperation in East Asia. As a result, the Finance Ministers Meeting was held in April 1999 and in May 2000 it agreed to financial cooperation among the ASEAN+3. Thus, Japan's RTA policy is now hindered by ministerial fragmentation, external intervention and the lack of a consolidated strategy.

5.2 An Historical Perspective on Japanese FDI

Section 5.1 demonstrated how Japanese ODA policy has remained an important supportive tool for the expansion of Japanese FDI in East Asia. In Section 5.2 we look in more detail at the changing geographical patterns of that investment since the end of the Second World War. First of all, it is essential to place those patterns in a broader regional and global

context. At the regional level, a new international division of labour based on national economies is partly being replaced by a division of labour rooted in regional and inter-firm networks. Of particular significance in terms of the present study is the declining role of the state in the global economy and the rise of new patterns of cross-border economic activities centred on the role of sub-state or sub-national activity in enhancing relations with external actors. Economic globalisation promotes more intense industrial competition among firms, and this competition is most visible at the regional scale, where specific industrial infrastructures and economic conditions shape patterns of cross-border interaction. Thus far, the Japanese economic presence in East Asia has been explained in terms of trade and investment links (e.g. the 'flying geese' model) and product cycle models, and by emphasising the importance of political and economic structural dependency (Cumings, 1987).¹² With the rise of global competition, firms have revised their production systems and moved towards more efficient production and procurement. An international division of labour based on national economies is being replaced by a division of labour rooted in regional, intra- and inter-firm networks.

Japanese FDI has contributed greatly to the rebuilding of economic links between Japan and East Asia at the micro level. In the late 1980s, Japan emerged as one of the largest sources of FDI after the United States. Japanese outward FDI accounted for between 11% and 13% of the world total outward FDI between 1989 and 1995.¹³ East Asia (NIEs, ASEAN 4 and China) is the major destination of Japanese FDI after the US and Europe (see Table 5.3). The development of interdependence between Japan and East Asia owes much to the shift of Japanese manufacturing industry from an export-led strategy (with production in Japan) to offshore production that followed the appreciation of the Japanese yen in the late 1980s. In particular, the establishment of offshore production in the Japanese electronics industry has done much to create a new international division of labour and system of production networks.

Table 5.3 The Dispersion of Japanese FDI by Country and Region, 1979-2000 (% of Total)

Country and Region	1979-83 average	1984-90 average	1991-93 average	1994	1995	1996	1997	1998	1999	2000
North America	32.4	47.4	43.6	43.3	45.2	47.9	39.6	26.9	37.1	25.3
United States	30.4	45.7	41.7	42.1	44.1	45.8	38.5	25.3	33.4	25.0
Middle and South America	18.4	11.9	8.4	12.8	7.5	9.3	11.7	15.9	11.2	10.8
Asia	25.3	12.5	17.0	23.6	24.0	24.2	22.6	16.0	10.7	12.2
China	0.2	1.1	3.0	6.3	8.7	5.2	3.7	2.6	1.1	2.0
NIEs	10.4	6.9	5.9	7.7	6.3	7.4	6.3	4.3	4.8	5.5
Taiwan	-	-	-	0.7	0.9	1.1	0.8	0.5	0.4	1.0
Hong Kong	-	-	-	2.8	2.2	3.1	1.3	1.5	1.5	1.9
South Korea	-	-	-	1.0	0.9	0.9	0.8	0.7	1.5	1.7
Singapore	-	-	-	2.6	2.3	2.3	3.4	1.6	1.4	0.9
*ASEAN 4	14.4	4.3	7.8	9.3	8.0	10.3	10.7	8.2	4.3	4.2
Europe	10.8	20.9	21.8	15.2	16.7	15.3	20.8	34.4	38.7	50.2
Other Areas	13.1	7.3	9.2	5.1	6.6	3.3	5.3	6.8	2.3	1.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: According to the categorisation of the MOF (Ministry of Finance), North America comprises the US and Canada; Europe comprises all European countries; 'other areas' refers to Africa and Oceania. ASEAN 4 includes Malaysia, Thailand, Indonesia, and Philippines. Kaku's data after 1994 are miscalculated, so the data from the MOF are used instead.

Sources: Kaku, Shishi (Guo Sizhi) (1999) *Nihon no tai Chūgoku Chokusei Tōshi* (Japanese FDI in China), Tokyo: Meitoku Shuppansha, p. 84 and MOF, <http://www.mof.go.jp/fdi/k008h2.htm/>

5.2.1 Post-war Japanese Outward FDI

Japanese outward FDI in the early post-war period was shaped by the emergence of a new political and economic order, and the requirements of Japan's war reparations. Cumings (1987) stresses that the regionalisation of production in East Asia can be traced back to the Japanese colonial period. However, post-war Japanese outward FDI did not focus on Japan's former imperial territories (Korea, Taiwan and Manchuria). Rather, it started up in south Asia (India and Pakistan) and southeast Asia (the Philippines and Indonesia) in the early 1950s. One reason for this is that there was severe anti-Japanese feeling in Northeast Asia. While the outbreak of the Korean War (June 1950) brought about an economic boom in Japan because of the need for special procurement, the start of fighting between the US and China resulted in heavy restrictions on Japan's trade with China.

The first country to which Japan agreed to pay war reparations was Burma (now Myanmar)

in 1954. Hitachi, one of the leading Japanese electronics firms, won a contract for three water hydraulic motors for power plants to supply 80% of the capital's electricity. In Burma, war reparations focused on transportation machinery and contributed especially to the exports of the Japanese shipping industry (Kobayashi, 2000: 64). This combination of war reparations and economic aid (along with the purchase of Japanese goods) became the initial model for Japan's war reparations strategy. The visit of the Prime Minister, Kishi Nobusuke, to southeast Asia in February 1957 was a turning-point for Japanese firms' advance in southeast Asia. He proposed the establishment of an Asian Development Fund (ADF) to support social and economic development in Asia.¹⁴ However, until 1972, because of the existence of exchange controls and the restrictions on outward FDI, Japanese FDI remained limited in scale. The Nixon Shock (August 1971) and the end of the fixed exchange rate resulted in the appreciation of the Japanese currency (*yen duka*)¹⁵, and the first oil shock of 1973 increased energy and production costs for corporations inside Japan. These factors inevitably raised the pressure on Japanese industries and encouraged Japanese manufacturing firms utilising an export-oriented strategy to move their production sites abroad.

5.2.2 The Plaza Agreement and Japanese FDI

The significant expansion of Japanese outward FDI began in the late 1980s, greatly assisted by the 1985 Plaza Agreement¹⁶, which stemmed from the trade tension between the US and major trading partners (European countries and Japan), and from the rise of protectionism in the US. The agreement established a coordinated strategy to push down the dollar vis-à-vis the currencies of America's major partners. This resulted in the appreciation of the Japanese yen against the US dollar and, to a lesser extent, against the major European currencies. The cost effectiveness of production for exports sharply decreased, and the loss of international competitiveness encouraged Japanese firms to move to the East Asian NIEs, ASEAN, the US, Europe and central and south America. The original tensions between Japan and the US were quickly extended to South Korea and Taiwan, which enhanced their competitiveness vis-à-vis Japanese firms. The Reagan administration and the US Congress were then faced with pressure for currency appreciation and the liberalisation of access to these countries' markets because of a sharp increase of imports from these countries. The increase of voluntary export restraints and

non-tariff barriers by the US restricted access to the US market. Furthermore, the currencies of South Korea and Taiwan were revalued.¹⁷ In addition, South Korea and Taiwan brought the generalised system of preference (GSP)¹⁸ to an end in 1989. The currencies of ASEAN and China depreciated after the Plaza Agreement, and these countries became more attractive as export platforms for Japanese FDI.¹⁹ Japanese FDI subsequently expanded in quantitative terms: its average level between 1979 and 1983 was \$US 2.2 billion per year, and this jumped to \$US 16.9 billion between 1984 and 1990.²⁰ In the four-year period 1986-89 Japanese FDI increased at an average annual rate in excess of 50%.

In terms of the destination of Japanese outward FDI, Table 5.3 shows that the US was the largest single destination until it was overtaken by European countries in 1998.²¹ Japanese outward FDI in East Asia accounted for more than 20% of the total until the Asian financial crisis of 1997. In 2000, Japanese outward FDI in Asia did not fully recover. In that year, Europe was the major destination of Japanese outward FDI, accounting for more than 50% of the total. In particular, the UK was the single largest destination -- far ahead of other countries.²² The NIEs and the ASEAN 4 were the largest destinations of Japanese FDI in the 1980s. China has steadily gained in importance as a destination of Japanese FDI, and in 1995 ranked above the NIEs and the ASEAN 4. However, since 1996, Japanese FDI to the NIEs and the ASEAN 4 has exceeded FDI to China. It should be stressed, though, that this does not reflect the real flow of FDI. One reason is that it overlooks the reinvestment activities of Japanese subsidiaries. Another reason is the increase of reinvestment or 'roundabout' FDI through Central American island countries such as the Cayman Islands. For example, Japanese FDI to the Cayman Islands accounted for 11% of total Japanese outward FDI in 1998, 3.4% in 1999 and 5.6% in 2000.²³ Thus, it is important not to heavily rely on the official statistics for the patterns and contents of Japanese production networks.

From the perspective of the recipient countries, Japanese FDI has been an undisputed major source of inward FDI. For example, according to Chinese statistics, the average share of Japanese FDI in total inward FDI in China between 1986 and 1999 was 9.53%.²⁴ In the case of Taiwan, the average share of Japanese FDI in Taiwan's total inward

investment between 1952 and 1999 was 22.9%, and in the late 1990s it was slightly lower: at an average of 17.6% between 1995 and 1999.²⁵ In the case of South Korea, the share of Japanese FDI was 11.26% in 1999 and 15.6% in 2000.²⁶ In Hong Kong, although there are no official data on inward FDI, in 2000 the number of Japanese regional headquarters in Hong Kong accounted for 14.7% of total foreign regional headquarters in Hong Kong.²⁷

5.3 The Main Characteristics of Japanese FDI

Japan is a manufacturing country. In 1997, manufacturing industry's share of Japan's GDP was 24.23%.²⁸ But the share of manufactures in Japan's exports in 1999 was 94% (World Development Indicators). The leading top ten manufacturing firms (Toyota, Honda, Sony, etc.) account for almost 30% of Japan's total exports (NKS, 28 July 2001). The electronics industry is Japan's largest single exporting sector. In 1998, exports of electronics products accounted for 30.41% of total exports. The increase of Japanese manufacturing FDI has transformed Japanese manufacturing industry from an export-oriented industry (with production in Japan) to an industry based on offshore production. The amount of offshore production by Japanese firms already exceeds domestic production (NKS, 28 July 2001). The shift of offshore production in East Asia has dramatically increased intra- and inter-firm trade between Japan and East Asia.

5.3.1 Manufacturing FDI and Trade

According to data of MOF (the Japanese Ministry of Finance), although non-manufacturing FDI (finance, insurance and services, etc.) was also a major source of Japanese FDI in the 1990s, electronics FDI was the largest sector in Japanese manufacturing FDI. In Asia, manufacturing FDI was dominant in the 1990s. In Asia the average share of Japanese manufacturing FDI between 1990 and 2000 achieved 55.6% of total Japanese FDI in Asia.²⁹ This indicates that Japanese electronics FDI in East Asia was high compared with the world share of Japanese electronics FDI. According to Kaku (1999: 100-103), from 1987 to 1996, 63% of Japanese FDI in ASEAN was in manufacturing. In the case of China, until the 1980s, the proportion of Japanese manufacturing FDI was low, but from 1991 to 1996 it jumped to 74%. Corresponding to the shift of manufacturing bases in East Asia, the NIEs were the largest recipients of

Japanese FDI from 1985 to 1987. Then ASEAN took over the leading position as a recipient of Japanese outward FDI in East Asia. By 1995, the numbers of Japanese subsidiaries among manufacturing firms in ASEAN were: 385 in the electronics industry; 230 in the chemical industry, 163 in the automobile industry (including components); and 128 in the textile industry (Nakagawa, 1997: 15).

The increase of Japanese manufacturing FDI has produced a distinctive pattern of trade relations between Japan and East Asia. According to the data based on Hook et al. (2001) and Tsūsanshō (2000), while the US has continued to be Japan's single largest trading partner, its share has varied, and the EU and East Asia have steadily increased their shares of Japan's trade. In 1999, Taiwan was the second largest destination of Japan's exports. In the same year, China ranked third and South Korea fourth. In imports, China has sharply increased its presence in the late 1990s. It was the second largest destination for Japan's imports in 1999 and South Korea was ranked third. By 1998, Japan had become the largest national individual trade partner for China and Indonesia, the second largest for South Korea, Taiwan, Thailand, Malaysia, and the Philippines, and the third largest for Singapore and Hong Kong (Hook, et al., 2001: 197).

Except for China and Indonesia, other East Asian countries have had huge trade deficits with Japan. China has enjoyed a huge trade surplus (\$US 24.77 billion in 2000 according to Japanese figures: Keizai Sangyō Shō: hereafter Keisanshō, 2001), especially in textiles, and Indonesia has been a main supplier of natural resources for Japan. This indicates that East Asian countries have been less successful in penetrating the Japanese market. The East Asian NIEs have constantly had the largest trade deficits with Japan -- at around \$US 68.19 billion in 2000 (Keisanshō, 2001). Malaysia and the Philippines, which enjoyed trade surpluses with Japan in the 1970s and 1980s, now display the same patterns as those of the NIEs. ASEAN has had trade deficits with Japan -- at around \$US 8.92 billion in 2000 (Keisanshō, 2001). Thus, the ASEAN countries have followed the same pattern as the NIEs in terms of trade with Japan.

The trade deficits of East Asian countries are due mainly to the performance of manufacturing imports and exports such as electronics, transport and precision machinery.

Table 5.4 shows the manufactured goods trade between Japan and East Asia. In the NIEs, the trade deficit in manufactured goods is a main contribution to the trade deficit with Japan as a whole. In 1998, Japan was the largest single source of imports for Taiwan (25.8% of its total imports), China (20.4%), Thailand (25.7%), Singapore (17.7%), Malaysia (22.0%), the Philippines (25.1%) and Indonesia (19.9%), and the second largest source of imports for Hong Kong (13.7% of total imports) and South Korea (18.1%).³⁰ It is apparent that Japan has been dominant in many manufacturing sectors in East Asia. On the other hand, the US has continued to be the single largest trading partner for many East Asian countries. In 1998, the US was the largest source of exports for South Korea (17.2% of total exports), Taiwan (26.6%), Thailand (22.3%), Malaysia (21.6%), the Philippines (21.6%) and Singapore (19.9%). Japan also relies heavily on the US market (29.7% of its total exports in 2000)³¹, and manufacturing exports contribute significantly to Japan's trade surplus. In the 1990s, a triangular trade pattern emerged. According to Tsūsanshō (2000: 126), Japan enjoys a trade surplus with both East Asia and the US, but East Asia compensates for its trade deficit with Japan by a trade surplus with the US. Both Japanese and East Asian exports depend on the US market.

Table 5.4 Japan's Manufacturing Trade with East Asia, 1999 (\$US million)

Country and Region	Japan's Manufacturing Export	Japan's Manufacturing Imports	Japan's Trade Balance	
			Manufacturing Trade	Total Trade
China	22,777	35,202	-12,425	-19,653
Hong Kong	21,581	1,689	19,891	20,359
Taiwan	28,170	11,499	16,671	16,145
South Korea	22,279	11,966	10,313	6,907
Singapore	16,177	4,805	11,372	10,902
Malaysia	11,072	7,670	3,402	199
Thailand	11,175	6,132	5,043	2,466
Philippines	8,742	4,233	4,509	3,456
Indonesia	4,749	4,491	258	-7,726
US	127,771	48,856	78,915	61,460

Source: The figures are the researcher's calculations using data from Tsūsanshō (2000) *Tsūshō Hakusho 2000* (White Paper on Commerce and Trade), Tokyo: Ōkurashō Insatsukyoku.

The share of East Asia (NIEs, ASEAN and China) in Japan's foreign trade has grown significantly. In 1980, the share of these countries in Japan's exports was 25.7%, the share of the US was 24.46%, and that of European developed countries was 16.27%.³² The share

of East Asia in Japan's foreign trade increased to 29.61% in 1990, corresponding to the increase of manufacturing FDI. In 1998, East Asia accounted for 33.16% of Japan's total exports (compared with the US 30.86%, and European developed countries³³ 19.4%). Japan's imports from the NIEs, the ASEAN and China have also increased. In 1980, the share of East Asia in Japan's imports was 22.36% and this increased to 34.85% in 1998.³⁴ In other East Asian countries, there is a similar trend. The share of the East Asian countries (including Japan) in Taiwan's exports was 25.63% in 1980 and this increased to 41.9% in 1998. The share of East Asian countries in Taiwan's imports was 33.78% in 1980 and this increased to 47.12% in 1998. The share of East Asian countries in China's exports was 52.44% (compared with Japan 22.07% and Hong Kong 23.83%) in 1980, and this decreased to 47.88% (compared with Japan 16.17% and Hong Kong 21.11%) in 1998. In 1980, the share of East Asian countries in China's imports was 32.71% (Japan dominated the share with 26.44%) and this increased to 56.31% (Japan 20.18%) in 1998.³⁵

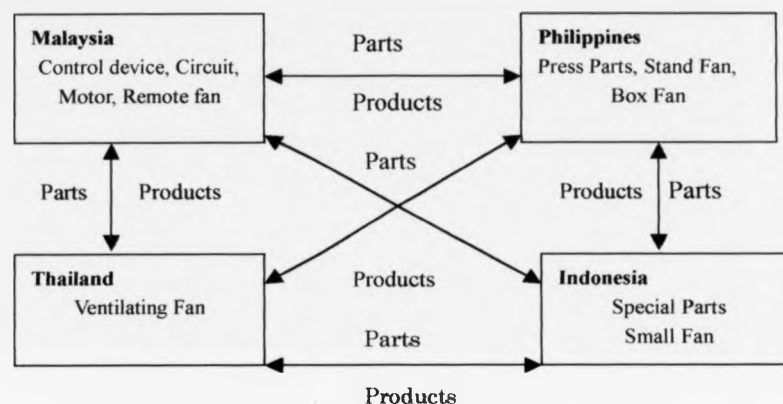
5.3.2 Intra- and Inter-Firm Trade

The growth of intra-and inter-firm trade is a major cause of the expansion of foreign trade between Japan and East Asia. In the case of Japan-China trade, almost 60% of China's exports to Japan are undertaken by Japanese subsidiaries or joint ventures in China (Shō, 2001: 30). In the case of the Japanese electronics industry in China, the finished products have often been exported to Japan, the US and the EU. For example, in 1992, the trade of the affiliates of Japanese electronics firms in Asia was largely dominated by intra-firm trade: 85% of the affiliates' purchases and almost 90% of sales were intra-firm trade (Ernst, 2000a: 83). Thus, East Asian economic interdependence has reflected the growth of Japan-centred production networks through the procurement activities of manufacturing firms.

The increase of intra-firm trade in the electronics industry has also had a distinctive impact on the triangular trade among Japan, East Asia and the US. East Asia has rapidly gained importance as a PC-related production site. According to Tsūsanshō (2000: 126), while the share of Japanese PC-related exports in total Japanese exports to the US declined between 1990 and 1998 (4.5% to 4.0%), the share of East Asian PC-related exports to Japan and the US increased rapidly (0.8% to 3.1% to Japan, 2.7% to 6.6% to the US). Thus, Japanese

manufacturing trade, especially electronics FDI, has contributed to the development of a distinctive pattern of international trade. The triangular trade has also changed with the shift of production sites from Japan to East Asia.

Figure 5.1 The Cross-Border Production Networks for Electric Fans, Matsushita Electric Industrial in ASEAN



Source: Horaguchi, Haruo (2000) 'Takokuseki kigyō no kokusai bungyō taisei to AFTA: Nikkei denshi, denki sangyō no dōkō o chūshin ni' (International division of labour of multinational corporations and AFTA: The trend of Japanese electronics and electrical industry), in T. Maruya ed. (2000) *Ajia Kokusai Bungyō Saihen to Gaikoku Chokusetsu Tōshi no Yakuwari* (Rearrangement of Asian International Division of Labour and the Role of FDI), Chiba (Japan): Ajia Keizai Kenkyūsho, p. 121.

Another important impact of Japanese FDI is its outstanding role in promoting industrial integration and liberalisation in East Asia. In ASEAN, for example, under the ASEAN Industrial Cooperation Scheme (AICO), which was started in 1996 and was regarded as a direct predecessor of the ASEAN Free Trade Area (AFTA), Japanese manufacturers are the most important players among all the multinational firms in terms of not only their contribution to deeper industrial integration in the ASEAN region but also their role as the most powerful pressure group for liberalisation (Legewie, 2000). AICO plans to exempt customs on imports and exports of components and products within the ASEAN region. Matsushita Electric Industrial and Sony were approved to use the AICO scheme by 2000. For example, Matsushita uses a mutual supply system for components and products by using the AICO scheme. Figure 5.1 shows Matsushita's production networks in the electric fan industry across the ASEAN. Matsushita's subsidiaries in the ASEAN undertake export-oriented production. A production base in the ASEAN is very important for

Japanese manufacturers, because they do not have any other cheap production base outside Asia. Japanese manufacturers need to pursue the rationalisation of the production system in their key production locations.

5.3.3 The Location and Local Sourcing of Japanese FDI

Locational decisions are of vital importance for manufacturing firms, since such firms are not very mobile. ASEAN is seen primarily as an export base.³⁶ China is selected for a variety of reasons, including better access to the domestic market, the expectation of high growth rates, cheap labour, low-cost materials, as well as its suitability as an export base. One of the main purposes of offshore production in China is to bring the products back to Japan. These production sites are established in the Yangtze River Delta, Tianjin, Dalian and Qingdao, all of which are relatively close to Japan (Kuroda, 2001: 232). In terms of opportunities for preferential treatment, the advantages of ASEAN are placed higher than those of China.

In the late 1980s and early 1990s, compared with the subsidiaries of other MNCs, the subsidiaries of Japanese firms depended much more on imported capital goods and components from Japan (Ernst and Ravenhill, 2000: 231). According to the study by Kaburagi, Noda and Ikehara (2000), in the electronics industry in ASEAN the local procurement rate by Japanese firms is higher than in other industries. In 1998, Japanese electronics firms in the ASEAN 4 exported 61.3% of their production, and by 1999 the figure had increased to 70.3%. The electronics industry is keen to expand the proportion of local procurement. For example, NEC and Fujitsu sell low-price personal computers, which use 96%-100% Asian components (Ishii, 1996: 24). This example highlights the impact of globalisation on the supply of components and helps to explain why the proportion of overseas production in Japan's manufacturing industry continues to rise at the same time as production in Japan is declining.

Belderbos's study (1997) of decisions by Japanese electronics MNCs to invest abroad suggests that inter-firm linkages are the major determinants of decisions to invest in Southeast Asia. This is because the regional core networks established by the major electronics firms are vitally important in reducing the barriers that prevent related firms

from setting up manufacturing plants there. It is worth noting that almost half of Japanese FDI is by SMEs, and the main inducements for investment abroad in such cases are the use of local labour and local sales, and the need for a production base to export to Japan. According to research by Japan's Economic Planning Agency, SMEs are more sensitive than large firms to the cost of labour and the conditions of business infrastructure (*Economic Research*, June 1998). According to research on Japanese SMEs, good infrastructure, the degree of industrial agglomeration, and the stability of the government are also considered to be very important factors (*ibid.*). Also the costs of production-related factors are still very important for Japanese manufacturers. Despite the pace of economic development in China, factory workers' salaries in Yokohama (Japan) are 32 times the level of salaries in Shenzhen (Kuroda, 2001: 115). In addition, in Japan, it is becoming more difficult for SMEs to recruit young workers with high levels of motivation or challenging minds in production work (*ibid.*: 236).

One of the major problems facing Japanese firms wanting to set up production sites abroad is that of finance. Most Japanese firms obtain their financial resources from banks with which they have lasting relationships. In the Japanese system, firms tend to act on the basis of long-term business calculations. This affects the financial behaviour of Japanese firms abroad. The amount of remittance from the corporate headquarters in Japan is only part of the picture. Nakagawa (1997) points out that in 1995 the total remittance from headquarters was 83.9% of total finance in China, because local finance for foreign firms was difficult. On the other hand, in ASEAN the amount of remittance from corporate headquarters in Japan was 43.3%, and in the NIEs it was 53.3% of total finance, in 1995. The Japanese subsidiaries in ASEAN and the NIEs actively re-invest and promote localisation. This also suggests that in ASEAN and the NIEs the agglomeration of Japanese firms is advanced, but in China, because of the difficulties of long-term financing, remittances from headquarters are still dominant. Therefore, in the NIEs and ASEAN, the total amount of real Japanese FDI is often twice as much as the official financial accounts suggest. This high scale of re-investment reflects the strong confidence of Japanese firms in the NIEs and ASEAN, where Japanese firms have gained high and stable returns. In terms of manufacturing FDI, the electronics industry is especially active in re-investment, because in order to respond to rapid technological innovation continuous investment is

required (Murakami, 1998: 99).

5.3.4 Japanese Electronics FDI

In terms of the expansion of the electronics industry, Japan's nine leading firms (Hitachi, Toshiba, Mitsubishi, Matsushita, Sony, Sharp, Sanyo, NEC and Fujitsu) have actively established production bases abroad. By 1999, Matsushita had established 211 foreign subsidiaries, and other firms -- Toshiba (95), Mitsubishi (91), Hitachi (106), Sony (84), Sharp (51), Sanyo (94), NEC (99), and Fujitsu (75) -- had also set up many foreign branches.³⁷ If we include the number of subsidiaries of family firms, the totals increase. For example, five Matsushita family firms (Matsushita Communication Industrial, Matsushita Electric Works, Matsushita Electronic Components, Matsushita Refrigeration, Matsushita-Kotobuki Electronics) had established 79 foreign subsidiaries by 1999. According to Fujita and Hisatake (1999), in 1975 these nine companies had a total of 285 production sites, and the number increased to 689 by 1994. This included an increase in the number of domestic factories from 211 to 354, and in the number of foreign factories from 74 to 335. In East Asia, the number of factories increased from 40 to 163; in North America from 7 to 80; and in Europe from 7 to 67. The overseas production of the nine companies clearly focuses on East Asia, North America and Europe. In the same period the number of research institutes (R&D) increased from 24 to 115 in Japan and from 1 to 32 abroad (East Asia 0 to 6; the US 1 to 18; Europe 0 to 1) (Fujita and Hisatake, 1999).

The increase in overseas production as a result of Japanese FDI has had a major impact on the structure of operations of production and the operating profit of Japanese electronics firms. By 1994, in colour TV production Sharp's overseas production ratio accounted for 86% of total TV production and Sanyo's overseas production ratio in video cassette players was 71% of total production.³⁸ In 1999, 69.1% of Sony's operating profit, 39.7% of Toshiba's, 25.7% of Sanyo's, 25.7% of Matsushita's, and 26.8% of Sharp's operating profit came from abroad. In particular, Matsushita has gained 77.7% of its profit from overseas operations in Asia and the south Pacific (based on *NKS*, 7 July 2000). In 1999, Toshiba also gained more than half of its overseas operating profit in Asia (*NKS*, 7 July 2000).

5.4 Japanese FDI in Hong Kong and China

5.4.1 Japanese FDI in Hong Kong

For Hong Kong, the US and Japan have been the major sources of inward FDI. In 1974 inward FDI from the US (49.6%) and Japan (15.4%) accounted for 65% of total inward FDI in Hong Kong, and in 1980 it was 62.9% (US 40.2% and Japan 22.7%) (Mok, 1997: 138). Japanese FDI continued to increase and in 1990 Japanese accumulated FDI for the first time exceeded that of the US, accounting for 31.5% of Hong Kong's total accumulated inward FDI (Sakura Sōgō Kenkyūsho, 1992: 49-50). In terms of industrial sector, the share of electronics FDI dominated Hong Kong's inward FDI in the 1970s (i.e. 34.9% in 1971, 35.6% in 1974, 26.1% in 1977 and 21.6% in 1980) (Mok, 1997: 135). The share of the US and Japanese FDI statistically declined through the 1990s. This was due to a change in the pattern of investment in Hong Kong, partly in order to minimise the risk of investment accompanying Hong Kong's reversion to China. In 1999, the British Virgin Islands (\$US 118.6 billion) were the top investor in Hong Kong, mainland China (\$US 104.5 billion) was second, and Bermuda (\$US 40.0 billion) was third.³⁹ However, these figures do not reflect the actual origins of capital flows. The increase of central American islands' share of Hong Kong's inward FDI is largely due to the increase of Taiwanese 'roundabout' FDI through these island countries. The presence of foreign firms can be seen in the figures for the number of regional headquarters and regional offices in Hong Kong. In 2000, the number of US regional headquarters accounted for 24.6% of all regional headquarters in Hong Kong, and Japanese headquarters accounted for 14.8%, exceeding the UK (9.4%) and mainland China (8%). In terms of the number of regional offices, Japanese regional offices accounted for 22.9% of the total in 2000, exceeding the US (16.66%) and mainland China (7.4%).

Almost one in ten of the overseas firms headquartered in Hong Kong use it as a site for manufacturing production operations, and Japanese firms are the leading foreign investors in Hong Kong's manufacturing sector.⁴⁰ At the same time, Japanese non-manufacturing sectors, including the finance and banking sector (26.7% of total Japanese FDI in Hong Kong: 1951-95) and wholesale and retail sectors (25.5% of total Japanese FDI: 1951-95), are large investors in Hong Kong. The Japanese banks hold a high proportion of Hong

Kong's borrowing from foreign banks.⁴¹ Aided by a supportive business environment, Japanese manufacturing FDI in Hong Kong has gained a strong presence, accounting for 10.1% of total Japanese FDI in Hong Kong between 1951 and 1995.⁴² In 1997, the figure was 30.9%; in 1998 17.9%; in 1999 13.9% and in 2000 10.5%.⁴³ Among Japanese manufacturing FDI in Hong Kong, electronics investment is the largest single source, accounting for 31.9% of Japanese total manufacturing FDI between 1951 and 1995. By 1999, all nine leading firms had established subsidiaries in Hong Kong: Matsushita (4), NEC (4), Sanyo (4), Sharp (1), Sony (3), Hitachi (4), Toshiba (2), Mitsubishi (3) and Fujitsu (2).⁴⁴ Hong Kong's advantages of geographical location, strong transportation and communication infrastructures, free and open trade, professional administration, a fair legal system, and liberal taxation policies have all attracted Japanese electronics FDI. For Hong Kong, Japan is the second largest source of imports following China and the third largest country for exports. With the rise of electronics investment, electronics products have been the major trading commodities between Japan and Hong Kong. In 1999, they accounted for 36.5% of Japan's exports to Hong Kong and 31.7% of Japan's imports from Hong Kong (Tsūsanshō, 2000).

After Hong Kong's expansion into Guangdong province in China, many Japanese electronics firms have invested in Hong Kong with the purpose of reinvesting in China. Some firms use their own subsidiaries in Hong Kong, and others utilise joint-firm arrangements with Hong Kong firms. In addition, even without the base in Hong Kong, some firms utilise the processing trade networks of the Hong Kong firms with which they have equity relations. The number of Japanese FDI projects in China via Hong Kong was estimated to have reached at least 132 by 1996, and the number of Japanese FDI projects via Taiwan had reached 12 (Tōyō Keizai, 1996). Sanyo, for example, has invested in Shenzhen through its subsidiaries in Hong Kong; it has established joint-venture enterprises for a variety of products. It is also estimated that about 80% of Japanese FDI in Hong Kong is re-invested in Guangdong (Matsuzaki, 1997: 160). Thus, Hong Kong is used as the central 'gateway' to China, and its intermediary function for the operation of production activities in Guangdong is crucial.

5.4.2 Japanese FDI in China

Despite geographical proximity, according to official Chinese statistics Japan has lagged behind the US in terms of FDI in China. Japanese companies have been more prudent investors than those of the US in the case of China. The major reasons for this are: different financial structures in the two countries, a fear of political instability, a lack of knowledge of Chinese business conditions. However, more importantly, Japanese FDI in East Asia uses offshore production sites as export platforms rather than direct entry into the domestic market. In statistical terms, Japanese FDI in China has not always been measured correctly, because much of it has been channeled via subsidiaries in Hong Kong and Taiwan (as well as other third countries).

Table 5.5 Japanese FDI in China, 1979-2000

Year	Chinese Statistical Data			Japanese Statistical Data	
	Number of Contracts	Value of Contract Investment (\$US 100 million)	Value of Utilised Investment (\$US 100 million)	Number of Contracts	Value of Registered FDI (\$US 100 million)
1979-83	52	9.5			
1984	138	2.0	31.1	66	1.1
1985	127	4.7	3.2	118	1.0
1986	94	2.1	2.0	85	2.3
1987	113	3.0	2.2	101	12.3
1988	237	2.8	5.1	171	2.9
1989	294	4.4	3.6	126	4.3
1990	341	4.6	5.0	165	3.4
1991	599	8.1	5.3	246	5.7
1992	1,805	21.7	7.1	490	10.7
1993	3,488	29.6	13.2	700	16.9
1994	3,018	44.4	20.8	636	25.6
1995	2,946	75.9	31.1	770	45.9
1996	1,742	51.3	36.8	365	26.0
1997	1,402	34.0	43.3	258	20.0
1998	1,198	27.4	34.0	112	10.0
1999	1,167	25.9	29.7	76	7.4
2000	1,614	36.8	29.2	102	10.2

Sources: *Zhongguo Duiwai Jingji Maoyi Nianjian 1999 2000, 2001*; Nicchū Keizai Kyōkai (1999) *Nicchū Keizai Kōryū 1998nen* (Japan-China Exchange in 1998), Tokyo: Nicchū Keizai Kyōkai; Mitsubishi (2001) *Chōgoku Jōhō Handobukku* (Information on China), Tokyo: Sōsōsha, and *Jetoro Chūgoku Dēta Fairu 2000*

The full scale of Japanese FDI in China emerged in the 1990s (see Table 5.5). There is a huge gap between the Japanese and Chinese figures, especially in terms of the number of

contracts. One possible reason is that in the Japanese figures small amounts of FDI may not be counted. Table 5.6 reveals the dispersion of Japanese FDI in East Asia. In 2000, China was the top destination. However, Hong Kong and Thailand are still the top destinations of Japanese FDI. One of the main characteristics of Japanese FDI in China is its concentration in electronics investment. Indeed, Japan's leading electronics firms rushed into China in the 1990s (Kaku, 1998: 19-23). Between 1991 and 1996 the share of Japanese electronics FDI in China was 19.06% of total Japanese FDI in China (ibid.: 13).

Table 5.6 China's Position in Japanese FDI in East Asia, 1996-2000 (%)

Country	1996	1997	1998	1999	2000
China	21.6	16.3	16.3	10.5	16.8
Indonesia	20.8	20.7	16.5	12.8	7.0
Hong Kong	12.8	5.7	9.2	13.6	15.8
Thailand	12.1	15.3	21.0	11.4	15.7
Singapore	9.6	15.0	9.8	13.4	7.1
Malaysia	4.9	6.5	7.9	7.3	3.9
Philippines	4.8	4.3	5.8	8.6	7.7
Taiwan	4.5	3.7	3.4	4.0	8.6
South Korea	3.6	3.6	4.6	13.7	13.7
Others	5.3	8.9	5.5	4.7	3.7

Source: Mitsubishi (1999, 2000 and 2001 editions) (*Chūgoku Jōhō Handobukku* (Information on China), Tokyo: Sososha).

Table 5.7 shows the geographical dispersion of Japanese FDI in China. Until 1990, Guangdong was the third largest recipient of Japanese FDI following Liaoning and Beijing. In the 1990s, Guangdong fell to fourth position after Shanghai, Liaoning and Jiangsu. This suggests that with the sharp increase of Japanese manufacturing FDI in China, Shanghai and Jiangsu have become the main targets of Japanese FDI. However, in terms of electronics investment, the presence of Guangdong in Japanese FDI is remarkably high. By 1998, the total number of subsidiaries of these firms in Guangdong was 206, greater than the number in Liaoning (123) and Jiangsu (118), and lower only than Shanghai (248) (*Chūgoku Shinshutsu Kigyō Ichiran* 1999). Japanese electronics FDI has a unique geographical interest in the Yangtze River Delta area and in Northeast as well as southern China. By 1999, Matsushita, for example, had established 36 subsidiaries in China (out of a total 211 overseas subsidiaries), Sanyo had established 29 (out of a total 94), Hitachi 26 (total 106), Toshiba 14 (total 95), Fujitsu 13 (total 75), Mitsubishi 15 (91), Sony 5 (total

84), Sharp 5 (total 51) and NEC 14 (99). Matsushita is the most advanced Japanese electronics firm in terms of investment in China. By 1999 its regional dispersion was as follows: Beijing (6), Tianjin (2), Shanghai (4), Hubei (1), Liaoning (3), Jiangsu (3), Zhejiang (4), Fujian (2), Shandong (3), Henan (1), Guangdong (8). Thus, on the basis of the dispersion of subsidiaries, Matsushita has favoured Guangdong. By 2000, Matsushita employed 34,447 workers in China (including 280 Japanese staffs) (*Kokusai Bōeki*, 14 August 2001). The locational strategies of Japanese electronics firms are also based on product characteristics. For example, in the case of notebook PC production, by 2001 Toshiba and Sony had established a production site in Jiangsu for China's domestic market (Mizuhashi, 2001 and *NKS*, 16 November 2001).

Table 5.7 Japanese FDI in China by Region, 1987-1996 (\$US 10,000, %)

	1987-1990	Average Share, %	1991-1996	Average Share, %
Coastal Total	105,527	95.6	1,936,865	92.90
Jiangsu	5,536	5.0	374,778	17.97
Liaoning	27,748	25.1	294,430	14.12
Shanghai	7,834	7.1	456,483	21.90
Guangdong	13,538	12.3	204,738	9.82
Shandong	7,739	7.0	160,264	7.69
Beijing	15,761	14.3	79,635	3.82
Tianjin	6,212	5.6	86,641	4.16
Zhejiang	1,936	1.8	118,905	5.70
Hebei	1,844	1.7	70,665	3.39
Fujian	5,064	4.6	53,835	2.58
Hainan	9,984	9.0	26,059	1.25
Guangxi	2,331	2.1	10,432	0.50
Inland Total	4,841	4.4	147,744	7.10
Total in China	110,368	100.0	2,084,605	100.00

Source: Kaku, Shishi (Guo Sizhi) (1998) 'Nihonkigyō no tai Chū shinshutsu ni tsuite' (Advance of Japanese firms in China), *Keizai-gaku Nenshi* (33).

In the case of Guangdong, Japanese OA equipment and precision makers have played an important role in developing industrial agglomeration in electronics industry. Although the initial electronics investment was undertaken by Hong Kong firms and then Taiwanese firms, the concentration of Japanese OA equipment and precision makers in Guangdong is also remarkable.⁴⁵ The leading camera firms, such as Canon and Ricoh, have moved their production sites from the NIEs to China. Canon (Zhuhai), Olympus (Shenzhen) and Kyocera (Dongguan) produce not only assembly products but the key components of

cameras. The leading OA equipment firms, such as Seiko Epson (Shenzhen) and Fuji Xerox (Shenzhen), also produce printers in Guangdong. Canon (Zhanjiang) produces toners and Ricoh (Shenzhen) makes colour printers.

The performance of Japanese electronics firms in China varies. Among the top 500 foreign firms in China in 1997, there were 22 Japanese electronics firms. In the case of four Japanese subsidiaries, exports accounted for 100% of sales (Seiko Epson in Shenzhen, Mitsumi in Tianjin, Ricoh in Shenzhen, and Mabuchi in Dalian). The figure was over 90% in the case of another 12 firms. In 1997, three Japanese firms – Ricoh (OA equipment), Sanyo (consumer electronics), and Hitachi (the largest comprehensive manufacturer of electrical machinery) – were listed in the largest ten foreign firms in Shenzhen (Nihon Kokusai Bōeki Sokushin Kyōkai, 1999: 223). As far as China's domestic market sales are concerned, the business performance of Japanese firms has not been very good. The major reason is severe competition with local brands, and imported products through smuggling, oversupply, falls in price, the difficulties involved in creating sales networks, troubles in collecting credit with partner firms, and a gradual business recession since 1993 (Kuroda, 2001: 41). This has inevitably been reflected in the poor performance of Japanese electronics firms, as indicated by the decline in sales of firms that rely on the domestic market. Many Japanese investment projects have been withdrawn from China. For example, in 2000, 213 Japanese firms closed their subsidiaries in Shanghai (Shin, 2001: 18). In general, it seems that Japanese firms which use China as an export base have a better performance than those that focus on the domestic market (ibid.: 21).

In terms of the type of investment of Japanese electronics firms in Guangdong, Sanyo and Matsushita illustrate contrasting patterns. Sanyo uses Hong Kong subsidiaries as the base for managing business activities in Guangdong, with a focus on the Shenzhen area. The form of Sanyo's investment is a joint investment with affiliated firms and Nissho Iwai, one of the leading Japanese trading companies (*Sōgō Shōsha*). The Matsushita group has invested directly in Guangdong by establishing joint firms with local Chinese firms. Matsushita procures capital, human resources, and technology experience within its group. In Guangdong Matsushita has established production sites in Guangzhou, Xinhui, Zhuhai and Shunde. In Shenzhen, Matsushita has only a sales and service firm. Thus, in many

ways, Sanyo's strategy for investing in Shenzhen (through Hong Kong) has become a model for other Japanese latecomers (Seki, 2000: 203).

5.4.2.1 The Role of Sōgō Shōsha

As in the case of Sanyo, Japanese trading companies, known as *Sōgō Shōsha*, have often served as intermediaries for Japanese investors in China. They have more than 100 years experience as commission merchants and now comprise the core of the major Japanese *keiretsu* groups (on *keiretsu*, see Section 5.5 in this chapter).⁴⁶ They have brokered many major (not only Japanese) investment projects in China and have also worked with investors from other countries of the world (H. Wang, 2001: 96). Between 1979 and 1996, 23.3% of all Japanese subsidiaries in China were brokered or jointly invested with *Sōgō Shōsha* (Kaku, 1999: 137). The latter have widespread networks in China as a result of their long tradition of doing business in that country. Over the years their numerous offices and experienced employees have developed many useful *guanxi* connections with Chinese officials (on *guanxi*, see Chapter 7). This advantage has attracted Japanese firms which did not themselves have a good knowledge of local production in China. However, compared with other industrial sectors, only a small amount of Japanese electronics FDI has been through *Sōgō Shōsha*. This is because Japanese electronics firms have already established their own sales networks (ibid.: 140).

5.5 The Governance of Production Networks

Japanese manufacturers have shown a capability to develop a vertically integrated form of governance of their production systems. However, in the case of the electronics industry, the traditional approach to organising production networks is being replaced by economies of scale and scope, strategic alliances, and the outsourcing of production. This section discusses how these changes have affected the reorganisation of Japanese production networks.

5.5.1 Keiretsu

Among Japanese companies, M&As (mergers and acquisitions) and TOBs (take-over bids) are not very common: about 90% of Japanese FDI is based on the establishment of new

subsidiary companies (Tōyō Keizai, 2000). According to the UNCTAD, Japan's cross-border M&As in 2000 were worth \$US 15.5 billion, which was far smaller than the respective figure for the US (\$US 324.4 billion).⁴⁷ The governance structures of production networks are sensitive to the peculiar features of national institutions and markets. One of the main characteristics of Japanese inter-firm relations is described as *keiretsu*, a network which includes a lead firm, affiliates and subsidiaries, sub-contractors, suppliers, service providers and other firms participating in cooperative arrangements. The six major *keiretsu* groups are the Mitsubishi, Mitsui, Sumitomo, Fuyō, Sanwa, and Ichikan groups.⁴⁸ Firms of these groups centre around a main bank and/or a trading firm, and are held together by financial, personal and other types of relations. The lead electronics firms belong to these *keiretsu*; Toshiba (Mitsui), NEC (Sumitomo), Hitachi (Fuyō, Sanwa, and Ichikan), Sharp (Sanwa), Fijitsu (Ichikan), etc. Each lead electronics firms organises its own *keiretsu*. The inter-firm relations of *keiretsu* in terms of stock relations vary. For example, in the case of a subsidiary company, the lead firm holds the power of equity control (majority voting rights at the general meeting of stockholders: more than 50% of stock). In the case of an affiliated company, the lead firm holds a certain equity share (usually more than 10% of stock) and has a strong influence on the management of the firms through personnel, capital, technology and business transactions. But a lead firm may not hold the power of equity control through stockholding over sub-contractors, suppliers, service providers and other firms participating in cooperative arrangements.

The lead firm organises the processes of assembly and the suppliers form the multi-layered division of labour among subcontracting firms. The network is organised in a centralised manner. As most Japanese sub-contractors are small, in general they are supplied parts and components from the lead firm, and they can gain the profit through assembly fees (*Nikkei Business*, 6 and 13 August 2001: 27). The Japanese *keiretsu* relations have enabled firms to maintain long-standing partners for the supply of capital goods and components in order to minimise risk. The merit of long-standing partnership is that it enables cost reduction by cutting adjustment costs, trust-building costs, search costs, negotiation costs, and monitoring costs (Kaku, 2000: 60). As local suppliers in ASEAN and China still have problems in relation to quality, delivery times, and after service, the subsidiaries of Japanese firms rely on intra-firm trade. When Japanese firms began to focus on more

export-oriented production in ASEAN in the 1980s, this trend of Japanese networks was closed to outsiders. In order to minimise risk and reduce the time-consuming process of building local capabilities through 'trial-and-error', and since Japan is a latecomer in international production, it has tended to maintain closed and centralised production networks (Ernst and Ravenhill, 2000: 235).

As Kaku (2000) explains, the transfer of such Japanese inter-firm relations in East Asia is carried out through joint investment between *keiretsu* firms (affiliates) and non-joint investment by small and medium firms (sub-contractors, suppliers, service providers and other firms). First, Japanese FDI is often conducted through joint investment with *keiretsu* affiliates. The lead firms do not invest alone but invest with the affiliated companies by establishing 100%-owned subsidiaries or joint firms with local firms. In East Asia, governments often impose the duty on investors to establish joint firms with local firms. For example, among 79 Matsushita's subsidiary firms in ASEAN and China, 40 firms are based on joint investment in which more than two of Matsushita's *keiretsu* firms participate (Kaku, 2000: 61). Thus the Beijing Matsushita Color CRT Co. Ltd. was a joint venture funded by Matsushita Electric Industrial (25% of equity), Matsushita Communication Industrial (25%) and Beijing Huadian (50%). In the case of Hitachi, there are 27 cases out of a total of 46 subsidiaries in ASEAN and China which have a form of joint investment by Hitachi family firms (ibid.: 61). Furthermore, the form of joint investment by the affiliated companies is another characteristic of Japanese electronics investment. The lead and affiliated firms often develop complementary relations. For example, Matsushita has used the networks and specialities of affiliated companies by establishing joint investment firms, and affiliated firms have utilised the networks, market share, sales and technology of the parent firms. In addition to these forms, the small and medium firms (sub-contractors) without joint capital relations with the parent firms have proceeded with the shift of production sites of the parent and affiliated firms. Despite the lack of equity relations, cooperative relations between the lead and affiliated firms, and small and medium firms, are another feature of Japanese electronics FDI. Here the form of joint investment participated in by the *keiretsu* group (having either equity relations or cooperative relations in the Japanese market), which is organised by centralised management, has determined the nature of the inter-firm division of labour and inter-firm cooperative relations centred

on the leading Japanese electronics firms.

5.5.2 The Evolution of Production Networks

The heavy reliance on intra- and inter-firm networks based on a division of labour for sourcing components is now rapidly changing. Centralised and relatively closed production networks centred on the lead firm cannot respond to the demands of the market. The change of technology from analog to digital highlights several disadvantages of conventional intra- and inter-firm relations in the electronics industry. Furthermore, the computerisation of electrical and electronics products requires enhanced technological cooperation between computer firms and consumer electronics firms. The disadvantage of centralised and relatively closed production networks is the inflexibility of arrangements with sub-contractors (Ernst and Ravenhill, 2000: 239). The *keiretsu* and its inter-firm relations have developed on the basis of a regional and inter-firm division of labour in Japan. With the rise of global competition, this system is likely to present obstacles to firms searching for international procurement, greater economies of scale, and a more rapid development cycle. Also, the *keiretsu* has now become too big. For example, the Toshiba group consists of 328 group companies, and Fujitsu consists of 517 group companies.⁴⁹ The introduction of rationalisation and internationalisation to reduce dependence on high-cost domestic supply sources is now necessary.

Forming alliances is one of the options to reduce production costs and increase economic scale. Since the late 1990s, Japanese electronics firms have started to form alliances with foreign firms. For example, NEC and Hitachi decided to establish a joint venture to design and develop future generations of computer memory chips (*Financial Times*: hereafter *FT*, 24 June 1999). Forming an alliance is not confined to Japanese firms. The rapid development of communication equipment has become a major area for establishing cooperative relations. Siemens (Germany) and NEC agreed to establish a joint venture to produce cellular phones (*FT*, 19 November 1999). Qualcomm (US telecommunications equipment manufacturer) and Hitachi agreed to establish a joint venture. Alcatel (French telecommunication equipment) and Fujitsu agreed to form a joint venture in mobile phone communications systems (*FT*, 3 May 2000). Hitachi and Matsushita plan to establish an alliance to develop digital appliances in refrigerators, air conditioners and other industries

(*FT*, 22 May 2001). As a result of the Sony-Ericsson alliance in the mobile phone business in April 2001, Matsushita and NEC agreed to form an alliance to respond to the new generation of mobile phone production in the world market (*NKS*, 21 August 2001). Thus, alliance-formation has had a major impact on the *keiretsu* system.

Outsourcing and restructuring are other alliance options for cost efficiency. According to recent research by *Nihon Keizai Shinbun* (9 August 2001), almost one-third of Japanese manufacturing firms produce by using outsourcing production. Moreover, nearly half of leading Japanese manufacturers intend to raise their share of offshore production within three years, and 22% intend to cut domestic production. In the electronics industry, the life cycle of products has been shortened and prospective market demand is becoming difficult. In order to minimise the risk of market changes, the outsourcing of production contributes to the flexibility of coordination of production. In electronics production, a contracting manufacturing system has become popular for outsourcing. This includes OEM (original equipment manufacturing). Recently EMS (Electronics Manufacturing Service) has emerged as a new form of contract manufacturing -- from the development, design and procurement of electronics products to production. EMS was developed as a new form of production system in the 1990s, mainly by US firms. EMS became well known in Japan when Sony sold its two factories (in Miyagi prefecture and Taiwan) to the leading EMS firm, Solelectron (based in Silicon Valley, US), in 2000. Japanese electronics firms suffer from the burden of sustaining inefficient production sites (because of high labour costs) in Japan. The leading Japanese electronics firms began to restructure and reduce employment in the summer of 2001.⁵⁰ The Japanese conglomerates now lack the scale or focus to compete effectively (*The Economist*, 1 September 2001). In particular, as a result of the specialisation of Taiwanese electronics firms in PC-related products (through the experience of OEM and ODM), Taiwanese firms have emerged as major outsourcing units for Japanese PC-related firms, not only in outsourcing production but also in contract made-to-order computer chips and production (EMS). Taiwanese firms have strengthened their cost competitiveness by shifting their production sites to mainland China. The Japanese *keiretsu* system has been faced with a major challenge from these emerging firms. In order to achieve cost-efficient management, NEC, for example, intends to separate its semiconductor production factories and transform them into a new EMS firm (*NKS*, 9

August 2001). Thus, though there are variations in response to global competition, outsourcing production and the emergence of the EMS production system are replacing (or restructuring) the *keiretsu* system, which has traditionally been based on long-term retail relations.

5.5.3 Small and Medium-Sized Enterprises (SMEs)

One of the key features of the Japanese electronics industry is the important role of SMEs.⁵¹ The reform of the *keiretsu* system in Japan, and the increasing outsourcing production of the lead firm to foreign firms, have raised the question of the relevance of conventional inter-firm relations, especially with sub-contractors, which are almost all SMEs. For example, in the electronics parts industry alone, there are about 520,000 Japanese SMEs.⁵² In the case of the southwest of Tokyo, the SMEs have undertaken assembly production by being supplied parts and components from the lead firms. The assembly production of Japanese SMEs has relied heavily on the lead firms (i.e. research and development, distribution of finished products). Although SMEs undertake the OEM production for leading Japanese electronics firms, in the restructuring of the production system, SMEs are now faced with a choice: whether to develop offshore production with client firms or to focus on the improvement of domestic production. A Japanese battery maker decided to set up offshore production in Dongguan because of the request of the main client (Toshiba).⁵³

According to recent research (NKS, 23 July 2001), as a result of the offshore production of the parent firms, almost 40% of SMEs have experienced a decline in orders from those firms. The Suwa area (Nagano prefecture) has been a major production site for precision and electrical equipment because Seiko-Epson's and Sankyo's complex manufacturing plants are there. In Suwa the rate of firms undertaking offshore production accounts for 25% of total firms, which is the highest level for any region in Japan. One quarter of SMEs in Suwa have already established offshore production. In the Higashi Osaka area in Osaka, which is the home of Matsushita's and Sanyo's manufacturing plants, there is a movement to increase offshore production by SMEs (NKS, 24 July 2001). While some SMEs are trying to undertake offshore production following the parent firms, 74.1% of SMEs focus on the improvement of domestic production (NKS, 23 July 2001), mainly because they do

not think that they have an offshore production capability. In order to respond to the hollowing out of precision and electrical equipment factories in the Suwa area, the local government (Okaya) created an industrial promotion division in the spring of 2000 and intends to establish a base for human development and the development of new technology (NKS, 23 July 2001).

Thus the governance of production networks in the Japanese electronics industry began to evolve quickly in the late 1990s. In particular, the emergence of alliances and outsourcing production has given firms an opportunity to have a more innovative and flexible production system, but at the same time it requires the revision of conventional inter-firm relations, and ultimately this may lead to the break-up of the *keiretsu* groups. The vertical integrated industrial structure of Japanese firms is becoming more disintegrated and market dependent. The response to the new situation is varied among the Japanese SMEs. In the electronics industry, they have to face the challenge of competition with East Asian (especially Taiwanese) firms based on cost, flexible supply and technological up-grading.

5.6 Conclusion

This chapter has examined the pattern of Japanese FDI, its links with ODA, and the development of CPNs, including the role of the Japanese government and the forms of governance of these networks. It has focused on the processes and tactics of Japanese FDI in exploiting East Asian countries as export-base, and varying strategies of key actors (the state and firms) in penetrating their interests.

Japanese ODA has been a central, and perhaps the only visible, political and economic tool of Japan's national interest in foreign policy. It has undoubtedly contributed much to the re-entry of Japanese firms into the East Asian market under the name of economic assistance. The norm of the developmental state, based originally on Japan's own success, with a high level of state interventionist and strong government discipline of the market and of the private sector, was applied to Japanese foreign economic policy. However, with the rise of global competition, the sharp economic growth of East Asian countries, and the increasing variations in firms' strategies (from export-oriented to local sales), the Japanese

traditional approach to ODA as a mechanism of support for the entry of Japanese firms into East Asia has heavily declined. New actors (SNGs and NGOs) have also participated in Japanese ODA networks. More importantly, Japan's long term recession in the 1990s has raised the question of the effectiveness of Japan's 'developmental state' model.

Japanese foreign policy toward East Asian regionalism dramatically changed in the late 1990s. Japan's new foreign economic policy seems to emphasise the role of FTAs. However, as this has not yet materialized in practice, its effect on Japanese FDI cannot be captured. Furthermore, in the case of the involvement of the ASEAN+3, Japanese ministerial sectionalism and external intervention by the US have made it difficult to create a consolidated new strategic role for Japan on the basis of a regional (RTA) mechanism. Most importantly, as a result of the spread of Japanese FDI, production networks in East Asia, and deepening interdependence, the strategies and interests within Japan are incredibly diverse, and this makes it more difficult to apply a single foreign economic policy.

Japanese FDI in East Asia has sought to establish offshore production sites on the basis of export-oriented strategies. This investment strategy has major implications for the development of a distinctive pattern of trade and investment in East Asia. It has contributed to the supply of capital and technology as well as managerial know-how, and has had a huge impact on the processes of manufacturing activities. In the electronics sector, with the supply of Japanese electronics technology and components, East Asian countries have succeeded in transforming themselves into electronic products-exporting countries. They are thus able to make up for trade deficits with Japan by exporting electronics products to the US market. This interdependency among Japan, East Asia and the US is a critical feature of the development of cross-border micro-regionalisation.

At the microlevel, Japanese manufacturing FDI has had an impact on industrial integration in East Asia through the rationalisation of the production system. While there is no clear intention, Japanese FDI has undoubtedly encouraged the opening up of international production networks across Japan and East Asia. In trade, except for China and Indonesia, East Asian countries tend to have huge trade deficits with Japan, mainly due to the increase

of manufacturing imports and exports, including electronics, transport, and precision machinery, with Japan supplying key components for East Asian production through intra- and inter-firm transactions. Also in Japan-China trade the share of Japanese intra- and inter-firm trade accounts for the major proportion.

The development of CPNs across East Asia has major implications for the viability of the conventional management structures of the Japanese *keiretsu* in electronics products manufacturing. A micro-level analysis of production networks in the electronics industry reveals the unique structure of their multi-layered governance arrangements. As long as the production networks were confined to Japan, the *keiretsu* were indeed helpful in sustaining Japan's competitive production on the basis of long-term relations. When leading Japanese firms went abroad, they tried to organise local mini-*keiretsu* firms. This is illustrated by the experience of the automobile industry in the US and Europe, and the electronics industry (case of Matsushita in Taiwan). However, the digitalisation and computerisation of consumer electronics has led to the urgent need to achieve quicker development cycles and technological upgrading as well as the rationalisation of procurement in the electronics industry. The outsourcing of manufacturing and the formation of international alliances became popular strategies among Japanese electronics firms in the 1990s.

With the restructuring of production in the electronics industry, the reform of the *keiretsu* system has had a major impact on conventional inter-firm relations. SMEs previously formed cooperative relations with the parent firms, but then had to decide whether to commence offshore production or focus on the improvement of domestic production. The client's request has a major impact on their decision. This helps us to understand the varying impact of changes of the governance of production networks on the shift of Japanese electronics firms into East Asia. Such firm-led integration processes present an enormous challenge to policy-makers not only in Japan but also in host countries. The improvement of the broader political and economic environment is also a crucial factor for business activities. Firm-led micro-regionalisation is therefore not confined to the reform of business activities (cross-border production networks) but also challenges conventional notions of economic governance.

¹ For example, Tsūsanshō (2000: 40) presents the key processes of industrial agglomeration in Guangdong and the involvement of foreign firms (Japanese, Hong Kong, Taiwanese, US, South Korean firms) and local Chinese firms.

² The figure is from Kohama (1997).

³ The researcher's calculation based on the lists from Mitsubishi (2001 edition).

⁴ <http://www.roc.taiwan.or.jp/data/fags.html>

⁵ For example, see the comment by the Finance Minister, Xiang Huangcheng, in January 2001. <http://www.sankei.co.jp/paper/today/itimen/09iti003.htm>

⁶ For example, Beijing airport was funded by Japanese ODA and established in 1999. However, the management company of Beijing airport was then listed on the Hong Kong stock market.

⁷ It is difficult to see China as a developmental state. See Shaun Breslin (1996). Taiwan is also greatly effected by its cultural roots. See for example, Lam and Clark (1994).

⁸ These are (1) active intervention by the government (often by MITI); (2) emphasis on a specific industry; (3) the promotion of exports; (4) guidance; (5) a selective protectionist policy; (6) the restriction of inward FDI; (7) the loose implementation of the Anti-Monopoly Act; (8) the rationalisation of declining industries, led by the government; (9) the approval of cartels; (10) the regulation of the financial market and limited implementation of corporate governance; (11) research and development funded by the government; (12) the solid management of the macro economy. See Porter and Takeuchi (2000: 41).

⁹ The figure is taken from Yamazawa (2001).

¹⁰ These and the following arguments are based on Ehashi (2001).

¹¹ The FTA between Japan and Singapore was agreed in January 2002. <http://www.yomiuri.co.jp/top/20020113it13.htm/>

¹² For theoretical discussions, see Chapter 2.

¹³ The figure is the researcher's calculation using Yeung (1998: 12).

¹⁴ The establishment of the ADF was formally approved in 1973 at the ADB's (Asian Development Bank's) annual meeting.

¹⁵ For example, the value of the Japanese yen appreciated by 42.5% against the US dollar between 1970 and 1978.

¹⁶ In September 1985, in order to respond to the rise of protectionism and trade friction, the Group of Five (meetings of the governors of the central banks and finance ministers from the US, the UK, France, West Germany and Japan) agreed to enhance international cooperation, including joint intervention by the financial authorities in the foreign exchange market. The name of the accord was taken from the Plaza Hotel, where this meeting was held.

¹⁷ Between 1985 and 1987, the NT dollar (Taiwan) appreciated by 28%, and the Korean won also appreciated by 17% from 1986 to 1988. See Bernard and Ravenhill (1995: 180).

¹⁸ Developed countries grant preferential tariff treatment for imports of manufactures and semi-manufactured products from developing countries. See Rutherford (1992).

¹⁹ The RMB depreciated by 63% between 1985 and 1990. There was a further 80% depreciation between 1990 and 1994.

²⁰ The figures are taken from Kaku (1999).

²¹ According to the categories of MOF's data, 'Europe' refers to all European countries, including Eastern Europe.

²² The UK is the largest destination of Japanese FDI. Japanese FDI in the UK accounted for 24% of total Japanese outward FDI in 1998, 17.6% in 1999 and surprisingly 39.4% in 2000. MOF (<http://www.mof.go.jp/fdi/1c008j2.htm/>)

²³ These figures are taken from MOF, <http://www.mof.go.jp/fdi>. Japanese investment in these countries is due to their attraction of the tax-haven. According to Tōyō Keizai (2000), by 1999, there were 44 Japanese firms (most of them are financial and trading firms) in the Cayman Islands.

²⁴ The figure is the researcher's calculation using MOFTEC (http://www.moftec.gov.cn/moftec_cn/tjsj/2000_9-22-15.html)

²⁵ The figure is the researcher's calculation using *Kōryū* No. 572 (1998), and No. 626 (2000). However, Taiwanese roundabout investments through the central American island countries are also included. Thus, in practice, the percentage of Japanese FDI in Taiwan's inward FDI is higher than the statistics suggest.

²⁶ The figures are from <http://www.mofat.go.kr/embassy.htm/asia/japan/>

²⁷ <http://www.investhk.gov.hk/ENG/FAC/foreign.htm>

²⁸ The share of the government-related sector was 23.98% in 1997. These figures are taken from *Higashi Aja eno Shiten*, spring special edition (2000).

²⁹ The figure is the researcher's calculation based on data from MOF.

³⁰ These figures are from Tsūsanshō (2000).

- ³¹ The figure is taken from Keisanshō (2001).
- ³² European developed countries here include France, Belgium, Luxembourg, the Netherlands, Italy, Germany, the UK, Ireland, Denmark, Greece, Spain, Portugal, Austria, Sweden, Finland, Switzerland, Iceland and Norway.
- ³³ Same as above.
- ³⁴ These figures are the researcher's calculation using data from *Higashi Ajia eno Shiten*, 2000, spring special edition.
- ³⁵ These figures are taken from *Higashi Ajia eno Shiten* 2000, spring special edition.
- ³⁶ Based on the research by Kaburagi Shinji, Noda Hidehiko, and Ikehara Gakushi (2000).
- ³⁷ The figures are from Tōyō Keizai (2000).
- ³⁸ The figure is from Kim (2001: 142).
- ³⁹ The figures are taken from <http://www.investhk.gov.hk/ENG/FAC/>
- ⁴⁰ Japanese firms accounted for 34% of the total value of Hong Kong's inward manufacturing investment, followed by the US (27%) and China (10%) in the mid of 1990s. See Enright, Scott and Dodwell (1997).
- ⁴¹ The average share of Japanese banks in Hong Kong's borrowing from foreign banks between 1994 and 1998 was 45%. The figure was calculated by the researcher by using *Higashi Ajia eno Shiten*, 2000, spring special edition.
- ⁴² These figures are calculated by the researcher using Tobari and Ryu (1996).
- ⁴³ These figures are calculated by the researcher using the USA Trade Website <http://www.usatrade.gov/Website/ccg.nsf/CCGurl/CCG-HONG-KONG2002-006D4D2/>
- ⁴⁴ These figures are taken from Tōyō Keizai (2000).
- ⁴⁵ The following is based on Inagaki (1997).
- ⁴⁶ The *shōsha* and (group) relations are as follows: Mitsubishi Corporation (Mitsubishi Group), Mitsui & Co (Mitsui Group), Sumitomo Corporation (Sumitomo Group), Marubeni (Fuyo Group), Nissho Iwai (Sanwa), and Itochu (Ichikan).
- ⁴⁷ The figures are taken from <http://www.unctad.org/en/pass/pr0116en.htm/>
- ⁴⁸ The six major groups have been transformed into four big groups (Mitsubishi, Mitsui-Sumitomo, Mizuho and UFJ).
- ⁴⁹ The figures are taken from *The Economist* (1 September 2001).
- ⁵⁰ In the summer of 2001, Toshiba announced that 19,000 jobs would go, Fujitsu would cut 16,000, NEC would cut 15,000, Kyocera would cut 10,000, and Oki Electric would cut 2,200. *The Economist* (1 September 2001: 59).
- ⁵¹ In Japan, small and medium firms are in general defined as firms with capital of less than 100 million yen and with less than 300 full time workers. In the case of the retail and service sectors these numbers are smaller.
- ⁵² The figure is taken from Kyaria Deberopumento Sentā (2001: 137).
- ⁵³ Interview with the president of a Japanese electronics firm in Dongguan (13 October 2001).

CHAPTER 6

CROSS-BORDER PRODUCTION NETWORKS ACROSS THE TAIWAN STRAIT

Taiwan is a world-class supply source for a variety of electronic hardware products. In 2000, Taiwan even exceeded Japan in terms of the volume of PC-related exports.¹ Taiwan is the world's largest producer of computer monitors, motherboards, switching power supplies, mouse devices, keyboards, scanners and a variety of add-on cards. Most of these products are sold to American, Japanese and European computer firms and are resold under their own brand names. Such success raises the question of the role of the government and the market. Taiwan is a small island country (with a population of 22 million in 1999), and most PC-related firms are of small or medium size. These factors place limits on resources, knowledge and technologies, but they have not affected the sharp growth of Taiwan's PC-related industry. Of crucial significance are the offshore production activities of Taiwanese electronics firms in mainland China, Taiwanese government-business relations, the capability of the government in industrial policies, the exploitation of the scale and scope of economies, and the development of cross-border production networks (CPNs) and international commodity chains (ICCs) linking Taiwanese firms with large foreign MNCs.

A negative factor has been the unresolved political tension across the Taiwan Strait. Wang (2001a) observes that the formation of economic integration between Taiwan and China has been largely due to the role of local government in China and the industrial networks of Taiwanese firms. China's formation of multi-level governance (MLG) is a vitally important factor for the offshore production activities of Taiwanese firms. In reality, Taiwanese PC-related firms have already created successful forms of CPNs, and the Taiwanese business community has emerged as a key actor in the transformation of cross-strait relations. This chapter thus focuses on the role of the development of the CPNs of Taiwanese PC-related firms, which effectively link Japan and China. The development

of micro-regionalisation among Guangdong, Taiwan and Japan cannot be understood without considering the broader relationship between changes in the political economy of individual states and changes in the organisation of production.

Section 6.1 considers the development of the electronics industry in the context of state intervention and industrial policy toward the electronics firms in Taiwan. Section 6.2 examines the development of networking linkages between leading Japanese electronics firms and Taiwanese firms, and the shift of Taiwanese electronics firms from commercial subcontracting to original engineering manufacturing (OEM) firms. It also seeks to explain why the creation of linkages with Japanese firms has helped to compensate for the limited capability of SMEs and indeed the small size of Taiwan itself. Section 6.3 discusses how the Taiwanese electronics industry has succeeded in expanding its economic scale and scope, especially in undertaking offshore production in mainland China. Section 6.4 examines the unresolved political challenge and its impact on business conditions across the Taiwan Strait. Section 6.5 deals with the evolving forms of governance in production networks in Taiwan and across the Taiwan Strait. Section 6.6 summarises the role of Taiwanese firms in creating new forms of multi-level networking relations among Japan, Taiwan and China.

6.1 The Taiwanese Government and the Electronics Industry

6.1.1 The Political Economy of the Electronics Industry

The Taiwanese government has contributed to the transfer of managerial resources and to the support of technological innovation. In policy terms, Taiwan adopted an open policy as early as the 1950s and implemented several preferential policies for inward FDI. The post-war roots of inward FDI in Taiwan date back to the overseas Chinese investment in the 1950s. The process started with Taiwan's adoption of preferential treatment for overseas Chinese investment in 1952. In the 1950s and early 1960s, the government was enthusiastic in attracting overseas Chinese FDI not only for economic development but also to support a political counter-alliance against mainland China. In 1955, Taiwan adopted a promotional policy for encouraging foreign investment. However, as industrialisation was premature and Taiwan was a largely agricultural economy, FDI was

still at a low level in the 1950s. In 1960, the Taiwanese government introduced aggressive policies (Statutes of Encouragement of Investment: SEI) to encourage foreign investment by adding several preferential treatments such as exemption from corporate taxation for five years. Domestic firms were also allowed to invest and enjoy the same tax and other privileges as long as they complied with the regulations. The SEI were revised several times for technological upgrading in order to attract inward FDI. In the 1960s the aim was to encourage the establishment of exporting industries; in the 1970s the aim was to encourage capital-intensive industries; in the 1980s the emphasis was on encouraging technology-intensive industries.

The Taiwanese government extended the open policy through the establishment of export-processing zones (*Jiagong chukouqu*). The first such zone was established in Gaoxiong (Kao-hsiung) in 1966. This gave foreign firms preferential treatment, including tax exemptions. This was intended to help achieve Taiwan's shift from an import-substitution to an export-oriented industrialisation strategy, and thus aimed to attract FDI, achieve technological upgrading, promote exports, and increase employment opportunities. This policy attracted Japanese businesses, which had already started to suffer from the rising cost of labour and land, and from stricter regulations on environmental pollution. Furthermore, the Japanese yen started to rise in value against the US dollar after 1971 (the Nixon Shock), and Taiwan began to be seen as an export platform. As Taiwan faced continuing diplomatic difficulties (US-China normalisation and departure from the UN) in the early 1970s, open economic policies continued. When formal diplomatic relations between Japan and Taiwan ended in 1972, semi-governmental organisations were established to maintain practical links. In 1973, two export-processing zones were established in Taizhong (T'aichung) and Nanzi. The Taiwanese government now sought to develop IC (integrated circuit) technology. In 1974, Taiwan approved a budget of \$US 10 million for IC development. In 1977, the government established the first demonstration factory for IC.

6.1.2 The Restructuring of the Manufacturing Sector from the 1980s

In the 1980s, Taiwan's export-oriented strategies were faced with new challenges. First, the persistent trade surplus increased the pressure on the revaluation of the Taiwan dollar

against the US dollar.² Secondly, there was intensifying trade friction with the US. The US withdrew the Generalised System of Preference (GSP) status from Taiwan in 1988. Taiwan thus needed to diversify its export trade away from the US. Thirdly, the increase of labour and land costs, as well as the shortage of labour, created domestic pressure for liberalisation as a result of the long process of economic development. Fourthly, the ASEAN countries and China (because of their opening up) entered the path of export-oriented, light industry-based, labour-intensive industrialisation. Taiwanese products then began to lose their competitiveness in the world market. Fifthly, the heavy dependence on imported Japanese intermediate goods brought about a structural imbalance in Japan-Taiwan trade. Taiwan had to comply with the need to maintain international quality standards, and this gave rise to the need for high levels of skill and managerial know-how. The rapid growth of science-based technology in developed countries means that industrial upgrading required a more liberal policy in terms of FDI (Smith, 2000: 413).

While the Taiwanese government continued to maintain competitiveness in some of the labour-intensive industrial sectors in the 1980s, it began to focus on the mechanical, information and electronics industries. In 1979, the Science and Technology Development Programme sought to raise R&D expenditure and focus on private-sector technology development. This was later integrated into the Eighth Four-Year Economic Plan (1982-85) and Ten-Year National Science and Technology Development Plan (1986-95). The government also established the Xinzhu (Hsin-chu) science industrial park, near Taipei (T'ai-pei) in December 1980, with the aim of attracting and developing high-tech industry.

Another fundamental purpose of the Xinzhu industrial park is to capture the spillover from the presence of firms supported by the government in terms of training, technology transfer and direct cooperation with local firms (Simon, 1994: 211). The heavy dependence on government finance of R&D is due to the poor research capabilities of SMEs. For example, the pioneer of 'foundry' contract-manufacturing, TSMC (Taiwan Semiconductor Manufacturing, founded in 1987) and UMC (United Microelectronics Corporation) were spin offs from government-funded research projects. The first IC demonstration factory was transformed into the first private IC firm, UMC, in May 1980. UMC was formed as a local joint venture and originally introduced technology from ERSO (the Electronics

Research Service Organisation, established by the Taiwanese government in 1977) and RCA. 25% of its capital came from the government Bank of Communications. It now has close cooperative relations with Hitachi. 48.3% of TSMC's capital came from the government's development fund and 27.5% came from Philips (Mizuhashi, 2001: 92). These two firms' combined production now accounts for more than 60% of the foundry market (*Kōryū*, No. 619, 2000). Thus, the Taiwanese government has been directly involved in upgrading industrial structure by funding R&D expenditure and by setting up special policies and research projects. In the late 1980s and early 1990s, the governmental fund accounted for about 50% of the total amount of R&D investment in Taiwan (Asamoto, 1996: 104). The Taiwanese government has also given incentives to Taiwanese private firms and has supported the spillover effect from government-funded research projects. In July 1998, another science industrial park, in Tainan (T'ainan), was launched.

The Taiwanese government has also provided cross-border networking relations in the electronics industry. In 1974, it established the Electronics Technological Advisory Committee (TAC) in the US. Its task was to promote relations with US electronics firms. The Xinzhu industrial science park was modeled on Silicon Valley in the US and has focused on high-technology production, including IC, informational hardware and PC-related products. According to Saxenian (2000), another aim of the Xinzhu science industrial park was to attract Taiwanese engineers studying in the US (especially in Silicon Valley). The Taiwanese researchers who came back were given high-grade houses by the government, and an American school was opened for the children of the researchers. The Monte Jade Science and Technology Association (MJSTA), established in 1989, has contributed greatly to business cooperation, investment and technological transfer by promoting exchanges between Taiwanese researchers in Taiwan and San Francisco. While the Taiwanese government does not actually fund MJSTA, it has close informal relations with the association. The number of researchers returning to Taiwan has increased (1990: 422; 1993: 1,004; 1995: 2,080; 1997: 2,859) (Saxenian, 2000: 331). These researchers have also contributed to the establishment of venture firms. As a result, the increasing entry of local firms has led to a fall in the share of foreign firms in the output of PC-related products in Taiwan. In 1995, the share fell to 15% (Kawakami, 2000: 64). With this strong support, the number of firms in the park increased, reaching 292 in 1999 (*Kōryū*, No. 634,

2001).

Government support is both formal and informal. In 1993, the Taiwanese government adopted a promotional law for investment in semiconductor and high-tech-related projects.³ According to the Daiwa Research Institute, although Taiwan's corporate tax is officially 25%, in practice only a 2.3% (average) corporate tax was imposed on 133 listed Taiwanese electronics firms in the late 1990s (*Asahi Shinbun*, 4 November 2000). Government policy has provided Taiwanese venture firms with advantageous conditions. There is no discrimination against the smaller and medium firms. This neutral policy has greatly supported the development of SMEs in Taiwan. Thus, in the case of the Taiwanese electronics industry, by using formal and informal practices the Taiwanese government has been a strong supporter of the transformation from labour-intensive to high-tech manufacturing. As a result, Taiwanese electronics firms are now a dominant industry (*Kōryū*, No. 632, 2000). Among the 20 top exporters, only three firms are non-electronics firms. All these firms have a high exporting rate except for the non-electronics firms. Thus strategic policies adopted by the Taiwanese government have provided a strong incentive for the transformation from labour-intensive to high-tech manufacturing.

6.2 Japanese FDI in Taiwan

The improvement of technology in offshore production and the gap in labour costs between Japan and East Asia have further encouraged Japanese firms to move out of Japan. With the improvement of local suppliers in terms of quality, technology, delivery time, and after-sales service, Japanese firms have more opportunities to find efficient sourcing partners outside Japan. The impact of Taiwan's link with Japan on the technology orientation of the island's electronics industry has been significant. Also, Taiwan is the stepping stone for Japanese firms seeking to operate in mainland China. It is said that almost 70% of Japanese affiliates in Taiwan have set up subsidiaries in mainland China (Kuroda, 2001: 230).

6.2.1 Japanese Electronics FDI in Taiwan

Japanese FDI projects in Taiwan have been the major source of evolution of the Taiwanese

computer industry. This is not surprising, since Taiwan responded to the East Asian division of labour in production at a relatively early stage and focused on the electronics industry. Inward FDI has played an important role in helping Taiwan to join the international division of labour and promoting the organisational evolution of production networks in Taiwan.

Taiwan has been especially successful in attracting electronics investment from the advanced countries, in improving its international competitiveness, and even becoming a supplier of FDI to other East Asian countries. The electronics industry in Taiwan has been the fastest growing industry since the 1980s. The main export products of Taiwan have come from the electronics sector. In 1999, the export of machinery and electrical equipment amounted to 52.8% of all exports (by volume), and among them electronics-related products (including personal computers) accounted for 18% of total exports (*Nittai Bijinesu Nyūsu*, No. 74, 2000). Table 6.1 shows Taiwanese firms' share in the production of personal computers. In 1999, PC-related firms occupied the top ten positions in the ranking of Taiwan's exports, and the degree of dependence on exports among these firms was very high: from 66.16% (Acer) to 100% (TSMC) (*Kōryū*, No. 632, 2000).

Table 6.1 Taiwan's Share of the World Computer Market, 1996-1999 (Volume of Production, %)

<i>Product Items \ Year</i>	1996	1997	1998	1999
Notebook PC	32	32	40	46
Monitor	54	55	58	59
Desktop Computer	11	14	17	22
Motherboard	50	56	61	76
SPS	55	64	66	68
CD-ROM	12	23	34	46
Case	65	73	75	76
Scanner	54	71	84	89
Graphic card	31	32	31	35
Keyboard	61	62	65	68
Mouse	65	63	60	60
Sound Card	41	44	48	57

Source: *Kōryū*, No 619 (15 May 2000).

First, we need to examine the situation of Taiwanese inward FDI. The amount of FDI received by Taiwan in the 1990s was equivalent to about 70% of the total accumulated FDI since 1952.⁴ The share of Taiwanese outward FDI in the 1990s accounted for 95.8% of total Taiwanese outward FDI since 1952.⁵ Thus, it seems that the role of Taiwan as a receiver and supplier of FDI was fully activated in the 1990s. Table 6.2 shows that the central American Island countries were the largest investors in Taiwan in 1999. They have also been the second largest destination of Taiwanese outward FDI after China.⁶ Thus the shares of Japan and the US in total inward FDI are much higher than the statistics suggest. The accumulated Japanese FDI between 1952 and 1998 accounted for 22.3% of total Taiwanese inward FDI in the same period – just lower than that of the US (23.3%).⁷ In terms of industrial sectors, the share of electronics investment accounted for 25.5% of the total inward FDI in Taiwan between 1952 and 1999, and this was equivalent to almost half of all manufacturing FDI in Taiwan.⁸ Turning to Japanese FDI in Taiwan, 68% of that investment between 1952 and 1999 was in manufacturing. Japanese electronics FDI is the largest single sector, accounting for 27.3% of total Japanese FDI in Taiwan between 1952 and 1999.⁹ Japanese electronics FDI also accounted for 24.5% of Taiwan's total inward electronics FDI between 1952 and 1999. While Japanese FDI is statistically second to the US, in terms of technology cooperation agreements Japanese firms have had more than twice as many cases of foreign investment (Simon, 2000: 526). Thus, from the point of view of technology orientation, the role of Japanese electronics firms is very significant.

Table 6.2 Sources of Inward FDI in Taiwan by Country and Region, 1995-1999 (%)

Country and Region	1995	1996	1997	1998	1999
Japan	19.5	22.2	19.9	14.3	12.1
US	43.6	19.7	10.6	23.2	27.1
Hong Kong	3.4	9.4	3.8	6.8	3.8
Europe	11.4	8.0	9.4	9.7	10.9
Central American Islands	5.1	16.9	15.4	19.0	28.7

Sources: *Kōryū*, No. 572 (15 April 1998), No. 619 (15 May 2000) and *Kōryū Kyōkai* (1999) *Taiwan no Keizai Dōta* (The Economic Data on Taiwan), Tokyo: Kōryū Kyōkai.

Table 6.3 Shareholding Relations between Japanese Electronics Firms and Taiwanese Firms

Company	Name of Local Body	Major Local Business Partner (a)	Share of Local Partner (b)
Matsushita (7)	Matsushita Electric (Taiwan)	Individual	41.3
	Panasonic Computer	-	0
	Panasonic Industrial Sales	-	0
	Panasonic Systems Sales	Individual	40
	Panasonic Taiwan Laboratories	-	0
	Taimatsu Industrial	Individual	40
	Taiwan Matsushita Technical Service	-	0
Mitsubishi (7)	China Electric Mfg	-	-
	China Ryoden	Dashenghang Group	50
	Eye Lighting Taiwan	-	0
	Meltonic	-	-
	Mitsubishi Electric Taiwan	-	-
	Powerchip Semiconductor	UMAX/Elite Group	75.2
	Shilin Electric & Engineering	-	-
Hitachi (5)	Hitachi Asia	-	0
	Hitachi Sales Corp of Taiwan	-	24
	Hitachi Technology	Acer	15
	Kaohsiung Hitachi	-	0
	Taiwan Hitachi	-	38.5
Sanyo (4)	Chen Ho & Co.	individuals	56.5
	Sanyo Electric Taiwan	-	1.84
	Sanyo Electronic Taichung	-	0
	Sanyo Semiconductor Taipei	-	0
NEC	NEC Electronics Taiwan	-	0
	NEC Taiwan	-	0
	Taiwan Telecommunication Industry	Tatung	58.1
Sharp	Sharp Corp	Shengbao	50
	Sharp Electronic Component	Aurora	35
	Sharp Electronics	-	0
	Technology Taiwan Corp	-	0
Sony	Sony Video Taiwan	-	0
	Taiwan Electronics & Technology	-	0
Fujitsu	Fujitsu Taiwan	-	0
	Fujitsu Telecommunications	-	0
Toshiba	Toshiba Electronics Taiwan	Individuals	10

Note: (a) a blank does not necessarily mean no local partners, some are not identified, (b) a blank does not mean zero for financing through the market

Source: Based on Tōyō Keizai (2000).

By 1999, nine leading Japanese electronics firms had established foreign subsidiaries in Taiwan, including Matsushita (7), Toshiba (1), Mitsubishi (7), Hitachi (5), Sony (2), Sharp

(3), Sanyo (4), NEC (3) and Fujitsu (2).¹⁰ However, if we add the *keiretsu* firms, the numbers are much higher. For example, Toshiba's family firms, such as Toshiba Ceramics, Toshiba Machine, and Toshiba Career, have also set up subsidiaries in Taiwan. Table 6.3 shows the proportion and relations of Taiwanese shareholders in the capital of Japanese subsidiaries in Taiwan: Acer is a 15% shareholder of one of Hitachi's subsidiaries, Tatung is the largest shareholder of Taiwan Telecommunication Industry, a subsidiary of NEC, and Shengbao is a major partner of Sharp. These links derive from the cooperative relations between Japanese and Taiwanese firms. For example, the Shengbao Company, which is one of the leading electrical goods firms in Taiwan, introduced technology from Sharp when the company was established in the 1960s, and Sharp is still a 7.28% shareholder of its capital.¹¹ Quanta has been able to produce TFT-LCDs by introducing technology from Sharp (Mizubishi, 2001: 194).

In many cases Japanese firms have tried to organise local networks of suppliers and subcontractors, thus applying the Japanese *keiretsu* system. Matsushita Electronic Industrial, for example, established Taiwan Matsushita (with 60% equity) in 1962. Since then, Taiwan Matsushita has tried locally to develop its own *keiretsu* system based on sales and production networks (Hori, 2000). In the 1980s, the company succeeded in developing its own R&D capability and exports network. It expanded its exports to the US market in radio cassette recorders, car audios, black and white TVs, etc. when Matsushita (Japan) gave up producing because of production costs in Japan. Taiwan Matsushita employed former engineers at RCA and commenced the manufacture of PC-related products. In the mid-1980s, it succeeded in acquiring orders for CRT (cathode ray tube) from IBM, replacing previous production by Matsushita through contracts with subsidiaries of IBM in Japan. Taiwan Matsushita then started to produce CRT for other computer manufacturers. Taiwanese local suppliers and subcontractors were coordinated by Taiwan Matsushita through 'satellite cooperative firm relations' (Hori, 2000: 175-91). Most of them were small firms. Entering into the Japanese sub-contracting system was the first step for their business. Taiwan Matsushita provided technological training to upgrade quality and develop workers' skills. While subcontractors handle individual parts of the production process, the manufacturer needs to manage the entire process. The Japanese electronics firm often distinguishes clearly between products made in Japan (high value-added

production) and Taiwan (low value added production). For example, Matsushita Communication Industrial produces high-grade car audio systems (i.e. TV and navigation) in Japan and low-grade car audio products in Taiwan (Seki, 2000: 283). However, this distinction can no longer respond to the emergence of new competition, which requires a quick development cycle, digitalisation and efficient delivery.

Japan-Taiwan trade relations have been characterised by Taiwan's huge deficit (\$US 21.95 billion in 2000) (*Kōryū*, No.637, 2001); but Taiwan compensates for this deficit by trading with China. As Hong Kong is used for China-Taiwan trade, Taiwan's trade surplus against Hong Kong in 2000 reached \$US 29.17 billion (ibid.). For Taiwan, Japan is the largest source of imports and the third largest destination for its exports. In 1999, the share of electronics goods in Japan's exports to Taiwan was 24.5%, and the figure for the share of electronics goods in Japan's imports from Taiwan was 23.3% (Tsūsanshō, 2000). Japan exported \$US 7.1 billion of electronics goods to, and imported \$US 3 billion of electronics goods from, Taiwan. In PC-related products Taiwan's presence has increased sharply. In 2000, Taiwan became the largest source of Japan's computer imports (21%), exceeding those of the US (*Kōryū*, No.637, 2001). In Japan's notebook imports, the share of Taiwan accounted for 78% in volume and 86% in value (ibid.). Taiwan has begun to play an important export role in PC-related products and in the supply of components in Japan-Taiwan trade.

6.2.2 Production Networks in Taiwan

The development of Taiwan's electronics industry must be seen in relation to the emergence of an East Asian international division of labour and specific production networks. The receipt of FDI has undoubtedly helped the process of technological transfer to Taiwan from the advanced countries. Taiwan's electronics industry was initiated in the 1960s and 1970s, when foreign firms such as RCA, Zenith, Philips, Matsushita, Mitsubishi and NEC went to Taiwan to set up wholly owned subsidiaries or local joint ventures for the production of electronics goods such as transistor radios, black-and-white television sets, calculators, electrical household appliances, and electrical components and parts. Such foreign-affiliated production accounted for more than 60% of Taiwan's electronics exports in the 1970s (Chin, 1996: 17). The domestic firms successfully emulated the local

multinational corporations (MNCs) and the electrical and electronics sector as a whole expanded steadily during the 1970s, becoming the biggest single source of Taiwan's foreign exchange earnings by the early 1980s. By 1998, the share of Taiwan's production of PC-related products in the world's total production was very high.¹²

The PC industry was established in Taiwan on the basis of both OEM and original brandname manufacturing (OBM) procurement activities and Taiwan's own indigenous effort. Japanese, US and European computer manufacturers have often approached Taiwanese firms for OEM/OBM facilities (Ikegami, 2000: 179). Japanese firms such as Fujitsu, Hitachi, NEC, Epson, Alps, Panasonic, Mitsubishi and Toshiba place orders for OEM production with Taiwanese firms. According to the Japan-Taiwan Interchange Association (*Kōryū Kyōkai*), in 1998 60% to 70% of Taiwan's PC-related products were in the form of OEM production.¹³ Almost 40% of OEM orders for PC-related products came from the US, 30% from the EU, and 10% from Japan. Among US computer manufacturers, Inventec Corporation and Arima Computer Corp produce OEM notebooks for Compaq, Acer Inc., Quant Computer Inc. produce for IBM, and Compall Electronics Inc. and Quant Computer Inc. produce for Dell (*Kōryū*, No.622, 2000). Acer, which is now the world's sixth largest computer and computer equipment firm, still has contracts with 130 firms to produce OEM products.¹⁴ 60% of its sales come from OEM production (Mizuhashi, 2001: 186). Table 6.5 shows the OEM/ODM (original development manufacturing) relations with Japanese firms. The US and Japan are major trading partners for Taiwan's PC-related production. The role of these two countries, however, is clearly different. Japan is the largest source for imports and the US is the largest destination for exports. Finished OEM products ordered from Japanese electronics firms are almost all exported to the US (30%), Europe (25%), ASEAN (15%) and Taiwan (15%) through their worldwide branches, and only 5% are imported into Japan.¹⁵

Clearly, concentration on OEM production is a key to the success of the Taiwanese electronics industry. For example, Delta Electronics and Compeq Manufacturing developed their technologies through IBM's technological guide in local procurement activities, and Acer and Mitac acquired computer technology through OEM production for ITT (Mizuhashi, 2001: 101). OEM production has enabled the introduction of technology

into Taiwan and is indeed very suitable for Taiwanese SMEs that do not have their own sales networks. In terms of firm size, 90% of all Taiwanese firms are SMEs. For OEM, the assembly technology and design technology are more important, and high-tech assembling technology is not required. As a result of improved design technology, Taiwanese firms have also increased their OBM role (Takaoka, 1997: 216). In the case of PCs, Taiwan has focused on the acquisition of OEM from advanced countries. With the rise of price competition in the PC market, Taiwan has been chosen as a major site for the assembly production of those countries. In the early 1990s, the orders from Japanese electronics firms expanded because of the rise of price competition in PCs. OEM then started to shift to ODM, which includes all stages from design to production (Mizuhashi, 2001: 102). This is different from Japanese SMEs, which have concentrated on assembling technology and have not developed research and development.

Table 6.4 Taiwan's Main PC-Related OEM Production, 1998 (\$US million, %)

	OEM/Total Production	Rate of Offshore Production	Main Country for Imports	Main Country for Exports
Notebook PC	86.0%	0%	Japan (80.2%)	US (51.9%)
Monitor	67.0%	72%	Korea (45.9%)	US (45.0%)
Desktop PC	67.0%	45%	US (57.2%)	Japan (42.7%)
Motherboard	30.7%	38%	-	-
SPS	98.0%	91%	China (89.3%)	US (35.2%)
CD-ROM	30.8%	53%	Japan (80.2%)	US (50.7%)
Case	42.0%	75%	Japan (23.4%)	US (34.2%)
Scanner	43.0%	38%	US (30.4%)	US (44.5%)
Graphics card	30.0%	65%	Japan (23.4%)	US (34.2%)
Keyboard	70.3%	91%	Malaysia (45.7%)	US (45.7%)
UPS	71.8%	25%	US (52.8%)	US (26.1%)
Mouse	69.4%	89%	Korea (45.9%)	US (45.0%)
Sound card	58.6%	65%	Japan (23.4%)	US (34.2%)
Video card	45.0%	18%	Japan (23.4%)	US (34.2%)
Total	64.8%	-		

Note: (1) Because of data limitations, imports and exports do not include the offshore OEM production, thus only products made in Taiwan are included. (2) Under main countries for imports and exports, monitors and mice are counted together, and cases, graphics cards, sound cards, and video cards are counted together.
Sources: *Kōryū*, No. 620 (31 May 2000) and No. 622 (30 June 2000).

Table 6.5 OEM/ODM Relations between Taiwanese Firms and Japanese Firms, 1999

Taiwanese Firms	Major Japanese Firms (including Japan Based US Firms)
Acer	Japan IBM, Akia
Qaunta Computer	Japan IBM, Dell Computer, Japan Gateway, Apple Computer
Inventec	Compaq Computer
Compal	Fujitsu, Dell Computer
MiTAC	Sharp
Arima	Compaq Computer
FIC	NEC, Mitsubishi, Sotech
Twinhead	NEC, Sharp
CLEVO	Hitachi

Source: Lin, Thomas (Lin Shikō) (2000) *Taiwan no Shikumi* (A Mechanism of Taiwan), Tokyo: Chūkei Shuppan, p.107

Table 6.6 Relations between Taiwanese Firms and Foreign Firms in Semiconductor Production, 1999

Taiwanese Firms	Major Foreign Firms
TSMC (foundry)	Philips, Fujitsu
UMC (foundry)	S3, Trident, MSI, Lattitce
Winbond (IDM)	Toshiba
Mosel-Vitelic (DRAM)	Siemens, Motorola, Oki
Macronix (IDM)	Nintendo, Philips
Vangurad (DRAM)	Motorola, Sharp, Matsushita

Source: Lin, Thomas (Lin Shikō) (2000) *Taiwan no Shikumi* (A Mechanism of Taiwan), Tokyo: Chūkei Shuppan, p.109

Since the late 1990s, EMS (Electronics Manufacturing Services) has emerged as a new strategy of Taiwanese PC-related firms. The digitalisation and computerisation of consumer electronics products encourages the convergence of computing, communication and consumer-related technologies. Furthermore, electronics firms need to achieve a shorter development cycle. EMS is a new form of contract manufacturing, from the development, design and procurement of electronics products to production. For Taiwanese firms, its merit is the more efficient use of mass production. Although in the world sales of EMS the US firms dominate the top rankings, Taiwanese firms have begun to undertake EMS production. TSMC, the world's largest chip foundry, produces OEM memory chips for Intel, IBM, Motorola, Fujitsu and AMD (*Kōryū*, No.623, 2000). TSMC became Taiwan's fourth largest exporter in 1999. Almost 90% of TSMC's business activities in 1998 were contract made-to-order computer chips, called 'foundry' (ibid.). Table 6.6

presents the production relations in semiconductors between Taiwanese 'foundry' and DRAM manufacturers and foreign firms. TSMC undertakes 'foundry' for Fujitsu and Philips, Mosel-Vitelco produces DRAM for OKI, and Vanguard produces DRAM for Sharp and Matsushita (Lin Thomas, 2000: 109). With the worldwide increase of outsourcing production in the electronics industry, Taiwanese OEM firms are transforming themselves into EMS firms: by the end of 2000 about 200 Taiwanese firms claimed that they were EMS producers (*Kōryū*, No. 634, 2001).

Through various forms of cooperation (OEM, EMS, or technological cooperation) a significant degree of interdependence between Japanese and Taiwanese firms has developed. The total OEM orders placed by Japanese electronics firms with Taiwanese firms in 1996 amounted to \$US2.16 billion; in 1997 \$US 2.03 billion; in 1998 \$US2.13 billion. The development of links has changed the sub-contracting system. For example, UMC, which became the third largest foundry producer in the world in 2000, bought a Japanese semiconductor firm in December 1998 and even started production activity in Japan. It initially introduced technology from the ERSO and RCA, but it also has cooperative relations with Hitachi (*Kōryū*, No. 619, 2000). Asuteck Computer Inc. (founded in 1990) undertakes OEM production of motherboards for Intel (US), HP(US), and Sony (Japan). The key components (i.e. LCDs), however, still depend on imports from Sanyo or Hitachi (*ibid.*). Thus, Taiwanese networking linkages give rise to a unique, complex interconnectedness in which the key components of rival firms are used for the products of rival makers. The EMS business model has provided further opportunities for Taiwanese electronics firms. Japanese and Taiwanese electronics firms have also started to co-invest in mainland China, and joint Japanese-Taiwanese firms have emerged. For example, Matsushita Electric Works have established joint firms with Compec Manufacturing (45% of equity) in Guangzhou. In Kunshan, JVC (Japan) and Unicap Electronics Industrial (Taiwan) have set up joint firms (Mizuhashi, 2001: 180).

6.3 Taiwanese FDI in China

Taiwanese firms began to gain a foothold in China in the late 1980s. In 1987, the Taiwanese government abolished martial law and lifted the ban on kinship visits to the

mainland. This allowed Taiwanese business people to see the investment environment in mainland China for themselves. The foreign exchange regime was also liberalised to allow free capital movement under NT\$ 5 million. In 1988, business activities in the mainland were permitted by the Taiwanese government. In the late 1980s, the revaluation of the Taiwanese dollar also encouraged Taiwanese outward FDI. Almost 40% of Taiwanese outward FDI between 1952 and 1999 was in manufacturing (*Kōryū*, No. 626, 2000). With the growing shortage of labour, the escalation of production costs, and the rise of environmental regulation in Taiwan in the 1980s, Taiwanese manufacturing firms were forced to relocate their labour-intensive production processes, initially to ASEAN and then to China. In particular, electronics FDI has been the major part of Taiwanese outward FDI (almost 41% of total Taiwanese outward manufacturing FDI between 1952 and 1999).¹⁶

6.3.1 Taiwanese FDI in ASEAN and China

Taiwanese outward FDI first began to extend to ASEAN in the mid-1980s. Taiwan was the original assembly production site for leading electronics firms. It had the advantages of labour-intensive manufacturing in the 1970s. However, by the early 1980s Taiwan was faced with a rise of production costs (labour, land) and stronger environmental regulations. Economic restructuring in the 1980s coincided with political reform and democratization, and workers began to mobilise to demand labour rights. Economic liberalisation had a spillover effect that induced social groups, including environmentalist and labour organisations, to become active (Wang, 2001b: 354). With the increasing importance of rationalisation, economies of scale, and costs of production, Taiwanese firms had to expand their production system abroad. They started to invest in the ASEAN countries from the mid-1980s, and the trend peaked in 1994. Taiwan has now become a large investor in ASEAN countries. In Thailand accumulated Taiwanese FDI (\$US 9.9 billion between 1959 and 1999) is the fourth largest source of total inward FDI following Japan, the US and Hong Kong. In Malaysia Taiwanese FDI is the third largest investment (total \$US 8.6 billion from 1959 to 1999) following that of Japan and the US. In Vietnam Taiwan is the second largest investor following Singapore (*Kōryū*, No. 631, 2000).

As ASEAN achieved sharp economic growth between the mid-1980s and the mid-1990s, the rise of labour and land costs reduced the advantages of offshore production for

Taiwanese manufacturers. Although, in 1993, the Taiwanese government adopted the 'southward policy' (*nanxing zhengce*), which aimed to facilitate Taiwanese investment in ASEAN, much Taiwanese investment was then reinvested in China (*Kōryū*, No. 622, 2000). In the late 1990s, China became the largest destination of Taiwanese outward FDI. As direct investment is still prohibited between Taiwan and China, the central American island countries are now a major destination of Taiwanese outward FDI because they serve as a route for 'roundabout' investment. Most of them have reinvested in China or in Taiwan.¹⁷

Table 6.7 confirms the sharp increase of Taiwanese outward FDI in China. By 2000, Taiwanese outward FDI had reached \$US 44.06 billion (official figures approved by Taiwanese Economic Ministry only, including indirect FDI in China). Mainland China is the largest destination of Taiwanese FDI, accounting for almost 38.8% of total Taiwanese outward FDI (\$US 17.1 billion, between 1952 and 2000). The Central American island countries are the second largest destinations, accounting for 20.86% of total Taiwanese outward FDI (\$US 9.19 billion, *Liang'an Jingji Tongji Yuebao*, April 2001). Thus it seems that the Taiwanese FDI in China accounts for well over 50% of total outward Taiwanese FDI. This also reveals that this investment has mushroomed in a very short period. The accumulated Taiwanese FDI in China between 1991 and 2000 already accounted for about 39% of total accumulated Taiwanese outward FDI between 1952 and 2000.

Table 6.7 Taiwanese FDI in Mainland China (\$US million, %)

	1995	1996	1997	1998	1999	Total from 1952 to 2000
Total outward Taiwanese FDI (A) (a)	2,713.8	3,394.6	4,508.3	5,330.9	4,521.8	44,058.6
Taiwanese FDI in China (B)	1,092.7	1,229.2	1,614.5	2,034.6	1,252.8	17,102.6(b)
(B)/(A) (%)	40.3	36.2	35.8	38.2	27.7	38.8

Note: (a) Total outward Taiwanese FDI includes indirect FDI in China. Because of a change of the law, the data for 1997 often include ex post facto investment items but here exclude the ex post facto investment. (b) Data for China for the period 1991-2000.

Sources: *Liang'an Jingji Tongji Yuebao* (April 2001), *Kōryū*, No. 572 (15 April 1998) and No. 626 (31 August 2000).

6.3.2 Taiwanese Electronics FDI in China

The Taiwanese government officially admitted indirect Taiwanese investment in the mainland in October 1990 (primarily through Hong Kong, later through the central

American islands countries). This change is reflected in the statistics. In the 1990s the central American island countries became the top destination of Taiwanese outward FDI excluding China (officially approved figures) (*Kōryū*, No.626, 2000). Most of this investment is thought to go mainly to China. The major share of Taiwanese FDI in China is in manufacturing industry. From 1991 to 1999, the share of Taiwanese manufacturing investment in China was equivalent to 91.5% of total Taiwanese FDI in China (ibid.). In terms of composition by industrial sector, electronics investment in China is remarkable. The accumulated Taiwanese outward electronics investment (between 1991 and 2000) in China accounted for 28.04% of total Taiwanese FDI in China (*Liang'an Jingji Tongji Yuebao*, April 2001). By 1999, accumulated Taiwanese electronics FDI in China (\$US 3.68 billion) accounted for almost 50% of total Taiwanese outward electronics investment (*Kōryū*, No.622, 2000). The Taiwanese government has imposed restrictions on electronics investment in mainland China and has gradually increased the allocation to electronics products. In 1990, it permitted investment in calculators, computer keyboards and telephones, and in 1991 extended this to computer power supply units. In 1997, the liberalisation of the foreign exchange regime was expanded to allow free capital movement under NT\$ 50 million. However, personal computers (except those under 486 CPU), DRAM, colour scanners, TFTs and digital cameras are still prohibited.

Despite the remaining restrictions, Taiwanese FDI in China sharply increased throughout the 1990s. By 1999, the number of Taiwanese firms investing in the mainland was estimated to be about 44,000, and the total investment (actual use) from Taiwan reached \$US 24 billion, which accounted for 7.8% of total inward FDI in China (*Beijing Weekly*, 6 June 2000). Some 250,000 Taiwanese in the mainland run factories and firms, and are responsible for about 12% of China's total exports (*Business Week*, 12 August 2000). Table 6.8 shows the dispersion of Taiwanese FDI in the mainland by region. From the perspective of total Taiwanese FDI from 1991 to 1999, Guangdong (34.6%), Jiangsu (17.5%) and Shanghai (14.5%) were the leading areas for inward Taiwanese investment. Fujian (10.8%) was in fourth position, a long way behind. However, in terms of electrical and electronics investment, the share of Guangdong far exceeds that of other regions. By 1999, the accumulated Taiwanese electronics FDI in China (officially approved as \$US 3.68 billion) went to Guangdong (49.5%, \$US 1.82 billion), Jiangsu (14.9%, \$US 550

million), Shanghai (11.1%, \$US 410 million) and Fujian (5.4%, \$US 200 million) (*Kōryū*, No. 622, 2000). In terms of the city level, by 1999 Dongguan in Guangdong province had received \$US 810 million of investment, which is equivalent to 22% of total Taiwanese electronics FDI in China, followed by Shanghai (11.1%, \$US 410 million) and Shenzhen (\$US 350 million).¹⁸ By 2000, the accumulated Taiwanese electronics FDI in China reached \$US 5.14 billion, and Dongguan had received \$US 1.07 billion Taiwanese FDI (20.8% of the total), followed by Shenzhen (\$US 570 million) and Shanghai (\$US 560 million).¹⁹

Table 6.8 The Dispersion of Taiwanese FDI in China, Main Provinces, 1991-1999 (\$US million, %)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total from 1991 to 1999
Total Taiwanese FDI	174.2	246.9	3,168.4	962.2	1,092.7	1,229.2	1,614.5	2,034.6	1,252.7	14,495.4
Guangdong	42.1	45.4	33.1	24	20.4	23	33.5	40.5	39.9	34.6
Fujian	32.1	12	15	10	11.1	9	4.5	7.4	4.7	10.8
Jiangsu	14	14	26.3	40.7	15.6	24.3	22.9	29.9	25.9	17.5
Shanghai					20.5	19.8	18.9	14.1	12.1	14.5
Zhejiang	0.1	6.7	3.9	6.5	5.2	2.7	5.1	4.2	6.3	5.8

Note: For data between 1991 and 1994, Shanghai is included in Jiangsu

Sources: *Kōryū*, No. 572 (15 April 1998) and No. 626 (31 August 2000).

6.3.3 Taiwanese Electronics Firms in the Pearl River Delta

Taiwanese electronics firms have agglomerated in Guangdong, especially in the Pearl River Delta. By 1999, the number of registered Taiwanese firms in Guangdong was estimated to have reached 11,000,²⁰ equivalent to almost one-quarter of the total number of Taiwanese firms in the mainland. Dongguan is the leading city in terms of the concentration of Taiwanese inward investment. Such concentration in one area and in a single sector (electronics) has enabled Taiwanese investors to create some 'electronic cities' and form a number of special zones (Lin, 1998). By 1999, the number of registered Taiwanese firms in Dongguan had reached 3,200, and the number of Taiwanese residents in the city was about 40,000 (*Asahi Shinbun*, 3 February 2000). In Dongguan there were some 1,800 IT-related firms, including more than 1,000 Taiwanese firms (*ibid.*). The level of industrial agglomeration in the electronics industry in Dongguan is remarkable, and

Taiwanese electronics firms occupy a dominant position. By the late 1990s, Taiwanese firms employed a third of the city's population (3.5 million) and contributed to 70% of the city's exports (*Kōryū*, No. 622, 2000). According to the mayor (*Asahi Shinbun*, 3 February 2000), in Dongguan 95% of all components of personal computers can be obtained within the city. This makes it easier for Taiwanese firms to gain access to local procurement activities.

By September 2000, 82 Taiwanese-listed electronics firms owned production sites in mainland China (*Kōryū*, No. 631, 2000). Among 232 subsidiaries of 82 Taiwanese-listed electronics firms in China, 134 Taiwanese firms were 100% Taiwanese-owned firms. The rate of offshore production in PC-related products, for example, reached nearly 50% in 1999 (*Kōryū*, No. 622, 2000). In 1999, China accounted for 70% of the offshore production of Taiwanese PC-related products (*ibid.*). By 2000, among 232 Taiwanese subsidiaries, the major location is Dongguan (39 Taiwanese-listed electronics firms' subsidiaries); 29 in Shenzhen, 25 in Shanghai, 17 in Guangzhou, 8 in Zhongshan, 3 Shunde, 10 in Kunshan, 13 in Suzhou, 11 Beijing, and 3 in Tianjin.²¹

Table 6.9 Taiwan's IT Production in mainland China

Product Category	Top Five Overseas Producers
Desktop Computers	Mitac (Shunde), PC Chip Group (Shenzhen), Acer (Zhongshan), Tatung (Shanghai), FIC (Shenzhen)
Mainboards	PC Chip Group (Shenzhen), Asutek (Suzhou), Giga-Byte (Dongguan, Huangjiang), Micro-Star (Shenzhen)
Scanners	Silitek (Dongguan), Avison (Qingxi, Shanghai, Suzhou), Primax (Dongguan), Mustek (Dongguan), Umax (Suzhou)
CD-ROM drives	Lite-ON IT (Dongguan), Behavior Tech (Dongguan), Pan-International (Dongguan), Acer Peripherals (Suzhou)
Monitors	TPV Technology (Fuzhou, Beijing), Acer Peripherals (Suzhou), Lite-ON (Dongguan), Jean (Huangjiang), Compal (Kunshan)

Note: There is no particular date on this research. The original source is *Jingji Ribao* (24 August 2000).

Source: *Liang'an Jingmao*, No. 112 (10 April 2001)

Dongguan is a major production site for Taiwanese electronics firms. Delta Electronics Inc., Primax, Lite-on, GVC, ADI, Chocony, Suyin, and Yashin Industrial have all established production sites in Dongguan. Other firms with production in Shenzhen have also set up factories in Dongguan, e.g. Honhai, Acer, Mitac, FIC (*ibid.*). In terms of OEM production

in Dongguan, Honhai set up factories in 1996 in order to produce half-completed PC products ordered from Compaq (US). This was a strategic product for Compaq, which announced it was producing a \$499 PC (*Jetoro Sensā*, February 2001). By 2000 Delta Electronics Inc., which is a major OEM manufacturer of SPS, had established five electronics production sites in Dongguan and employed 21,910 workers (Mizuhashi, 2001: 156). Lite-On Technology, which is major OEM manufacturer of monitors, manages its production in Dongguan. Table 6.9 shows Taiwan's IT production sites in mainland China. It reveals the strong position of Dongguan in Taiwanese electronics production.

6.3.4 The Evolution of Production Networks and the Shift of Production Sites to the Mainland

Taiwanese firms have moved to offshore production in order to maintain comparative advantage in the production of PC-related products. The demands of clients seeking to sell electronics and informational products in mainland China has encouraged Taiwanese firms to shift their production sites (*Jetoro Sensā*, July 2001) by establishing a pattern through which they receive an order in Taiwan and produce in China. In 1996, the value of production of OEM was \$US 2.482 billion; 4.25 billion in 1997; and 6.269 billion in 1998 (*Kōryū*, No. 622, 2000). Taiwanese firms now produce almost 70% of all China's PC-related products. As a result of recent expansion, offshore production now accounts for more than 50% of total Taiwanese PC-related production. Although the offshore production of notebook PCs is still restricted by the Taiwan authorities, 72% of monitors were produced outside Taiwan in 1998. In the same year, 45% of desktop PCs were produced outside Taiwan (*ibid.*). The major offshore production site is now in mainland China. As a result, China contributed 29.0% of Taiwan's PC-related production in 1998 and 32.2% in 1999 (*ibid.*).

In 1999, with the increase of Taiwanese offshore production, China became the fifth largest exporter of PC-related products. Most of this is attributable to production by Taiwanese firms in China. In 1999, Taiwanese firms contributed 72% of China's production of PC-related products (total \$US 18.46 billion) and 64% of China's PC-related exports (total \$US 11.7 billion).²² Moreover, production by Taiwanese firms in mainland China contributes to almost half of the total consumption of PC-related products in China (total

\$US 13.7 billion). For example, in 2000, Taiwanese production of scanners accounted for 93% of world production, and its share of production in the mainland reached 85%. As a result, the production of scanners in China reached 79% of world production in 2000.²³ Following the increase of Taiwanese FDI in China, cross-strait trade is also developing. In 1999, total trade was valued at \$US 23.5 billion, with Taiwan becoming China's seventh largest trading partner. Taiwan enjoyed a huge trade surplus of \$US 15.5 billion against China (*Guoji Shangbao*, 14 January 2000). The major export goods from Taiwan to the mainland are electrical and electronics machinery, and in 1998 such exports amounted to 19.2% of total cross-strait trade (*Kōryū*, No. 594, 1999). This growth is largely attributable to the shift of production bases from Taiwan to China.

6.4 The Political Economy of the Taiwan Strait

6.4.1 The Asymmetric Relations across the Taiwan Strait

Taiwanese FDI in China did not emerge until the mid-1980s. The political rivalry between Taiwan and China separated the people and society. Indirect trade and investment finally began through Hong Kong in the mid-1980s. Taiwan-mainland China relations remain unresolved and are characterised as asymmetric relations on the basis of deepening economic integration and political hostility. With the introduction of China's open door policy, Taiwan's economic liberalisation and the change of the international environment (Sino-US diplomatic normalisation in 1979, Sino-Japan diplomatic normalisation in 1972), the door was opened for economic exchange without resolving fundamental political conflicts.

Since then China has continued to call for Taiwanese FDI in the mainland. It has adopted several laws and regulations to support Taiwanese businesses. While China called for direct contacts by 'three communications' (postal service, transportation and commerce) in 1979, Taiwan insisted on gradualism in further opening up cross-strait economic relations. The Executive Yuan approved a revised mainland policy in March 1991 under the Guidelines for National Unification (*tongyi gangling*). This reasserted the 'One China' (*yige Zhongguo*) principle offered by mainland China, but for the first time defined the unification processes in terms of three stages: (1) eliminating hostility and the recognition

of Taiwan's status as a political entity as well as implementing democracy and the rule of law; (2) establishing official communication channels, and direct postal, transport and commercial links; (3) the unification, in accordance with the will of the people, of a democratic, free, equitable and prosperous China. Taiwan thus clearly rejected the 'one country, two systems' formula presented in *Relations Across the Taiwan Strait* (Mainland Affairs Council: MAC) in 1994. In July 1999, President Lee Tenghui appealed for the recognition of reality and proposed 'special relations between two countries'.

The Taiwanese government fears a heavy dependence on mainland China for reasons of national security. The possibility of political fluctuations in mainland China carries it with the risk of a direct impact on Taiwan (e.g. through economic sanctions). The Taiwanese government is thus faced with a dilemma from an economic perspective, because the mainland is a natural location for Taiwanese business. The 'southward policy' in the early 1990s was a challenge by the Taiwanese government to direct the flow of investment to Southeast Asia. This policy reflected a desire to avoid excessive dependence on economic ties with mainland China (Yahuda, 1998: 290). It was also driven by economic and commercial considerations, and officials from the Ministry of Economic Affairs and Taiwan's central bank played a crucial role (Chan, 1996: 97). Claiming they were on 'vacation' or an 'informal visit', President Lee Tenghui and Chief Executive Yuan Lien Chan visited southeast Asia in 1993-4. Taiwan succeeded in setting up high-level contacts and semi-governmental offices, and Taiwanese businessmen were able to establish networks of trade associations with ASEAN countries. Lee often used the Latin American countries as intermediaries, and in September 1997 he attended the Panama Canal International Conference. Despite China's opposition, Taiwan has succeeded in expanding its informal networks and international political exposure through so-called 'pragmatic diplomacy' (Ijiri, 1997). Taiwan's aid diplomacy has also succeeded in establishing friendly relations with small developing countries in the Caribbean, the South Pacific and Africa (Chan, 1997).

However, the sharp increase of Taiwanese FDI in China in the 1990s gave rise to new problems, including trade disputes, issues of document authentication, illegal entry, property inheritance, etc. In November 1990, Taiwan established the Strait Exchange

Foundation (SEF) to negotiate practical problems with the PRC authorities. The PRC soon responded by setting up the Association for Relations Across the Taiwan Strait (ARATS). These two associations have an unofficial status, but they make it possible for the two governments to communicate indirectly with each other. In April 1993, the leaders of these associations, Koo Chenfu and Wang Daohan, had a meeting in Singapore, where they agreed to the establishment of regular channels of communication. However, the second Koo-Wang talks, scheduled for July 1995, were postponed by the PRC because of Lee Tenghui's visit to the US in May 1995. This time China engaged in missile exercises in the Taiwan Strait and tension was raised. The SEF is a non-profit-making private organisation whose objective is to promote contacts and exchanges across the Taiwan Strait. On the other hand, the ARATS was set up to promote the three direct links across the Taiwan Strait, and more importantly, to carry out peaceful unification on the basis of 'one country, two systems' (Cabestan, 1998: 223). In the face of difficulties created by increasing political tension, in October 1998 Koo Chenfu visited the mainland and talked with President Jiang Zemin. Nevertheless, since Lee's declaration of 'two countries in special relations' in 1999, there has been little progress in cross-strait political relations.

6.4.2 Business and Politics in Taiwan

The real pressure for the revision of Taiwan's economic policy toward China has come from 'bottom-up' demands by the Taiwanese business community to ease economic restrictions on the three communications (postal, transportation and commercial relations). As the Taiwanese economy fell into economic recession in the late 1990s, Taiwanese businesses sought better production sites and operations. Taiwan's economy became less and less able to ignore mainland China (Cabestan, 1996: 1273). The slowdown of the US economy in 2000 heavily influenced the performance of Taiwanese PC-related firms. Business leaders such as Wang Yongqing (Wang Yung-ching), chairman of Taiwan Plastic, and Zhang Zhongmou (Chang Chungmou), chairman of TSMC, began to urge the relaxation of Lee's restrictive policy (*jieji yongren*) (*Kōryū*, No. 634, 2001). The Xinzhu science industrial park also faced criticism because of the lack of land, inadequate water supply, unstable electricity supply, and heavy traffic.

In August 2001, Taiwan finally decided to change its economic policy toward mainland

China. This decision was influenced by the change of the Taiwanese business environment. In March 2000, Chen Shui-pian was elected as the first DDP (Democratic Progressive Party) President of Taiwan. However, as the DDP's political power base is weak (it gained only 39% of the vote in the Presidential election in 2000 and below the majority of Legislative Yuan seats)²⁴, Chen needs to gain the support of as many groups as possible, especially businesses. Although the Taiwanese government still prohibits high-technology investment, SMEs have continued to enter China through third countries. The leading firms, which have maintained the restrictions, have been frustrated by this unfairness. In August 2001, the Taiwanese government decided to approve direct investment in China and even investment from mainland China in Taiwan. Significantly, this process is led by influential Taiwanese business leaders such as Wang Yongqing (Wang Yung-ching) and Zhang Zhongmou (Chang Chungmou) (NKS, 27 August 2001). On the Chinese side, leaders in the mainland understand their own country's attractiveness, and have concentrated their endeavours on Taiwan's business community, especially Taiwan's relatively large businesses (Leng, 1998: 151). Thus, although high-level political interplay over the Taiwan Strait (especially between China and the US) is very important, the deepening economic interconnectedness between China and Taiwan is also proving to have a major impact in the economic arena, especially in the case of Taiwan. Cross-strait relations increasingly embrace the economic dimension.

6.5 The Governance of Production Networks

While the support of the Taiwanese government has greatly helped PC-related firms, the creation of networking linkages with large electronics firms has minimised the disadvantages of small-sized firms through the acquisition of OEM, ODM and EMS in relations with advanced countries. In addition to networking linkages with large firms, Taiwanese firms have created unique inter-firm linkages which are different from the *keiretsu* system that dominates Japanese inter-firm relations. Taiwanese firms have also introduced a unique, innovative system of governance of production networks across the Taiwan Strait.

6.5.1 The Inter-Firm Relations of Taiwanese SMEs

In 1996, almost 98% of Taiwanese enterprises were SMEs²⁵. SMEs are constrained by their limited resources and capabilities, especially in the case of small countries, where the small domestic market restricts the ability to function as a buffer against fluctuations in the international market. On the other hand, the great advantage of SMEs is their flexibility. Taiwanese SMEs have developed an extreme form of specialisation by engaging in single tasks. While the scale of production is small, SMEs are able to avoid the burden of fixed capital cost. The rate of owner's equity is very high (on average about 80%), and SMEs have developed their own financial networks without relying on bank loans (Sugioka, 2001: 37). Another feature is the structure of inter-firm relations on the basis of loose and short-term networks. Thus SMEs in Taiwan have developed without strong government support. In 1993, they accounted for 69% of total employment and 55% of Taiwan's manufactured exports (Ernst, 2000b: 113). In 1996, the number of workers employed by SMEs was equivalent to 78.6% of Taiwan's total employment (Sugioka, 2001: 31).

However, with the rise of a highly competitive business environment, SMEs need to develop a variety of linkages in order to survive. Kawakami (1998) focuses on the functional side of inter-firm relations in the computer industry. Taiwanese computer firms have created an inter-firm division of labour based on functions, production processes, and vertical and horizontal divisions. For example, one firm specialises in the design and final investigation of finished goods, while other firms, acting as subcontractors, focus on production in factories. In terms of the inter-firm division of labour in production processes, Taiwanese computer firms often divide those processes into sections and give orders to a number of producers who match the requirements in terms of cost and technology. Furthermore, there is a vertical and horizontal system of external ordering: when a firm gains a contract that exceeds its production capacity, it asks a competitor firm to undertake a part of the production. Although small firms are constrained by the limits of their knowledge-creation capacity, Taiwanese firms have developed 'knowledge outsourcing' through a variety of inter-organisational linkages (OEM, etc.), which has made it possible for small firms to compete in globalised high-tech industries (Ernst, 2000c). Thus, the development of the Taiwanese electronics industry owes much to its complementary inter-firm relations in production and the introduction of advanced technology. While this

flexibility in design and production, and cooperation with foreign firms, are the results of a division of labour rooted in inter-regional intra- and inter-firm networks, they are also supported by a concentration of firms in a certain place, which helps low-cost production.

6.5.2 Business Groups

By 1996, Taiwan had 113 business groups and 1,215 affiliated firms under core firms.²⁶ While the number of business groups in Taiwan has been the same for 20 years, their economic presence has dramatically increased. By 1996, 113 business group employed 6.4% of the total population in Taiwan but their sales accounted for 44.8% of Taiwan's national GDP.²⁷ The electronics industry has come to occupy an increasingly important position. Other non-electronics firms, such as Formosa Plastic, have already participated in the manufacturing of electronics products. The development of Taiwanese inter-firm linkages dates back to the government's shift in economic strategy from the public sector to the private sector in the 1950s. The emphasis on the electronics industry in the 1970s gave a further stimulus to the formation of business groups. Taiwanese electronics firms undertook OEM arrangements and international sub-contracting, and developed linkages with the world market. The larger size of firms then became essential to secure economies of scale and scope. As the leading MNCs formed local production networks, the core Taiwanese firms, including Tatung, MiTAC and Acer, came to rely on loosely affiliated domestic suppliers. Taiwanese SMEs in the electronics industry have been integrated into business groups. In particular, Taiwanese traditional family-owned firms are under considerable pressure to change. Family-owned inter-firm linkages have been thought to be helpful in terms of cost and flexibility, but the rise of competitive requirements has begun to erode loose networks based on these linkages. The top ten firms today control roughly 80% of total production (Ernst, 2000b: 119).

Ernst (2000b: 119-123) identifies five distinctive forms of inter-firm linkages in the development of Taiwanese firms: informal 'peer group' networks; hierarchical centre-satellite systems; business associations; industrial parks; and variations in the business group model. Informal peer group networks comprise classmates (for example from elite schools) and former colleagues (foreign affiliates). Taiwanese firms have relied heavily on the informal exchange of information since their foundation, and Acer is a good

example of this reliance. In 1984, a hierarchical centre-satellite system was launched by the government to develop vertically integrated production in 1984 similar to the Japanese *keiretsu* system (Ernst, 2000b: 121). The establishment of business associations is also encouraged by the government in order to facilitate the exchange of information. Industrial science parks have also played an important role in deepening inter-firm relations (see Section 6.1 in this chapter). Business groups also organise the holding companies in order to respond to the needs of flexible and efficient production.

6.5.3 Geographical Concentration

Another feature of Taiwanese electronics firms is their geographical agglomeration. The majority of PC-related firms are located between Taipei and Xinzhu. The central place is the Xinzhu science industrial park. In 1997, out of 230 firms, the number of integrated circuit-related firms was 86, the number of computer-related firms was 45, and the number of telecommunication-related firms was 36 (*Ciekkon Ajia*, February 1998). In 1996, about 77% of Taiwanese electronics components firms were located between Taipei and Xinzhu (Kawakami, 2001: 78). For the PC-industry, the procurement of components at low cost is vital. Geographical proximity among components suppliers helps to provide an efficient division of labour in PC-related production. Thus, networking is the most critical feature of Taiwanese inter-firm linkages and is evolving and being reorganised in relation to the various forms of governmental support and external influences.

6.5.4 The Governance of Production Networks across the Taiwan Strait

Taiwanese investors see China as a production base centred on the electrical and electronics industry. In particular, this investment has been stimulated by the rapid growth of the use of personal computers across the world. Japanese, US and European computer manufacturers often approach Taiwanese firms for OEM and ODM as well as EMS production. Through the expansion of Taiwanese FDI in China, Taiwanese inter-firm relations have also moved to the mainland and production networks have been created across the Taiwan Strait.

6.5.4.1 The Forms and Strategy of Investment

According to the Chung-Hua Economic Research Institute (Taipei), initially (early in the

1990s) the average level of Taiwanese FDI in China was about \$US 1 million. It then continued to increase, and in the late 1990s it averaged \$US 2.12 million per project (*Kōryū*, No. 632, 2000). In terms of the forms of investment, one study suggests that the 100%-Taiwanese owned firm was dominant. This is because Taiwanese firms found that when they invested in China through joint ventures or co-operative operation enterprises, they often encountered managerial problems on the Chinese side. Thus, the 100%-Taiwanese owned firm was the best way to avoid this problem (*Kōryū*, No. 575, 1998). Indeed, according to research by the Chung-Hua Economic Research Institute, in 1992 the 100%-Taiwanese owned firms accounted for about 40% of Taiwanese firms in China, and this increased to more than 50% in 1995 (*Kōryū*, No. 632, 2000). In addition, Taiwanese firms were able to gain local information without joint local partners, and sought to keep control of the production technology (*ibid.*). Because of unresolved political tensions, Taiwanese FDI in China is generally 'roundabout' investment. For example, Key Systems Corp (founded in 1983) has established 100%-owned subsidiaries in the Cayman Islands (Cayman Genius Holding) and the Virgin Islands (Virgin Island Key Inc.).

6.5.4.2 A Model of the International Division of Labour between Taiwan and China

Table 6.10 Model of the Division of Labour Across the Taiwan Strait (%)

	1995 <i>Research</i>	1999 <i>Research</i>
(1) Components Production by Parent Firm (Taiwan). Assembling (China)	25.9	11.8
(2) Component Production by Subsidiaries (China). Assembling (Taiwan)	29.9	9.5
(3) Production on Both Sides but Valued Added Production in Taiwan	67.0	33.1
(4) Production on Both Sides but Value Added Production in China	7.2	1.0
(5) Production on Both Sides. Products are the Same.	33.0	30.1
(6) Production on Both Sides. Products are Completely Different	17.5	10.6
Firms in Sample	140	960

Note: The research in 1995 was done by Gao Xijun group, and that in 1999 was done by the Ministry of Economy (Taiwan).

Source: *Kōryū*, No. 632 (30 November 2000).

The rate of Taiwan's offshore production in PC-related products reached nearly 50% in 1999 (*Kōryū*, No. 622, 2000). In the same year, China accounted for 70% of the offshore production of Taiwanese informational products (*Kōryū*, No. 622, 2000). Taiwanese firms have invested in mainland China mainly because of the low cost of labour. According to

the Economics Ministry in Taiwan, 74% of Taiwanese firms in the mainland are involved in labour-intensive production (*Taiwan Tsūshin*, 16 March 2000). Table 6.10 shows a model of the international division of labour between Taiwan and China. It shows that the division of parts and products assembly between Taiwan and China has declined, i.e. vertical integration has declined as horizontal integration has increased.

6.5.4.3 Finance

Taiwanese direct investment in mainland China is still restricted by the Taiwanese government. Taiwanese firms thus need to invest through third countries which have investment protection treaties with China. Hence, they use their holding companies and subsidiaries established in places such as Hong Kong, Singapore and the Central American island countries. Most of these are 'paper companies'. Besides formal transaction processes, there are some illegal channels and gray markets for financing Taiwanese firms in China. For example, illegal financial firms in Hong Kong deal with Taiwanese remittance to their subsidiaries in the Pearl River Delta by using higher exchange rates than the official rates (*Kōryū*, No. 575, 1998). Taiwanese firms in China also have other options for their finance: the use of the stock market (investment by individuals, firms and government) and loans (long-term and short-term, corporate bond). Once Taiwanese investment enters China, it rarely returns to Taiwan. Due to the heavy restrictions by the Chinese government on taking foreign currency out of China, only 0.6% of total Taiwanese investment in China has returned to Taiwan (*NKS*, 27 August 2001). Given such restrictions, Taiwanese firms try not to hold RMBs for a long time. When they import goods, they often require payment in advance.

6.5.4.4 Technology

Production technology in Taiwanese firms in mainland China owes much to the parent firms in Taiwan, especially the latter's provision of technology.²⁸ However, one of the crucial changes is the increasing level of R&D in mainland China. Some Taiwanese firms now prefer to employ researchers in mainland China rather than in Taiwan. Acquiring OEM is another channel for the introduction of technology for Taiwanese firms in mainland China. Similarly, Taiwanese firms have undertaken 'foundry' production in exchange for the provision of technology from the client firms (*Kōryū*, No. 632, 2000).

6.5.4.5 Local Procurement

Local procurement activities provide useful information on the degree of localisation of Taiwanese firms in mainland China and the degree of exchange of materials and components for production processes. These firms are still dependent on the supply of materials and parts from the parent firms in Taiwan (Table 6.11). However, the share of procurement by non-Taiwanese firms in mainland China is steadily increasing. In the procurement of materials, the share of non-Taiwanese firms is higher than that of Taiwanese firms in China. In the case of the supply of parts, non-Taiwanese firms have steadily increased local procurement for Taiwanese firms in China. However, Taiwanese firms in the mainland still depend to a certain degree on the supply of materials and components through imports from third countries.

Table 6.11 The Procurement of Taiwanese Firms in China, 1995-1998

Procurement Route	1995 Research	1996 Research	1997 Research	1998 Research
Materials (Number of Firms)	719	967	752	826
Taiwan	52.5	50.3	49.0	44.1
Taiwanese Firms in Mainland China	17.2	17.6	16.6	19.4
Non-Taiwanese Firms in Mainland China	18.2	19.5	21.7	23.2
Import from Other Country	12.1	12.6	12.7	13.3
Components and Parts (Number of Firms)	546	537	550	605
Taiwan	56.3	53.0	52.9	47.5
Taiwanese Firms in Mainland China	18.2	18.6	19.9	23.3
Non-Taiwanese Firms in Mainland China	18.8	20.5	19.2	21.7
Import from Other Country	6.8	7.9	8.0	7.5

Source: *Kōryū*, No. 632 (30 November 2000).

6.5.4.6 The Dispersion of Production Sites

Thus far, Taiwanese electronics investment has been concentrated in Guangdong, especially Dongguan. In the late 1990s, the Suzhou and Shanghai areas emerged as major destinations for Taiwanese investment in China. According to data from the Taiwanese Economics Ministry, between January and March 2001 Taiwanese FDI in Jiangsu reached 55.14% of total Taiwanese FDI in mainland China, thus exceeding the investment in Guangdong (30.3%) (*Xianggang Wenhuibao*, 29 May 2001). The major Taiwanese electronics firms have already established notebook PC production sites in Shanghai (Quanta and Inventec), Suzhou (FIC and ASUSTec) and Kunshan (Compal) (see Table

6.9). In Kunshan, Delta Electronics and Arima have also established notebook PC production (*Sinorama*, July 2001). Though the production of notebook PCs in mainland China is not yet legally permitted, Taiwan's earthquake (September 1999) affected the supply of electronic parts and components.

Secondly, China's further opening of the domestic market as a result of WTO membership (in 2001) will induce foreign investment targeting the domestic market. After China joins the WTO, the restriction on foreign firms' domestic sales will be abandoned (*Dajingmao*, October 2001). For OEM production, the movement of foreign firms is vitally important. For example, Toshiba's launch of notebook PC production in Shanghai in 2000 greatly affected the shift of Taiwanese electronics firms (Mizuhashi, 2001: 158). Also, as Sony plans notebook PC production in Jiangsu by early 2002, Taiwanese electronics firms will further concentrate notebook PC production in the Yangtze River Delta. In order to receive OEM orders from the world's leading electronics firms, these firms cannot ignore the trend of investment in China by other electronics firms. In the case of notebook PC production, there is already concentration in the Yangtze River Delta, but in Dongguan there is still no production site. In addition, due to local requirements (at least 60% of components must be purchased in mainland China), a Taiwanese head office cannot take an order from a local production site (e.g. Motorola in Tianjin), but Taiwanese subsidiaries (e.g. in Kunshan) can take this order as local firms (*Sinorama*, July 2000). The number of Taiwanese firms in Suzhou has already reached almost 2,000 (*Zhongguo Qiyejia*, No. 10, 2001). The key features of Taiwanese FDI in the Yangtze River Delta may be summarised as: (1) its large scale of FDI; (2) its tendency to follow the group firms, and (3) 100%-owned investment (Saka, 2001: 12). Taiwanese firms realise that Dongguan is more suitable for SMEs and sales for abroad on the basis of processing arrangements (*Xianggang Wenhui*, 29 May 2001). Thus, the Yangtze River Delta is seen as suitable for different strategies and is likely to be the site of a new agglomeration of the electronics industry.

The shift of Taiwanese electronics firms is also illuminated by research on the investment environment in China conducted by the Taiwanese Electrical and Electronics Manufacturing Association (TEEMA) in early 2001. This research focused on the significance of the natural environment, infrastructure, public facilities, the social

environment, and the legal environment. In terms of the degree of satisfaction of Taiwanese investors, Dongguan is ranked as worse than other areas (including the Yangtze River Delta, Shanghai, the Bo Hai area, Shenzhen and the southeast coastal area) (*Zhongguo Qiyejia*, No. 10, 2001). The worsening of the investment environment in Dongguan (because of poor security and extensive corruption) is encouraging a further shift of Taiwanese firms to the north. The reputation for openness and flexibility associated with the Dongguan government has been replaced by the image of greedy local government officials (G. Yeung, 2001a: 213).

6.6 Conclusion

This chapter has sought to demonstrate the role of Taiwanese firms in the development of CPNs in relation to the links with Japan and China. The spread of networking linkages in the electronics industry is carried out through the various strategic interactions between different levels of political and economic activity. The growth of such linkages across Japan, Taiwan and Guangdong is closely linked to the emergence of a system of CPNs, with hierarchical arrangements giving way in many areas to non-hierarchical, intra-and inter-firm networks, and local and interpersonal networks of governance. In the economic domain, Taiwan is responding to the emergence of China's MLG.

This chapter has highlighted five major factors involved in the development of networking linkages and the innovation of PC-related production centred on Taiwanese electronics firms: the domestic political economy, the role of Japanese FDI, Taiwanese FDI in China, the political economy of the Taiwan Strait, and the governance of production networks across the Taiwan Strait. First, from the viewpoint of the Taiwanese government, it is extremely important to overcome the disadvantage of being a small country. The government has given extensive support to the electronics industry, which is not confined to the actual territory of Taiwan. The national development plan for the electronics industry, including the establishment of the Xinzhu science-industrial park, was a critical turning point for the Taiwanese electronics industry.

Japanese electronics firms, as external providers of capital and technology, have helped to

promote the shift of Taiwanese firms from low-valued added production to high value-added production. Taiwan was originally the production site for the US and Japanese firms. In the case of the relationship with Japanese firms, Taiwan shifted from a commodity-export role to a commercial-subcontracting role for the *keiretsu*, using imported components from Japan. Then it began to play an export-platform role, using Japanese FDI. It has also become a major components supplier. Entering the business networks of Japanese firms was a crucial first step for Taiwanese firms. The development of inter-firm relations between Taiwanese PC-related firms and advanced countries since the 1980s has led to more opportunities to introduce and upgrade technology. The acquisition of OEM orders from advanced countries has further helped to enhance the technological transfer of Taiwanese PC-related firms. Following the increase of OEM production, firms have become more capable of producing contract-made-to-order memory chips (i.e. EMS) for electronics products. Firms are now transforming themselves into EMS firms. Taiwan has thus begun to play an important export role for PC-related products as well as acting as a components supplier.

Taiwan has now emerged as the major investor in China, ordering the assembly of manufactured goods. It has extended its activities across the Taiwan Strait in order to meet the demands of low-cost production. The role of Taiwan as a recipient of Japanese FDI and a supplier of investment to China is crucial for the further development of production networks across Japan, Taiwan and China. The flexible Taiwanese inter-firm division of labour is extended to the international division of labour using production sites in China. Taiwanese manufacturing investors tend to concentrate in one area with a single sector, and have developed special production zones. However, expansion to China cannot avoid the issue of cross-strait relations, which politically remain unresolved. Taiwanese industrial policy, focusing on the development of the electronics industry based on the domestic sphere, needs to take into account these cross-border political considerations. For the Taiwanese government, economic development is a key political issue. Given the weak power base of Chen's cabinet, the government can no longer restrain the voice of business communities and indeed has started incrementally to move towards a further opening of the Taiwan Strait.

As Taiwanese firms are generally small or medium-sized, they have developed complementary inter-firm relations. Like the Japanese *keiretsu*, Taiwanese firms have also organised business groups. However, for the small firms, geographical concentration is very important. In terms of production networks across the Taiwan Strait, there is still much concern about the continuing political uncertainty. Nevertheless, Taiwanese firms have developed a distinctive form of production network in order to minimise risk. This can be seen in the common forms of investment, the international division of labour, and arrangements for finance, technology and local procurement. Although Taiwanese firms maintain their roots in Taiwan, they are steadily promoting the localisation of their subsidiaries in mainland China. Taiwanese electronics FDI has been going to the Yangtze River Delta in anticipation of China's WTO membership. Dongguan is already being used for export sales, and the Yangtze River Delta has emerged as a potential base for targeting China's domestic market. Thus, the development of Taiwanese CPNs has clearly responded to the development of MLG in China.

¹ *Kōryū*, No. 638 (31 March 2001).

² As a result of the Plaza Agreement in 1985, the Taiwanese dollar (NT) was revalued against the US dollar. The exchange rate against the US dollar went up from almost 40 NT per US dollar in 1985 to 25.2 NT (at its peak) in 1992. This damaged the foundation of the export base, especially in labour-intensive products manufactured in Taiwan.

³ More than 200 million (NT dollars) of investment enjoyed various kinds of preferential treatment.

⁴ The figure is taken from Ikegami (2000).

⁵ The figure is from Ikegami (2000).

⁶ *Kōryū*, No. 572 (15 April 1998) and No. 626 (31 August 2000).

⁷ The figures are calculated by the researcher using *Taiwan no Keizai Dōta* (The Economic Data on Taiwan).

⁸ The figure is the researcher's calculation based on *Kōryū*, No. 572 (15 April 1998) and No. 626 (31 August 2000).

⁹ The figure is the researcher's calculation based on *Kōryū* (various issues).

¹⁰ The figures are from Tōyō Keizai (2000).

¹¹ *Kōryū*, No. 576 (June 15 1998).

¹² For example, in 1998, the share of world notebook PC production (in volume) by Taiwanese firms was 40%. In monitors, it was 58% and in motherboards it was 61%. See *Kōryū*, No. 619 (15 May 2000).

¹³ The research targeted information hardware products which have a high rate of OEM, including notebook PCs, monitors, desktop PCs, motherboards, SPS, CD-ROMs, cases, scanners, graphic cards, keyboards, UPS, mice, sound cards, and video cards. See *Kōryū*, No. 619 (15 May 2000).

¹⁴ Shu En (Zhu Yan) (2000: 517). Acer had contracts with Apple, Canon, Mitsubishi, Fujitsu, Hitachi and TI in 1996. See also Takaoka (1997: 213).

¹⁵ The figure is from *Kōryū*, No. 622 (30 June 2000).

¹⁶ The figure is from *Kōryū*, No. 626 (31 August 2000).

¹⁷ In 1998, Taiwanese outward FDI in the central American island countries was valued at \$US 1,838.43 million and inward FDI from these countries in Taiwan was \$US 711.47 million. The figures are taken from Lin Thomas (2000: 89).

¹⁸ These figures are taken from *Kōryū*, No. 622 (30 June 2000).

¹⁹ The figure is taken from Mizuhashi (2001: 152).

²⁰ The figure is from Daiichi Kangyō Bank (DKB), <http://www.dkb.co.jp/houjin/report/china/200003/>

However, most Taiwanese firms are small and medium firms, and many do not register officially with the authorities. Thus, the real number is undoubtedly much higher than this figure.

²¹ These figures are calculated by the researcher by using *Kōryū*, No. 631 (15 November 2000).

²² The figure is calculated by the researcher using *Kōryū*, No. 626 (31 August 2000).

²³ The figure is taken from Shu En (Zhu Yan) (2001: 173).

²⁴ At the Legislative Election in December 2001, the DDP gained 87 seats among 225 total seats (*NKS* 2 December 2001).

²⁵ In the case of Taiwan, small and medium firms are defined as firms with capital of less than 60 million NT dollars and less than 200 workers.

²⁶ The figure is from Shu (Zhu) (2000: 488).

²⁷ The figure is from Shu (Zhu) (2000: 488).

²⁸ According to the research done by the Chung-Hua Economic Research Institute, more than 90% of Taiwanese firms in China are supplied technology by their parent firms in Taiwan. See *Kōryū*, No. 632 (30 November 2000).

CHAPTER 7

THE OPERATION AND STRUCTURE OF CROSS-BORDER PRODUCTION NETWORKS AMONG GUANGDONG, TAIWAN AND JAPAN

This chapter is divided into two parts. The first part investigates the intricate pattern and processes of cross-border production networks (CPNs) among Guangdong, Taiwan and Japan. Section 7.1 discusses the processes of Hong Kong manufacturing firms' shift into Guangdong, which became the basic model of cross-border production. Section 7.2 presents the role of local governments' 'para-diplomatic' activity, focusing on the provincial level (Guangdong) and the sub-provincial level (Dongguan). Section 7.3 examines the operation and structure of cross-border networks, including the role of *guanxi* and intermediary organisations between the Dongguan government and foreign firms. The second part of the chapter focuses on the impact of micro-regionalisation on the Chinese economy. Section 7.4 analyses the growth of the Chinese electronics industry and its impact on East Asian industrial structure. Section 7.5 considers whether this micro-regionalisation has promoted China's national economic integration. Section 7.6 summarises the chapter's main arguments.

7.1 Hong Kong and the Pearl River Delta

It is essential to discuss the role of Hong Kong in the process of micro-regionalisation among Guangdong, Taiwan and Japan. Hong Kong occupies a critical position in relation to the Taiwan Strait. Economic contacts between China and Taiwan since the late 1980s would not have developed without the role of Hong Kong. Hong Kong's reversion to Chinese sovereignty in 1997 was also a crucial turning point for the relationship between mainland China and Taiwan. However, as long as political hostility between China and Taiwan remains unresolved, and direct trade, postal and shipping links are impossible between Taiwan and China, Hong Kong has been, and will continue to be, an important

channel for trade and investment between Taiwan and China (Lin, 2000).

Hong Kong has played a major role in the creation of cross-border economic relations with Guangdong. Hong Kong was the catalyst which drew Guangdong's economy into the global economy after 1979 (Johnson, 2001: 217). Hong Kong's presence in Guangdong's inward FDI is very high. Between 1979 and 1997, FDI from Hong Kong (actual use), although including different origins, reached \$US 58 billion, accounting for 72% of Guangdong's total inward FDI (\$US 81 billion).¹ Hong Kong is also the largest export destination of Guangdong. In 2000, Guangdong's exports to Hong Kong accounted for 34.3% of total its exports (*Zhongguo Duiwai Jingji Maoyi Nianjian 2001*).

The expansion of the Hong Kong electronics industry has had a notable effect on Guangdong's production structure. The electronics industry is the second largest manufacturing industry after the clothing industry in Hong Kong's domestic exports.² Hong Kong's economic development was achieved through an export-oriented strategy in garments/textiles and the electronics industry between the 1950s and 1980s. With the shift of Hong Kong manufacturing industry into China, Hong Kong's exports are now dominated by re-exports of products from mainland China (88.5% in 2000) (*Hong Kong Census*). This is the result of Hong Kong's manufacturing industry movement out of Hong Kong in search of lower-cost land and labour. Hong Kong manufacturing firms own and manage an extensive network of activities in the Pearl River Delta of China. This transformation has enabled them to grow far beyond the size that would have been possible in Hong Kong alone. *Made in Hong Kong* has declined but *Made by Hong Kong* has grown in importance (Berger and Lester, 1997).

7.1.1 Hong Kong's Expansion into Guangdong

Throughout the 1970s, Hong Kong's exports of domestic goods accounted for more than 70% of total exports, and the level of re-exports was insignificant. The major exports of domestic goods were manufactured goods, which accounted for 95% of total exports of domestic goods. Although garments and textiles remained the most important export items, electronics goods, watches and clocks were also significant. In the mid-1970s, in addition to the acceptance of legal immigration, Hong Kong used a 'touch base' policy³ to regulate

immigration from the mainland, and this flexible policy offered low-cost labour for Hong Kong businesses. However, the Hong Kong government had to provide houses for new immigrants, and unskilled immigrants were increasingly seen as a liability for the social welfare system (Sung, 1998: 5). Following restrictions on immigration in 1980, Hong Kong manufacturers began to experience labour shortages, rising costs of labour and land, and higher environmental costs, and they consequently lost their price competitiveness in the international market. In the 1980s, although the Plaza Agreement⁴ strengthened Hong Kong's competitiveness (because of the depreciation of the Hong Kong dollar), it then became difficult to meet the increased demand for Hong Kong products. The overheating of the economy further increased the costs of land and labour.

The introduction of an open door policy in Guangdong in the late 1970s provided new opportunities for Hong Kong business. It allowed the entry of foreign firms and the creation of joint ventures with favourable taxes and other incentives. During the pre-reform period, the Pearl River Delta was an important source of foodstuffs and water supply as well as legal and illegal immigration, thereby supporting Hong Kong's labour-intensive manufacturing. The establishment of Shenzhen's SEZ, adjacent to Hong Kong, provided abundant land and inexpensive labour, together with flexible policies on employment, border and custom controls, and improved infrastructure. With the enhancement of the investment environment in the Delta, the full-scale advance of Hong Kong manufacturing firms across the border began in the late 1980s. These firms responded quickly to the emergence of a new lifeline -- 'like fish finding the water' (Ash, 2000).

The most popular form of industrial linkage between Hong Kong and Guangdong can be seen in the spread of processing-trade arrangements (PTAs). From 1979 to 1995, Hong Kong investors signed 23,605 cooperative production contracts with Guangdong, with an actual use of capital of \$US 14 billion (Sit, 1998: 896). The shift of Hong Kong manufacturing to the Pearl River Delta initially focused on labour-intensive production processes (shoes, sports goods, toys and travel goods, etc.), but later spread to value-added products (electrical and electronic goods, telecommunications, etc.). In the 1990s, product development operations, some managerial functions and even financial departments moved across the border. Many Hong Kong manufacturing firms now leave only management,

sales and procurement functions in Hong Kong. The processing trade based on re-exports from the mainland accounted for 87.6% of total re-exports of mainland products in 1998 (Maruya, 2000: 140). These arrangements have brought about a highly profitable pattern for Hong Kong firms except those in the textile industry. The rate of local procurement for plastic, toys, electronics goods and watches was over 50% in the late 1990s (Maruya, 2000: 140). The low cost of labour and land in China was a major incentive for the shift of Hong Kong manufacturing. According to research by JETRO, the monthly salary of factory workers in Shenzhen in 2000 was less than one tenth of that in Hong Kong (*Jetoro Sensā*, April 2001), and the price of factory land in Shenzhen was almost one eighth of that in Hong Kong.⁵

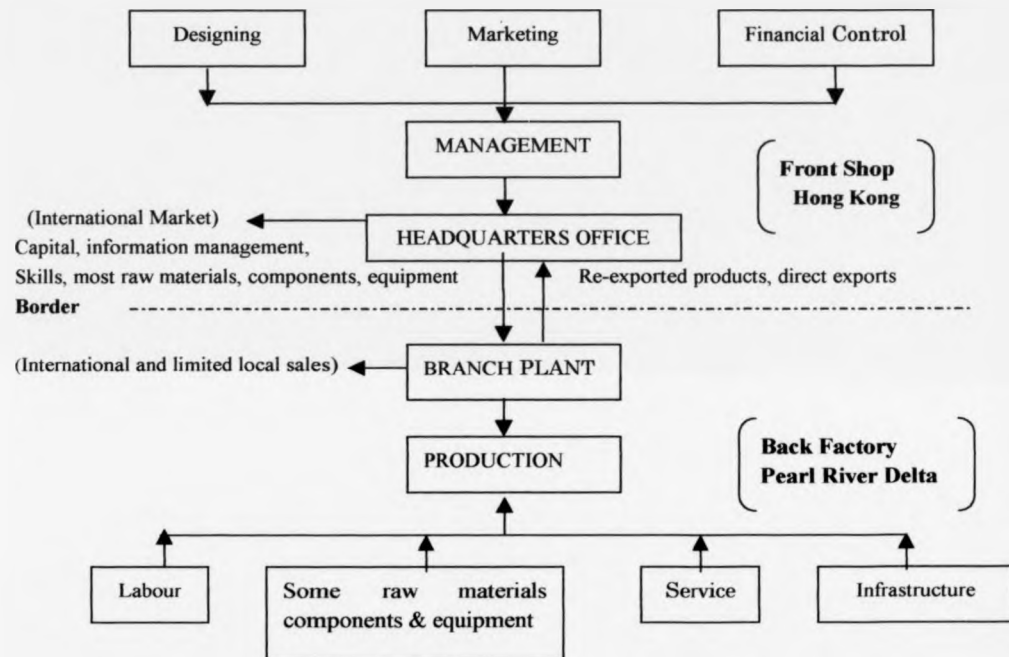
7.1.2 The Front-Shop, Back-Factory Model

The basic model of Hong Kong's extension of manufacturing activities in Guangdong is the division of labour corresponding to the so-called 'front-shop, back-factory' system (see Figure 7.1). According to this model, the headquarters in Hong Kong and the local branch plant in Guangdong establish an intra-firm division of labour. Front-shop activities focus on tertiary activities and the back-factory concentrates on production.

While Figure 7.1 illustrates the intra-firm division of labour, it is also important to examine inter-firm relations in Hong Kong-Guangdong linkages (see Maruya, 2000). The basic pattern is illustrated in Figure 7.2. Firm A (manufacturer) and Firm B (parts supplier) establish their own headquarter offices in Hong Kong, focusing on sales, parts supply, and financing, and their local branches focus on production in Guangdong. The inter-firm division of labour thus reduces the need for transactions between separate Hong Kong headquarter offices. While bills and payments are exchanged between the two headquarter offices in Hong Kong, parts supply is carried out between the local branches in Guangdong through the bonded zone (called *Zhuanchang*). Bonded zones – the first of which was established in Shanghai in September 1990 -- provide exemption from tariffs on imports in order to encourage production by foreign firms. By 1997, five bonded zones (two in Shenzhen, one in each of Guangzhou, Zhuhai and Shantou) had been established in Guangdong. In the case of a developing country, there is often a problem of inter-firm settlement system (payment system), and the foreign exchange system raises the cost of

production. Bonded zones allow foreign firms to act as agents for imports and exports, and help to reduce the transaction cost.

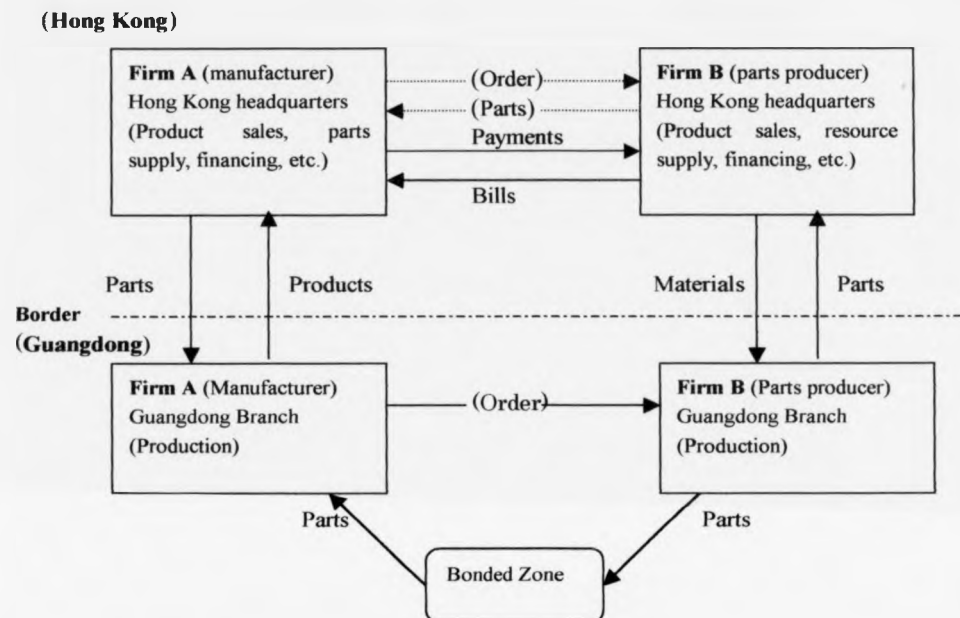
Figure 7.1 The Hong Kong-Pearl River Delta Cross-Border Manufacturing Model



Source: Sit, Victor F.S. (1998), 'Hong Kong's "Transferred" Industrialization and Industrial Geography', *Asian Survey*, Vol.38, No 9, September, p.899

Industrial expansion in the Pearl River Delta thus owes much to Hong Kong's developed expertise, its large pool of capital, skilled labour, and management personnel, and its access to equipment, technology and overseas markets, as well as various domestic factors including investment from the mainland, a benign host government policy and the improvement of infrastructure (Sit, 1998: 899). The intra- and inter-firm divisions of labour in the context of Hong Kong-Guangdong relations have been greatly improved. This has further attracted inward FDI into Hong Kong from Japan, the US and Taiwan, which have sought to exploit the advantages of Hong Kong-Guangdong links. In turn, this trend has resulted in further industrial agglomeration in the Pearl River Delta.

Figure 7.2 The Cross-Border Inter-Firm Division of Labour



Source: Maruya, Toyojirō (2000) 'Chūgoku Kanan no sangyō shūseki to Ajia no kokusai bungyō' (The Industrial agglomeration in Southern China and the rearrangement of the Asian international division of labour), in T. Maruya ed. *Ajia Kokusai Bungyō Saihen to Gaikoku Chokusetsu Tōshi no Yakuwari* (Rearrangement of the Asian International Division of Labour and the Role of FDI), Chiba (Japan) Ajia Keizai Kenkyūsho, p. 149.

7.1.3 The Characteristics of Production Networks in Hong Kong

Like Taiwanese manufacturing firms, the majority of Hong Kong manufacturing companies are family-based SMEs producing consumer electronics for OEM. More than 90% of Hong Kong manufacturing firms employ less than 100 workers, and furthermore the small firms (less than 20 workers) account for 80% of Hong Kong manufacturing firms (Sawada, 1999: 112). Hong Kong manufacturing firms have disadvantages in terms of capital and scale-sensitive components production. Also, research on Hong Kong manufacturing entrepreneurs reveals that more than 60% of small and medium entrepreneurs cannot speak English, and Cantonese is their daily business language (ibid.: 112).

Hong Kong electronics firms predominantly serve OEM production. According to Reif and

Sodini (1997), the electrical goods industry in Hong Kong falls into two major categories: (1) electronic end-products, including sound producing and recording products and audio equipment in general, communication equipment, electronic watches and clocks, etc.; (2) electronics components, including batteries, printed circuit boards, liquid crystal display and different types of semiconductor device components. The Hong Kong electronics industry imports most of its key components, packaging and integrating technologies, and components sourced elsewhere into new products (Enright et al., 1997: 155). Japan is the main source for key components for the Hong Kong electronics industry.

7.1.4 Hong Kong's Government and the Electronics Industry

The Hong Kong government has been able to provide a supportive environment for many types of business activities. The emergence of a Cold War structure in East Asia restricted Hong Kong's economic relations with mainland China. Hong Kong adopted an export-oriented strategy by introducing foreign investment. In the 1960s, because of its inadequate social welfare system, Hong Kong was faced with social instability (culminating in rioting in 1967). The colonial government then established several government-funded enterprises to improve housing and infrastructure, especially transportation, including airport and port facilities. One key feature of Hong Kong's governance is that public services are maintained by government-funded private enterprises. The Hong Kong government has also intervened extensively in tax policies with a simple and low corporate tax (Enright et al., 1997: 32). It has also made an effort to maintain a balanced budget. There is no restraint on exchange and on capital transfer abroad. There are few protectionist barriers in the trade sector and the procedure for imports is simple.

The Hong Kong government has supported the development of the electronics industry through programmes for human resources and development, technology, productivity and quality, business infrastructure and export promotion. It has set up various quasi-governmental supporting institutions such as the Vocational Training Council (VTC), the Hong Kong Productivity Council (HKPC), and the Hong Kong Industry and Technology Council Corporation (ITCC). According to Wai (1999), the ITCC offers a technology-based business incubation programme that provides support to establish firms,

and a technology transfer programme that encourages interactions between business and technology. The Hong Kong Investment Promotion Division (HKID) also promotes investment from foreign countries. These bodies are managed by a committee which includes members from management and labour, academics, and professionals as well as relevant government departments (Wai, 1999: 187). However, contrary to the case of Taiwan, Hong Kong's governmental support programmes have been targeted to include other industrial sectors. The growth of Hong Kong's electronics industry required the development of cooperative relations with advanced countries. Hong Kong actively established foreign representative offices for the promotion of trade and investment. By 1996, Hong Kong had established ten branches of the Hong Kong Economic and Trade Office, and the Hong Kong Industrial Promotion Unit had established seven foreign offices (Amako et.al., 1999).

7.2 The Role of Local Government

7.2.1 The Political Economy of Guangdong and the Electronics Industry

Guangdong has succeeded in attracting inward FDI since China's adoption of the open door policy in the late 1970s. The Guangdong government has adopted an export-oriented strategy and targeted the electronics industry as a priority industry. Following the formal decision to select the electronics industry as a core part of the national economy at the 14th NPC, in 1991 the Guangdong government launched an industrial policy based on advanced science and technology (especially through promotion of the electronics industry). Guangdong aims to reach the level of the East Asian NIEs by 2010 (Kantonshō Keikaku linkai, 1995). The electronics industry, however, needs a huge injection of finance, especially for R&D. The Guangdong government has therefore adopted various support programmes. The Guangdong Technology and Policy Bureau aims to support the introduction of technology and to coordinate the expansion of industrial scale. Under this bureau, the Industrial Technology Finance Firm undertakes to manage firms by holding a certain stock share of firms and supporting them financially. The Guangdong government has also adopted protectionist measures, including (1) tax exemption for any firms that invest in R&D; (2) the blocking of imports using the same ICs until the quality of products in Guangdong achieves the international standard; (3) the exemption from import

procedures for key components for machinery as long as they are made in Guangdong. In addition, the Guangdong government has organised an electronics industry expert group for economics and technology (ibid.: 134).

7.2.2 Guangdong's Foreign Economic Diplomacy

In the 1980s, the Guangdong government increased contacts with foreign investors through trade seminars, trade fairs, economic cooperation seminars, technological cooperative meetings, etc. Since the late 1980s, the government has sharply increased the number of formal contacts through meetings with foreign investors by sending delegations abroad. For example, in 1988 an economic delegation led by the Vice Governor visited Japan. By 1998, 14 such economic delegations had been sent abroad by the Guangdong government.⁶ The purpose of using such economic delegations has also expanded – from attracting foreign investment to the export promotion of Guangdong-made products. For example, in June 2001 a Guangdong Trade Mission (led by the Governor and 130 Guangdong firms) visited Africa to promote electronics goods (*NKS*, 29 July 2001). In terms of contacts with Japanese business groups, the Japan-Guangdong Economic Association and the Guangzhou-Japanese Chamber of Commerce have often arranged Japanese business delegations to visit Guangdong. Through such trade and investment promotional activities, the contacts between Guangdong and Taiwan have been also strengthened. For example, in 1992 the Guangdong Governor met with a former Taiwanese economic minister in Guangzhou. Guangdong's practices in foreign economic activities may be called 'multi-layered diplomacy' (see Chapter 2).

To some extent, the pattern of internationalisation at different levels of government reflects the political strategy of local governments. To take one example, the Guangdong provincial government and Guangzhou (capital of Guangdong) have sister city relations with different prefectures in Japan. Guangdong's provincial government has a sister relationship with Hyogo prefecture (one of SNGs in Japan) in the west of Japan (agreed in 1983). At the sub-provincial level in China, Guangzhou, however, has a sister city relation with Fukuoka city (agreed in 1979) in Fukuoka prefecture, located on Kyushu. Zhongshan and Shantou have sister city relations with Osaka's cities (Moriguchi, agreed in 1988, and Kishiwada, agreed in 1990). Foshan has a sister relationship with Itami (in Hyōgo prefecture, agreed in

1985). At the level of sub-municipal (township) level government, though Dongguan city government does not have a sister relation with any city in Japan, Wangniudun (a sub-municipal government of Dongguan) has a sister relation with a town in Kagoshima prefecture (southern part of Kyushu) in Japan.⁷ These relations reflect the historical and present economic relations between these regions. Osaka has the second largest population of foreigners in Japan (registered base). Hyōgo has the fifth largest population of foreigners. In both areas the Chinese population is the second largest group of foreigners. Furthermore, there are no direct links between Guangzhou and the eastern part of Japan (including Tokyo), but Osaka has direct flight links with Guangzhou. At present, Guangdong's sister relations in Japan extend to four different Japanese prefectures. It seems that there is little evidence of political coordination between the provincial and sub-provincial governments over such relations. For the purpose of strengthening economic relations, Dongguan is now seeking to establish sister city relations with a Japanese city.⁸

In Guangdong the extensive use of foreign capital adds up to a massive amount of external resources and also brings with it governmental power to circumvent some of the control measures imposed by the upper levels of governments. With increasing discretionary power, Guangdong has been able to facilitate flexible transactions among foreign firms in order to pursue its own development goals. Both national and provincial policies are continuously being made and remade through practices of MLG. In particular, economic development needs the improvement of social infrastructure as a whole. In this respect, Guangdong still has problems in terms of its inadequate legal system, energy supply, education level, transportation network, communication system, and financial market. Inward electronics FDI from advanced countries is regarded as a strong promotional measure in order to reinforce Guangdong's economic power base.

7.2.3 Local Corporatism in Dongguan

The proactive role of the Dongguan city government has been very important. Despite two decades of economic reform, the government still has a strong influence on the management of firms. It has invested heavily in social infrastructure (motorway networks, electricity supplies, telecommunications, and the enrichment of human capital endowment,

e.g. through school education). In addition, there is a highly cooperative relationship between the local government and investors. For example, communication with Hong Kong investors has been greatly strengthened and the Dongguan city government has tailored the social infrastructure to meet their needs (G. Yeung, 2001a). The opening up of the Guangzhou-Shenzhen-Zhuhai superhighway⁹ in the Pearl River Delta in 1994 improved Dongguan's accessibility dramatically. From Hong Kong international airport, it takes only three hours to get to Dongguan by direct bus service (run by a Taiwanese firm) with 27 departures a day. Also, Yeung suggests that in addition to government policy factors, other factors such as sub-contracting, local sourcing, Chinese 'cronyism', and personal networks have had a major effect on the decision-making of Hong Kong investors (G. Yeung, 2001a).

Dongguan has benefited from Shenzhen's political and economic conditions. In the 1990s, Shenzhen sought to upgrade toward high-value added industry and promoted a shift of assembling production outside the SEZs. Hong Kong and Taiwan firms needed to move out because they focused on labour-intensive and relatively low-value added light industry. While Shenzhen has secondary border controls (for the SEZ) and official restrictions directly controlled by Beijing, outside Shenzhen local governments are more flexible business negotiators and partners. In Dongguan it is easy to employ labour from inland areas. In terms of the cost of labour, in 1998, the average annual wage in Dongguan was 11,187 RMB, while that of Shenzhen was 18,130 RMB (*Kōryū*, No. 622, 2000). An abundant supply of migrant workers (reaching a total of two million in 2000 in Dongguan, and a total of 20 million in Guangdong as a whole) makes it possible to respond to the needs of the growing number of labour-intensive firms. This contract labour force is supplied through job centres in Sichuan and Hunan provinces (*ibid.*). Additionally, many of these workers are willing to do overtime work for extra money and undertake intensive job training. The majority of migrant workers are young women and many of them send their wages to their parents in order to help them build houses. Most of them return home after a few years work, and this helps foreign firms in terms of flexibility and low labour costs. On the other hand, enormous improvements in living standards have changed the behaviour of local people (registered residents). They have had little incentive to take lower-paid jobs. G. Yeung (2001a: 212) highlights two increasingly dangerous phenomena

-- 'voluntary unemployment' and 'voluntary drop-out from secondary school' -- which severely constrain human capital in Dongguan.

Dongguan's Foreign Trade and Economic Cooperation Bureau (DFTEC) functions as an intermediary organisation between local government and foreign firms. It approves the projects planned by foreign firms and manages their business. The dynamism of local corporatism is seen, for example, in the establishment of 'service days', where the representatives of bureaux (customs, fire, commerce etc.) meet with foreign investors to discuss the latter's problems. The lack of an effective channel for complaints has been a major factor leading to a heavy reliance on personal connections between foreign investors and local government. The lack of such a channel means that there is scope for low-ranking officials to accept bribes to the detriment of Dongguan's image. This innovative service started in September 2001 under the auspices of the DFTEC.

Investors still face a mountain of paper work and procedures at different bureaux in order to gain approval for starting a new business. The interpretation of documents related to foreign businesses is typically dispersed among different bureaux (*Nikkei Business*, 15 October 2001). While this situation continues, there is a steady growth of competition among local governments to attract foreign investors. According to an interview with the Vice Mayor (*Xianggang Wenhui*, 29 May 2001), after China's entry to the WTO it is inevitable that Taiwanese firms will seek even more strongly to target China's domestic market, and in this respect the Dongguan government is already paying close attention to the situation in the Yangtze River Delta. Taiwanese investors have appraised Kunshan's investment environment as offering excellent quality of service and highly efficient administration. For example, the Kunshan Party Chief and the Mayor allow investors 24-hours per day access to their mobile phones. If foreign firms wish to meet with the Vice Mayor, within two hours the appointment date and time will be decided (*Dajingmao*, No.10, 2001: 46). In Kunshan, the second Taiwanese school in mainland China (after Dongguan) is to be established (Saka, 2001: 12). The introduction of 'service days' to improve Dongguan's investment environment has already resulted in the enhanced exchange of information across bureaux, and to some extent this now compensates for the fact that personnel exchanges among different bureaux are rare.¹⁰ On the basis of this

evidence, there is no doubt that the increasing competition among local governments has helped to improve the efficiency of local governments.¹¹

The Dongguan city government has organised the 3C EXPO (Trade Fair for Computers, Communication and Consumer Electronic Products, co-organised with the Dongguan Taiwanese Business Association) annually since 1999 in order to attract foreign investment (especially in the electronics industry). At the first EXPO (in October 1999), approximately 500 firms attended and three-quarters of them were Taiwanese firms.¹² According to the Dongguan Mayor (interview in *Xianggang Wenhuibao*, 12 October 2001), at the first EXPO investment contracts worth \$US 550 million and trade contracts worth \$US 160 million were agreed. At the second EXPO held in October 2000, the value of investment contracts was \$US 554 million and that of trade contracts was \$US 715 million. The Dongguan government has sought to make this EXPO a representative international PC exhibition. The number of participant firms and units has increased sharply. At the third 3C EXPO held in October 2001, the 1,200 allocated spaces were already filled by August (*Nanfang Ribao*, 12 October 2001).

Another policy initiative by Dongguan for developing the electronics industry is the establishment of a technology and development park.¹³ In 2000, the Dongguan government decided to invest \$US 240 million in this project. The aim is to support engineering, research and development in electronics. Currently in Dongguan there is only one science and technology college (with almost 2,000 students). Despite an abundant supply of migrant labour, the Dongguan government faces a lack of qualified engineers and a difficulty with grading up technology.

7.3 Foreign Firms and Dongguan's Local Government

As a result of economic decentralisation, increased economic autonomy, and the emergence of MLG, local bureaucratic entrepreneurs in China have become the most important agents for foreign investors. These entrepreneurs have economic resources, political authority and social connections. The development of CPNs in China would not have materialised without a highly localised, cooperative business environment. While

other foreign firms in China have to deal with red tape in Beijing, smaller Taiwanese investors have been allowed to negotiate directly with local decision makers (Hsing, 1998: 128). Economic decentralisation itself has brought about a new institutional context and provided new opportunities for transnational capital flows at local levels in China. The partnership between overseas Chinese (mainly Hong Kong and Taiwanese investors) and local Chinese bureaucratic entrepreneurs is also personalised through *guanxi* (ibid. : 128).

7.3.1 *Guanxi and Its Efficiency*

Besides the formal localised processes of cooperation, the informal dimension is also critical. *Guanxi* is based on the operation of interpersonal relationships through pre-existing links among classmates, graduates, people from the same place, relatives, and superiors or subordinates in the same workplace. This shared identification supports the development of trust (*xin*), which is one of the foremost dimensions of human relations. For Taiwanese businesses, cultural and linguistic affinity undoubtedly helps to develop *guanxi* with local Chinese bureaucratic entrepreneurs. Though *guanxi* does not correspond with formal organisational borders, its influence in Chinese society ranges widely across political and economic activities.

In the case of investment in China, *guanxi* often plays a decisive role in business performance due to China's weak legal environment. H. Wang (2001: 106-7) cites the example of a Hong Kong investor in Shenzhen who failed because he did not have the necessary *guanxi* relations. But he subsequently did succeed when he moved to the place where he had studied in his youth: he was able to build on his *guanxi* relations with former classmates and colleagues. This story suggests that *guanxi* often serves as a key source of information (e.g. concerning changes of government regulation), a protection against government intervention (e.g. licenses, extra fees, taxation), a conflict resolution channel and the basis of a joint business partnership. *Guanxi* has a systematic and positive effect on the profitability, asset turnover and domestic sales growth of both Chinese domestic firms and foreign-invested firms (Luo and Chen, 1997). Firms with good connections with Chinese officials can often exploit the loopholes in China's weak legal system to secure profitable business opportunities (H. Wang, 2001: 104). Overseas Chinese investors are often able to obtain favourable investment conditions through local officials' flexible

interpretation of the regulations. In the case of the Taiwanese, this *guanxi* practice is not very different from their home business conditions: loose control by government of small firms, and negotiable policy implementation (Hsing, 1998: 134-5). Thus, *guanxi* networks have been interwoven with the rent-seeking economic structure, and work as a convenient tool for Taiwanese investors to work out a cooperative protocol with local partners under specific policy conditions (Wu, 2001).

One of the most important instruments for the successful operation of *guanxi* is gift exchange. Although it is not unique to Chinese culture, gift exchange practice is embedded in ongoing personal relations. Although mutual benefit is the ultimate principle of gift exchange, in practice it operates as a means of buying privileges and gaining special treatment for business. As the boundary between the public and private domains is increasingly ambiguous, giving gifts to Chinese officials in public institutions in exchange for favours overlaps with offering favours to officials in order to maintain special relations. The strategy of Chinese local officials vis-à-vis the higher levels of authority is popularly called 'looking for holes' (Hsing, 1998: 133). This is practically demonstrated by the flexible interpretation and implementation of the regulations imposed by higher-level governments. Top-down policies are often faced with countervailing responses by low-level authorities: 'policies from the top, counterstrategies at the bottom' (*shangyou zhengce xiayou duice*) (Ibid. : 133).

To the extent that it maintains the balance between senders and receivers on the basis of mutual trust, the efficiency of gift exchange and *guanxi* provides valuable help to investors. However, the regularised practice of gift exchange also has countervailing affects on production networks. The advantages of cultural and linguistic affinity also give rise to opportunities for corruption. For example, one Taiwanese firm has faced an extra burden for giving money to Chinese customs officials on a regular basis in order to gain smooth custom procedures (*Kōryū*, No. 637, 2001). *Guanxi* may serve even to facilitate patently illegal activities which benefit foreign investors. Thus, informal practice does not necessarily help in achieving favours from investors; indeed it may actually damage China's long-term business conditions. Nevertheless, the business partnership or alliance between local Chinese bureaucratic entrepreneurs and overseas Chinese investors plays a

key role in creating various forms of governance which minimise the role of central government.

7.3.2 Taiwanese Business Associations

The local cooperative relations between Taiwanese investors and local Chinese bureaucratic entrepreneurs are evident in the work of the Taiwanese Business Associations (TBAs). The TBAs are officially approved associations which encourage Taiwanese FDI in China. By 2000, there were 51 TBAs in China and 14 of them were located in Guangdong (*Kōryū*, No. 622, 2000). TBAs have played a crucial role in promoting Taiwanese business interests in mainland China. The major activities of the TBAs are (1) negotiating with the relevant authorities and the collection of information; (2) dealing with various problems faced by Taiwanese residents; and (3) supporting the establishment of an inter-firm network (Nagase, 1999). The development of local networks, including local authorities and businesses, has undoubtedly been vital in attracting further Taiwanese investment. In the case of Dongguan, city government officials (through the office of the Vice Mayor, the Chief of the tax authority, and the Chairman of the foreign trade and economy committee) have participated in the Dongguan TBA in an honorary capacity (Nagase, 1999: 28). In addition, officials from Dongguan's labour bureau, telecommunications bureau, public security office, and the communication police have been engaged in an advisory role.

A good example of cooperative relations is the establishment by the Taiwanese business community of the first Taiwanese school (based on the Taiwanese method of education) for children of Taiwanese investors in Dongguan in September 2000. This school is funded by the Taiwanese government (Ministry of Education). Also the TBA's women's group (with about 300 members) played a major role in its establishment¹⁴. The General Secretary of the Dongguan TBA has approved the role of local cadres in providing a supportive business environment, e.g. through land and tax incentives (*Sinorama*, February 2000: 83). According to a former chairman of the Dongguan TBA, the city government's cooperative behaviour is due to the increasing profit made by Taiwanese FDI in Dongguan. Both local authorities and Taiwanese businesses have avoided talking about political issues and have concentrated on the future development of Dongguan and the role of Taiwanese investment. The Dongguan TBA is said to be the most successful among 51 Taiwanese TBAs in

China.¹⁵ It also acts as a negotiator with businesses' home government in Taiwan. For example, it persuaded the Taiwanese government to improve medical services for Taiwanese businesses in mainland China by establishing a new hospital and facilitating medical insurance facilities (*Lianhebao*, 6 July 2001). Thus, Dongguan's experience implies that the MLG system, which is articulated by economic decentralisation, has undoubtedly improved the business environment.

7.3.3 Japanese Firms and Chinese Local Government

Just as the local Taiwanese Business Association (TBA) has played a crucial role in promoting Taiwanese business interests in Dongguan, the Tōkan (Dongguan)-Japan Consulting Support Service Co., Ltd. (TJCSS) has helped to attract Japanese investors. The researcher visited the TJCSS in Dongguan in October 2001 and obtained information about its activities. The TJCSS was co-founded by the Dongguan Foreign Trade and Economic Committee (DFTEC) and Dongguan's Japanese office based in Tokyo. The Tokyo office was established in 1997 to serve as an agent for the Dongguan government in attracting Japanese firms seeking Chinese business opportunities. Advisers to the Japanese office include Dongguan's Vice Mayor, the Chief of Customs, the Chief of the Commercial and Industrial Bureau, the Chief of the Tax Office, and the head of each sub-municipal district within Dongguan. The TJCSS thus incorporates offices in Tokyo and Dongguan, and is strongly supported by the Dongguan city government.

The major activities of the TJCSS are (1) acting for Japanese investors in establishing firms in Dongguan; (2) acting as a communication channel with the Dongguan city government and sub-municipal governments; (3) dealing with various problems that arise after new firms are established; (4) providing business information and introducing potential business partners; and (5) responding to requests for qualified staff and training provision.¹⁶ The development of local networks, including local authorities and businesses, has certainly played an important role in attracting further Japanese investment. In the case of Dongguan, the TJCSS acts as an agent for the city government in carrying out a wide range of promotional activities. These include sending missions to Japan's trade associations, giving lectures in Japan, inviting Japanese business delegations, and providing information to the Japanese mass media.¹⁷ TJCSS is also incorporated with

Dongguan's developmental strategy. Now the TJCSS is promoting the Yinghua Industrial Park in Hongmei Town, which is ranked as the sub-municipal district with the lowest exports and FDI (*Dongguanshi Waishang Touzi Qiye ji Quanbu Gongye Ziliao Huibian*, 2000). Thus the city government is playing an active role in supporting the development of foreign economic relations. The Yinghua Industrial Park, allocated to Japanese investors, is located next to the Taiying Industrial Park, which is designed for Taiwanese investors.¹⁸ The organisation of the TJCSS is based on a membership system: member firms pay 15,000 HK dollars per month. A good example of cooperative relations through the TJCSS involves the question of customs procedures. Japanese investors in Dongguan find these procedures extremely troublesome. So when the TJCSS receives the complaints from Japanese firms it gives a call to related offices and to urge a solution for the problem.¹⁹

Dongguan's case shows that the MLG system has helped to improve the city's physical infrastructure and business environment, especially through the development of local co-operative networks. What needs to be stressed is that there is an increasing involvement of firms and networks of firms in governance arrangements. This involves the blurring of the boundary between public and private agencies, the spread of non-hierarchical inter-firm networks and their corporate governance arrangements, and growing links between these business networks and the multi-layered state.

7.3.4 Multiple Local Networks and Sub-Municipal Government

The above examples of the TBAs (Taiwanese) and the Japanese TJCSS demonstrate the interactions between the political and socio-economic spheres in the case of one particular municipality. It is at this sub-municipal level that the key network relationships have developed. There are 32 sub-municipal districts (townships) in Dongguan. Seven sub-municipal level governments attended the second Dongguan international 3C EXPO in 2000 in order to find business partners (*Jetoro Sensā*, February 2001). This trade fair provides excellent opportunities to find business partners for both foreign investors and local governments. The researcher visited the third 3C EXPO in October 2001 in order to investigate the foreign economic activities of the sub-municipal (township) levels of government. A total of 30 sub-municipal governments participated and exhibited their investment facilities and preferential policies to potential foreign investors.²⁰ The

preferential policies on offer varied among the sub-municipal governments. For example, Tanxia Town offered taxation policy: export goods of foreign firms in the town are exempted from VAT, and imports of assembled products for external processing, and exports enterprises and their processing fees are both exempt from VAT and exercise tax. In income tax policy, Tanxia offers 'a two exemptions and three reductions' policy: from the first profitable year firms are exempt from income tax in the following two years (two-year exemptions) and enjoy a 50% reduction in income tax in the next three years (three-year reductions).²¹ Other sub-municipal governments (e.g. Zhangmutou) offered one Guangdong-Hong Kong direct drive-through licence for one private car if investment exceeds 1.5 million US dollars. Furthermore, those businesses engaged in processing trade arrangements (PTAs) over the scale of 1 million US dollar exchanges per year are entitled to apply for one or more direct Guangdong-Hong Kong drive-through licences.²²

Changan, located southwest of Dongguan (as a border township with Shenzhen), is the most successful sub-municipal government. It is Dongguan's leading township in many foreign economic activities. For example, by 2000, there were 1,650 foreign firms in Changan, 556 Taiwanese firms and 58 Japanese firms, and exports by foreign firms were valued at \$US 990 million.²³ Changan's registered population is 34,000 but about 600,000 of the temporary residents stay there for work (*Xianggang Wenhuibao*, 12 October 2001). Each of Dongguan's sub-municipal districts has its own foreign affairs office which undertakes promotional activities to attract foreign investment. In the case of Changan, a new Foreign Entrepreneurs and Investment Association has been established. This holds meetings at least three times per year with representatives of foreign investors and customs and local government officials. The chairman of the Association, Wang Zhimin, is also the chief of the Foreign Economic Affairs Office of Changan and is also presently Vice Mayor (*Xianggang Wenhuibao*, 12 October 2001). In February 1997, Li Peng (Chairman of the National People's Congress) visited Changan, and in January and June 1996 Zhu Rongji (Premier) visited the township. Since 1990, Changan has been awarded the 'township star'.

Humen, located in the south east of Dongguan (next to Changan), is also a very successful township (it is the second largest exporter after Changan). Its government organises 'service days' twice per month so that foreign firms can resolve the many problems they

face concerning export procedures, land applications, import and export applications, access to water and electricity supply, the investment environment, etc. (*Dajingmao*, No. 10, 2001: 45). Shijie, located in the northern part of Dongguan, and Qingxi, in the south east, have been especially successful in the production of PC-related products. In Shijie, for example, there are 180 foreign electronics firms (out of a total of 310 electronics firms). Both Shijie and Qingxi districts are worldwide production sites in electronics (*Jetoro Sensā*, February 2001). Shijie is the world's largest production site for PC power-supply units, computer keyboards and transformers, and is the second largest site in the world for the production of scanners and mice.²⁴ The key success factor for the sub-municipal areas is the ability to attract foreign electronics firms. In Shilong town, a township government funded firm offers a 24 hour emergency call service in the Japanese language for Japanese firms facing problems, eg. involving customs issues or industrial accidents (*NKS*, 28 December 2001). It also runs a Japanese language school to supply workers to Japanese firms in Shilong town. In general, the sub-municipal areas are able to take initiatives without first getting the formal approval of the central government. (G. Yeung, 2001b: 118-134). The differential degree of development among sub-municipal levels in Dongguan implies that there is intensive competition to attract inward investment. Indeed, 32 sub-municipal districts (townships) in Dongguan compete with each other to attract foreign firms, and the 'dumping' of factory land for foreign firms is becoming more common.²⁵

As the sub-municipal levels of government (townships) have actively created networking links with foreign firms, these networks have in turn attracted a multiplicity of foreign investors. The major firms have sought to develop good relations with the central government in Beijing. However, as a result of the decentralisation of economic power, governmental bureaux are not always able to control subordinate enterprises. Now it is very important for firms to maintain good relations with local governments at all levels. This dimension has become an increasingly important feature of the formation of interactive relations between MLG and CPNs.

7.4 The Chinese Electronics Industry

The tremendous inflow of electronics FDI and its geographical concentration have had a major impact on the pattern and processes of development of the Chinese electronics industry. This section discusses this impact and also the implications for East Asia's industrial structure.

7.4.1 Chinese Electronics Firms

China's electronics industry has developed steadily as a result of economic reform. In 1998, electronics industrial output accounted for 6.9% of China's total GDP.²⁶ The electronics industry is now the second largest manufacturing industry after the clothing industry in China's exports.²⁷ China is also the leading production base for the world's electronics industry: 38.3% of DVD players, 12.9% of mobile phones, 23.2% of VTRs, 24.6% of colour TVs, and 11.9% of desktop personal computers are produced in China (*NKS*, 27 July 2001). By 1999, China had achieved 58% of the world production of cameras, 46% for watches, 50% for air conditioning, and 58% for telephones (*Shūkan Daiyamondo*, 3 November 2001). China's PC-related exports (\$US 11 billion) accounted for 4.4% of China's total exports in 2000 and ranked as the largest single item in terms of exports.²⁸

In the domestic market, Chinese electronics firms have also grown rapidly: PC-related products accounted for 17.8% of total electronics industrial output in 1998.²⁹ Table 7.1 shows the share of the domestic consumer electronics market by firms. Except for mobile phones, Chinese local electronics firms have already acquired a dominant position in the domestic market. For example, in the colour TV market, the share of Japanese electronics firms has declined sharply and Chinese local firms have emerged as the top firms. Japanese firms are now faced with severe competition by local Chinese firms.

Legend (a Beijing-based state-owned enterprise) had nearly a 30% share of domestic desktop PC sales and 21% share of notebook PC sales (both figures were top ranking in the first half year of 2001).³⁰ Also, in 2000 local brands accounted for almost 80% of desktop sales and foreign brands for less than 20% of China's domestic sales (Mizuhashi, 2001: 172). Legend was established by 11 members of the Chinese Science Academy in 1984,

and 64% of its equity is still held by the Academy. However, such intervention by the state is now rare. Firms have the responsibility for personnel management, finance and general management (Kuroda, 2001: 31; Nakagawa, 2001: 158). In the case of the production of notebook PCs (a total of 419,000 units), in 2000 Legend accounted for 22% of China's total production (IBM was second with 18%, and Toshiba was almost same as IBM with 18%) (Mizuhashi, 2001: 169). The major factories of Legend are in Beijing (Zhongguan) and Guangdong (Huizhou) (Kuroda, 2001: 60). Legend now plans to produce notebook PCs in Shanghai. It has developed cooperative relations with major foreign firms such as AST, HP, Apple, Intel, Toshiba, Canon, Heiz and Motorola (Nakagawa, 2001: 157). Although its share of notebook PC production in China is ranked first, the products are almost all a result of OEM production by the Taiwanese firms FIC and Mitac (*Zhongguo Qiyejia*, No.10, 2001 and *Jetoro Sensā*, June 2001: 28). Legend has used technological guidance from FIC and has established cooperation with Chunghwa Picture Tubes and Hannstar Display for the production of LCDs (Mizuhashi, 2001: 172).

Table 7.1 The Share of the Chinese Domestic Electronics Market by Firms (% of Domestic Sales)

	1		2		3	
Refrigerators	Haier	32.9	Kerong	11.8	Xinfei	8.5
Colour TVs	Changhong	18.7	Konka	18.5	TCL	10.0
Air conditioners	Haier	18.7	Midea	13.8	Gree	12.8
Washing machines	Haier	23.6	Xiaotiane	22.4	Rongshida	7.5
Microwaves	Galanz	67.1	LG (Korea)	12.1	Masushita	5.3
VCDs/DVDs	Shinco	17.7	Bubugao	12.9	Wanlida	8.2
Mobile phones	Motorola	30.1	Nokia	28.7	Ericson	21.6
PCs	Legend	20.1	Changcheng	3.6	TCL	3.6

Note: The research was originally carried out in February 2000.

Source: Kuroda, Atsuo (2001) *Meido in Chama* (Made in China), Tokyo: Tōyō Keizai Shinpōsha, p. 46.

Other firms, such as Founder (established in 1985), which is a model of cooperative relations between academia (Beijing University) and industry, also use Intel's CPU and Taiwanese firms' products through the OEM system. Founder uses Taiwanese electronics firms in Guangdong for parts procurement (*Jetoro Sensā*, June 2001: 28). Changcheng (a Beijing-based state-owned enterprise, founded in 1986) has learned the management of production and technology through OEM production for IBM. IBM computers produced by Changcheng are also exported to south east Asia. The rate of brandname on these

computers is almost 1:2 (Changcheng and IBM brand) (Nakagawa, 2001: 163). Thus, even in state-owned firms the improvement of management has progressed, and these firms typically use various types of foreign firm in order to achieve growth. Although in Guangdong there is a limited university spin-off effect, there are many private ventures and township and village enterprises (TVEs), established by entrepreneurs who previously worked for foreign firms (Tsūsanshō, 2000: 39).

Competition in the Chinese domestic market is becoming increasingly severe. Chinese electronics firms have already undertaken offshore production in order to expand their markets. For example, Konka has established production sites in Mexico and India. Changhong has increased its share of colour TVs in the Indonesian domestic market through local production. TCL (a Huizhou-based firm established in 1980) started to produce colour TVs in Vietnam in 1996 and sharply increased its domestic sales (Kuroda, 2001: 70-71). Haier has established ten offshore production sites. It started to produce small refrigerators in the US in 2000 and already holds a 30% share of the US market (Kuroda, 2001: 71). It aims to advance in the Japanese market and has agreed with Sanyo to establish a joint venture in Osaka in Japan (*NKS*, 9 January 2002). Galanz (based in Shunde, founded in 1978) holds a very high share of microwave production (nearly 70%) in China, and produces more than 30% of the world's total production of microwaves. It now seeks to become the world's largest production factory for microwaves. Its key strategy for growth is the collection of OEM contracts from foreign firms. It now has more than 200 OEM contracts, and 55% of products are exported to the world market (*Nikkei Business*, 15 October 2001).

Despite their success, Chinese local firms have not yet become dominant in every product in the electronics industry. For example, in the case of IC production (contrary to the consumer electronics market), Chinese electronics firms have only a modest presence. In 1998, among the top ten firms for IC sales in China, there were eight foreign firms.³¹ The Chinese electronics industry still depends largely on imports for IC supply. However, the development of Chinese electronics firms has greatly contributed to the spread of CPNs and to deepening links with foreign firms.

7.4.2 China's Increasing Economic Presence

Chinese electronics firms have increased their presence in the electronics industry in East Asia. Between 1996 and 1999, China's output of electronics products exceeded that of South Korea, Singapore and Taiwan, and was second only to that of Japan (Kuroda, 2001: 194). In 2000, China's share of PCs exports to East Asia accounted for 8.4% of total PC exports to East Asia (*Jetoro Sensā*, June 2000: 27).

China's increasing economic presence in the electronics industry has affected the position of its trade partners. For China and ASEAN, the US market has been the major destination for their exports. The US is the largest export destination for China, the Philippines, Thailand and Malaysia, and the second largest destination for Indonesia. Table 7.2 shows the changing shares of US total imports. The shares of Mexico and China in US imports have steadily increased. On the other hand, in the late 1990s, Japan's share of US imports shrank, and the share of the ASEAN 4 decreased. Japan's decline is the result of its shift to offshore production abroad. Japanese electronics firms have used ASEAN as an export base for the US. In statistical terms, ASEAN's competitiveness has been increasingly challenged by China.

Table 7. 2 The Shares of Countries and Regions in US Total Imports, 1995-2000 (%)

	1995	1997	1999	2000
Canada	19.6	19.2	19.4	19.0
Mexico	8.3	9.9	10.7	11.2
EU 15	17.7	18.1	19.1	18.1
Japan	16.6	14.0	12.8	12.0
China	6.1	7.2	8.0	8.2
ASEAN 4	5.8	5.8	5.6	5.4
Taiwan	3.9	3.8	3.4	3.3
South Korea	3.3	2.7	3.0	3.3

Source: Kuroda, Atsuo (2001) *Meido in China* (Made in China), Tokyo: Tōyō Keizai Shinposha, p. 211

China's strong competitiveness is also evident in the increase of Chinese electronics products in Japan. For example, according to *Asahi Shinbun* (*Asahi.Com*, 24 November 2001), DVD players were once produced mainly in Japan (between 1996 and 1998). With the shift of offshore production to China, the imports of DVD players from China have

rapidly increased since 1999. The number of units for imports jumped from 190,000 (1999) to 600,000 (2000) and by July 2001 it had reached a total of 1.33 million. This resulted in a sharp fall of the price of DVDs in the Japanese market: from about 100,000 yen in 1996 to almost 20,000 or 30,000 yen in 2001. This has inevitably led to deflationary pressure in the Japanese market.

7.5 Micro-Regionalisation and China's National Economic Integration

Micro-regionalisation across Guangdong, Taiwan and Japan is the result of various factors including China's adoption of economic reform, the impact of Japanese and Taiwanese FDI, the position of Hong Kong, and the rise of local corporate networks. It has been further encouraged by the transformation of China's economic governance from a command system to a more market-oriented framework. This restructuring has induced an enormous inflow of FDI and accelerated China's economic reintegration with the world economy. It has had a huge impact on Chinese economic spatiality and the process of national economic integration. The emergence of unpredicted outcomes of that economic spatiality has presented a direct challenge to the central control capability over regional planning. It is thus vitally important to consider whether (and, if so, *how*) the patterns of micro-regionalisation across Guangdong, Taiwan and Japan have contributed to China's national economic integration.

There are no official data on inter-provincial trade, but we can use data for cargo transportation, purchases and wholesale transactions to assess the degree of inter-regional relations in China. In the 1980s, inter-provincial trade assumed three main forms: centrally planned trade, provincially planned trade, and free trade. Among these, centrally planned trade was dominant until the mid-1980s (Zhou, 1996: 130-31), but then there was a significant impact of inward FDI on inter-regional trade.

According to Kumar (1994), who has researched the flow of China's domestic trade in terms of provincial domestic imports and exports and total retail sales, there has been a significant increase in the foreign trade ratio compared with the ratio for inter-provincial trade in Guangdong (15.7% in 1980 and 67.4% in 1992). This suggests that the domestic

investment flows from other provinces are becoming less significant than foreign trade.

Inter-regional trade is also dependent on transportation infrastructures such as roads, waterways and railways. By using inter-provincial freight flows, several regional linkages can be identified. The share of railway transportation of freight has declined as road networks have been improved. In 1980, railway transportation accounted for 47.5% of total transportation of freight (distance base) and 20.4% of total weight cargo. By 1999, the share of railway freight had decreased to 31.3% of total transportation freight (distance base) and to 12.7% of total weight cargo (Mitsubishi, 2000). This is almost certainly a reflection of the changing pattern of inter-provincial freight flows. Table 7.3 shows the volume of railway freight between provinces. Despite the plan for a south coastal region comprising Guangdong and Fujian³², inter-provincial trade between the two provinces was very small. Hunan is the most important trade partner for Guangdong. On the other hand, for Fujian, Zhejiang is the most important trade partner. In terms of the Fujian-Guangdong link, Fujian's share of total railway freight from Guangdong has declined since the late 1980s.³³ Thus, from the viewpoint of flows of freight, the development of economic links with Hong Kong and Taiwan has not had much effect on economic integration between Fujian and Guangdong. Of course, domestic factors also need to be considered in relation to China's national economic integration, but this is beyond the scope of the present chapter.³⁴

Table 7.3 Railway Transport of Freight between Provinces, 1998 (Volume of Cargo, %)

To From	Guangdong	Fujian	Shanghai	Beijing	Hunan	Sichuan	Zhejiang	Jiangsu
Guangdong	23.11%	0.27%	2.22%	2.61%	12.68%	4.90%	2.72%	2.22%
Fujian	0.65%	48.99%	2.28%	1.46%	4.47%	0.51%	10.20%	3.83%
Shanghai	3.91%	3.56%	8.07%	4.34%	4.17%	5.56%	8.42%	4.86%
Beijing	1.99%	0.35%	0.90%	31.14%	1.09%	2.07%	1.44%	2.15%
Hunan	28.39%	2.56%	1.11%	0.36%	35.82%	1.27%	2.26%	1.20%
Sichuan	2.67%	0.39%	0.91%	0.65%	1.28%	55.55%	1.00%	2.08%
Zhejiang	2.72%	3.07%	9.15%	0.98%	6.95%	2.14%	36.44%	1.56%
Jiangsu	4.11%	2.50%	9.07%	0.74%	1.05%	2.00%	6.51%	34.19%

Note: The figures are based on the researcher's calculations. Data are taken from figures for inter-provincial rail freight (by volume).

Source: *Zhongguo Jiaotong Nianjian 1999*

One of the most plausible explanations of such a striking phenomenon is that both Guangdong and Fujian provinces are more closely integrated with Hong Kong and Taiwan than with each other. According to Y. Wang (2000), the degree of outward economic orientation affects the developmental pattern of the provincial economy. For example, in 1995, while the degree of China's average outward economic orientation was 21.2%, that of Guangdong was already 85.9% and that of Fujian was 35.8%.³⁵ Undoubtedly, Guangdong is more internationalised in economic terms than the rest of China. On the other hand, inter-provincial relations between Guangdong and Fujian are far less integrated than the relations with Hong Kong and Taiwan. This reveals that the pattern of Guangdong's economic development is influenced more by the circumstances of cross-border relations than by inter-provincial relations.

Indeed, despite the central economic planning of an economic cooperative region between Guangdong and Fujian, inter-regional trade between the two has declined since the late 1980s. This highlights the complex patterns of China's governance structure and questions the capability of new regulatory functions initiated by the centre, and, even more importantly, the role of the Party-state system in regional economic development.

7.6 Conclusion

The pattern of development of production networks among Guangdong, Taiwan and Japan underlines the crucial role of strategic networking linkages between Chinese local authorities and foreign firms. Hong Kong firms are pioneers in creating innovative form of CPNs. Guangdong's innovative policies (especially its internationalisation strategy) were formulated as a result of the loosening of central state control, and this has enabled Hong Kong firms to construct a profitable cross-border production system. Guangdong's para-diplomatic activities have added to the complexity of the economic and political domains in China.

Of equal importance is the way in which sub-provincial and sub-municipal units (e.g. Dongguan and its sub-units) have become dynamic entrepreneurial agents and helped to achieve a regional transformation. Chinese SNGs – representing the local state – are

significant economic actors that do much to create a successful business environment, as is illustrated by Dongguan's success in attracting Hong Kong, Taiwanese and Japanese investment. This process involves both the city government and the sub-units (townships) within Dongguan forming close channels of communication and cooperation with foreign investors, often based on the advantages gained by close personal and social connections (*guanxi*).

The TBA and the TJCSS in Dongguan play key roles as intermediaries between the city and foreign firms, especially in improving connections and facilitating the exchange of information. Furthermore, as a result of increasing competition, sub-municipal governments (townships) in Dongguan have become directly involved in attracting foreign investment. Thus the structure and operation of networking linkages in Dongguan have assumed increasingly complex and multiple forms.

This chapter has also investigated the impact of cross-border economic relations on the Chinese electronics industry and the country's national integration process. Despite its technological dependency on advanced countries, the Chinese electronics industry has already emerged as a key international player which links domestic and international production networks. The Chinese domestic market has become much more competitive. The deepening of various production networks with foreign firms has greatly assisted local Chinese electronics firms, which have increasingly undertaken exports and offshore production. China's sharp growth has also dramatically changed the East Asian industrial structure. In particular, through the impact of industrial agglomeration and the low cost of labour, China is partly replacing the role of ASEAN as an export base.

On the other hand, in terms of its domestic influence, micro-regionalisation does not necessarily strengthen the national economic integration process. Despite the central economic planning of cooperation between Guangdong and Fujian, inter-regional trade between these provinces has actually declined since the late 1980s.³⁶ This has presented a major challenge to the Chinese authorities in relation to the evolution of economic governance. The future development of CPNs across Guangdong, Taiwan and Japan will be built in large measure upon the further development of cooperation between China's

evolving MLG (especially at local authorities) and CPNs promoted by foreign investors.

¹ The figure is taken from Luo (2001).

² In 1995, Hong Kong's electronics industry accounted for 28.7% of Hong Kong's domestic exports (Enright, et al., 1997: 154).

³ Refugees who managed to have contact with a family member or friend without capture were defined as those 'having touched base' in Hong Kong, they were then allowed to stay. Hong Kong did not cut off the flow of refugees completely because of the continuing need for cheap labour (Sung, 1998: 4).

⁴ In September 1985, in order to respond to the rise of protectionism and trade friction, the Group of Five (meetings of the governors of the central banks and finance ministers from the US, the UK, France, West Germany and Japan) agreed to enhance international cooperation, including joint intervention by the financial authorities in the foreign exchange market.

⁵ From the investor's viewpoint, the exchange rate with the RMB is also an important factor. For example, in the case of Japanese investors in China, between 1989 and 1999 the RMB dropped almost one-third against the Japanese yen. Hence, the continuous rise of the cost of labour and land in China has to some extent been countered by the weakening exchange rate.

⁶ The figure is calculated by the researcher based on Guangdong Duiwai Jingji Maoyiweiyuanhui (1999).

⁷ Mitsubishi (2001).

⁸ Interview with officials at the Foreign Affairs and Overseas Chinese Affairs Bureau of Dongguan City (13 October 2001).

⁹ This road was built by the BOT (build, operate, transfer) arrangement funded by Hopewell Holdings Ltd (Hong Kong).

¹⁰ Interview with officials at Dongguan's Foreign Trade and Economic Cooperation Bureau (12 October 2001).

¹¹ Comment by Dongguan's Vice Mayor in *NKS*, 14 November 2001.

¹² The figure is taken from <http://www.worldtimes.co.jp/special/china-taiwan/ta000512.htm/>

¹³ This is pointed out in Shen and Mitsubussan Senryaku Kenkyūsho (2001: 149).

¹⁴ <http://www.worldtimes.co.jp/special/china-taiwan/ta000516.htm/>

¹⁵ Comments are from <http://www.melma.com/mag/42/m00001142/a00000064.html/>

¹⁶ Leaflet (*Tōkan-Japan Consulting Support Service Co., Ltd.*) and <http://www2.tky3web.ne.jp/~tokan/www/contents/Jimusho.html/>

¹⁷ Interview with the Project Director of TJSCC (12 October 2001).

¹⁸ Hongmei Town's Investment Guide and Map, provided at the 3C EXPO in Dongguan in October 2001.

¹⁹ Interview with the Project Director of TJSCC (12 October 2001).

²⁰ The number is the researcher's calculation at a visit to the 3C EXPO in Dongguan in October 2001.

²¹ Tanxia's booth at the 3C EXPO in Dongguan (13 October 2001).

²² *Zhangmutou Investment Guide*, provided at the 3C EXPO in Dongguan in October 2001.

²³ These figures are taken from *Xianggang Wenhuibao*, 12 October 2001.

²⁴ *Investment Guide of Shijie*, provided at the 3C EXPO in Dongguan in October 2001.

²⁵ Comments by Lin Shan Vice mayor (Shilong town) in *NKS*, 28 December 2001.

²⁶ The figure is taken from Ōnishi (2001: 119).

²⁷ In 1999, 15.86% of China's exports consisted of telecommunication and electronics products. Clothing and textile exports accounted for 26.86% of China's total exports. See Higashi Ajia eno *Shiten* (2001), spring special edition.

²⁸ The figure is taken from Kuroda (2001: 68).

²⁹ The figure is taken from Ōnishi (2001: 123).

³⁰ The figure is taken from *Shūkan Daiyamondo*, 3 November 2001.

³¹ The figure is taken from Moriya (2001: 201).

³² After Deng's 'tour of the south' in 1992, regional economic planning was revised. The plan for 'Seven Greater Economic Regions' proposed that Guangdong and Fujian should form a south coastal economic region.

³³ Fujian's proportion of total railway freight from Guangdong was 0.42% in 1986, it peaked at 0.55% in 1988 and declined continuously in the 1990s. In 1994 it was 0.32% and in 1999 it dropped to only 0.19%.

³⁴ Wang (2001) points out that market fragmentation in China is caused by regional friction and confrontation as well as by close relations between local governments and firms.

³⁵ The outward economic orientation is measured as: commodity export value/GDP \times 100. Y. Wang (2000: 150).

³⁶ According to the data for inter-provincial railway freight (volume of cargo: *Zhongguo Jiaotong Nianjian*, various years), Fujian's share of total railway freight from Guangdong has declined. In 1986, it was 0.42% and it peaked at 0.55% in 1988. It then began to fall – to 0.32% in 1994 and 0.19% in 1999.

CHAPTER 8

CONCLUSION AND IMPLICATIONS

This study has sought to explore and explain the key components and characteristics of the emergence of cross-border micro-regionalisation among Guangdong (in southern China), Taiwan and Japan with particular reference to the role of networks of governance linking Chinese sub-national governments (SNGs) and foreign firms. The electronics industry has been taken as a specific illustrative case study of these trends.

The study has been underpinned by three specific research questions:

1. How should we define and characterise the key components of micro-regionalisation among Guangdong, Taiwan and Japan?
2. What kinds of policy environment and what actors in the host and home countries are needed to support cross-border economic relations?
3. How do networks of multi-level governance (MLG) operate to facilitate micro-regionalisation?

These three questions have been approached through the combination of four specific research studies (see Section 1.4.2.4 and Table 1.1): the Chinese domestic context (related to research questions 1 and 2 and elaborated in Chapter 4), the international (Japanese) context) (related to research questions 1 and 2 and elaborated in Chapter 5), the regional, cross-Taiwan Strait context (related to research questions 1 and 2 and elaborated in Chapter 6), and the development of cross-border SNG networks (related to research question 3 and elaborated in Chapter 7 with particular reference to a case study of Dongguan and the electronics industry).

In this concluding chapter the main research findings will first be summarised in relation to each of the three research questions, drawing on the analysis in the relevant chapters

containing the case-study analyses (Sections 8.1, 8.2 and 8.3). Then the implications of the study and its findings for the theoretical understanding of micro-regionalisation will be discussed (Section 8.4). Section 8.5 focuses on the implications of the study for the future development of the Chinese policy agenda. The limitations of the research are considered in Section 8.6, and some key areas of research which deserve to be developed further in the future are discussed in Section 8.7. Finally, Section 8.8 summarises the contribution of the study to the academic analysis of micro-regionalisation in East Asia, and highlights the ways in which the study fills important gaps in the literature and provides a basis for further theoretical and empirical investigation.

8.1 How Should We Define and Characterise the Key Components of Micro-Regionalisation among Guangdong, Taiwan and Japan? (Research Question 1)

The theoretical discussions in Chapters 2 and 3 provided the foundations of our initial exploration of the concept of micro-regionalisation. In the case of micro-regionalisation among Guangdong, Taiwan and Japan, the empirical evidence presented in Chapters 4, 5 and 6 (the first three case studies) provides us with a basis for further specifying the main defining characteristics, allowing of course for the fact that this particular case of micro-regionalisation is bound to have some unique features as well as features which may more generally present themselves in processes of micro-regionalisation across the world.

In Chapter 2, the theoretical analysis was presented to furnish an overall framework, rooted in a 'network' perspective of cross-border economic governance. H. Yeung's (2000) approach, with its emphasis on the internationalisation of production systems across national boundaries through the locational strategies of multinational corporations (MNCs), was taken as a useful starting-point, particularly in its notion that the interplay between home country governance and host country governance at the regional scale contributes to the rescaling of political economy beneath the level of the state and creates conditions in which new network relations among the state, SNGs, firms and intermediate non-governmental associations can develop. Sub-national, cross-border interactions linking multiple levels of government and also the multiple levels of productive activity of MNCs form the basis for the emergence of what we have called micro-regions in distinction to the

larger-scale state-led sub-regions and supra-regions (macro-regional blocs) of the world. The emergence of micro-regions reflects the patterns of the new international division of labour (NIDL) based on the geographical mobility of firms seeking to invest in areas which offer access to low-cost labour and other efficiencies in order to maximise their potential within international commodity chains and cross-border production networks. The result is the formation of areas of industrial agglomeration, illustrated in the present study by the example of the Pearl River Delta area of the Guangdong province of southern China, with its special attractions for the electronics industry. In helping to encourage, shape and regulate the process of agglomeration, the role of SNGs – which in China means the provincial and sub-provincial (city and township) levels of government – is crucially important.

Chapter 3 examined China's distinct pattern of micro-regional integration with the world economy under the impact of globalisation and regionalisation with particular reference to the centrality of processing trade arrangement (PTAs) in Guangdong. China's gradual move away from highly centralised political authoritarianism and a closed economy to a more decentralised political system with an 'Open Door' to international trade and investment was a vitally important precondition for the development of micro-regional integration across the area of Southern China, Taiwan and Japan. But the central state in China could not by itself foster such remarkable economic dynamism: from the start this relied on the emergence of MLG and cross-border networks linking SNGs (especially at the city level) and MNCs. This trend in turn was further stimulated by the continuing rapid industrialisation of the East Asian region, involving the international, cross-border movement of factors of production and massive levels of FDI into southern China, including both direct and indirect investment from Japan and Taiwan.

Chapters 4, 5 and 6 focused respectively on the Chinese domestic context (with particular reference to industrial agglomeration in Guangdong), the role and impact of Japanese foreign direct investment, and the structure and operation of cross-border production networks across the Taiwan Strait. On the basis of these analyses, we can summarise the key components of micro-regionalisation among Guangdong, Taiwan and Japan as follows:

(1) *The opening up of new political and economic spaces in Guangdong as a result of China's domestic reform movement (including a transformation of state structures), and the emergence of a fluid and flexible system of MLC incorporating both horizontal relations among units rather than vertical relations.* This system is still emerging and is doing so within a political system that is still heavily controlled by the ruling Communist Party, but party officials have relinquished some considerable autonomy to SNGs and economic entrepreneurs, although this restructuring of party governance remains highly controversial. The reform of state-owned enterprises (SOEs) has been a major part of this transformation. In the case of Guangdong, provincial and sub-provincial leaders have made a determined effort to exercise entrepreneurial leadership and attract foreign firms to invest, and to gain concessions from the central government, e.g. in terms of the establishment of economic zones of various kinds offering inducements to foreign firms (Chapter 4).

(2) *The strategic decisions by Japanese firms, especially in electronics, to invest in southern China.* Japanese FDI has contributed greatly to the rebuilding of economic links between Japan and East Asia at the micro level, and a major part of this pattern is the growth of offshore production in the electronics industry, increasingly focused since the late 1980s on southern China. A triangular pattern of mutually dependent trade relations among Japan, East Asia and the United States has emerged (see Section 5.3.1), with southern China forming a major nexus of production for export within this triangle. Much of this production is 'exported' back to Japan and to the US market. In the electronics industry, Japan's nine leading firms have all established production bases abroad, many of them in southern China. For many Japanese firms, Hong Kong has been an especially important gateway to mainland China itself, in particular to Guangdong. In order to facilitate these cross-border movements, Japanese electronics firms have consolidated their inter-firm relations within the *keiretsu* networks (dominated by lead firms), but have also developed new more flexible, horizontal governance arrangements for the production process. This includes an expansion of the role of small and medium-sized enterprises (SMEs) in electronics production (Chapter 5). The changing position of Japanese firms in vertical international commodity chains and horizontal cross-border production networks

has encouraged them to engage in direct networking relations with Chinese SNGs.

(3) The expansion of cross-strait production networks between southern China and Taiwan.

Taiwanese firms (many of them SMEs) have in recent years (because of the changing political climate between Taiwan and the mainland) taken advantage of close geographical proximity and shared cultural, linguistic and social values to become major investors in southern China, especially in the electronics industry. The positive encouragement of the Taiwanese government in developing an electronics production capability and harnessing the skills of SMEs has played a decisive part in this process. At the same time, Taiwan has been receptive – through its own Open Door policy – to inward investment into Taiwan, much of it from Japan, and this has created a complex indirect route for Japanese investment into southern China. Japanese FDI has indeed been the major source of evolution of the Taiwanese computer industry. More recently, Taiwan has attracted large-scale investment from firms in advanced Western countries. Taiwan's role – like that of Japan – must be understood within the broader context of the new East Asian international division of labour and the determination of Taiwanese firms to retain their competitive advantage, especially in the production of PC-related products. A large amount of Taiwanese investment in China is 'roundabout' investment, e.g. through the central American island countries, because this circumvents the regulatory obstacles (still imposed by Taiwan's government) to many forms of direct investment (Chapter 6). The changing position of Taiwanese firms in vertical international commodity chains and horizontal cross-border production networks has encouraged them to engage in direct networking relations with Chinese SNGs. This process has been facilitated by *guanxi* connections and the social networks among the cross-Straits Chinese business community.

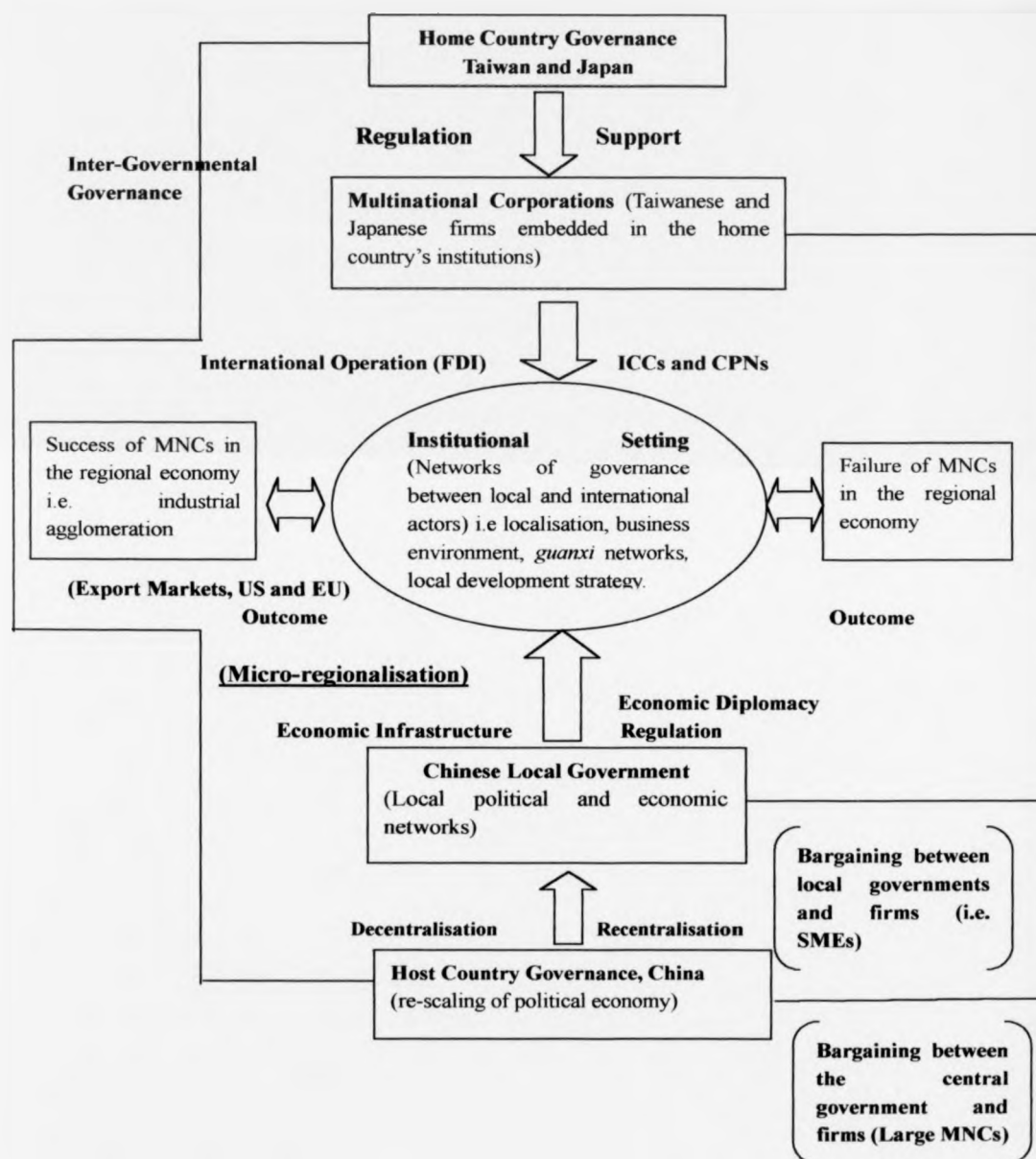
8.2 What Kinds of Policy Environment and What Actors in the Home and Host Countries Are Needed to Support Cross-Border Economic Relations? (Research Question 2)

The initial discussions in Chapters 2 and 3 revealed that existing theories of micro-regionalisation and studies of China's integration in the world economy have paid only superficial attention to the specific requirements of effective cross-border economic

relations in terms of key environmental factors and the role of specific actors. One main purpose of the studies presented in Chapters 4, 5 and 6 was to investigate these requirements in more detail with specific reference to the example of the electronics industry.

The model of micro-regionalisation presented in Chapter 2 (Figure 2.2) can be refined on the basis of this study's findings, as shown in Figure 8.1. Micro-regionalisation among Guangdong, Taiwan and Japan is the outcome of various strategic interactions deriving from domestic economic governance and the evolution of cross-border economic relations in response to the rise of global competition. The major actors are Chinese local (sub-national) governments, foreign firms (Taiwanese and Japanese), and intermediate business associations linking governments and firms. The home governance system of firms (in Taiwan and Japan) and the host governance facilities encouraged by the Chinese central government have transformed the local institutional setting. Global competition in the electronics industry is most visible at the regional scale (centred on Dongguan), where specific industrial infrastructures and political and economic conditions shape patterns of cross-border interaction. The role of Chinese SNGs in attracting foreign investment is decisive (a combination of formal para-diplomacy and informal social connections). The coordinating role of the SNGs in the local institutional setting of the host country is critical for stimulating micro-regionalisation. Micro-regionalisation among Guangdong, Taiwan and Japan is thus the result of the complex and uneven interplay of several strategic actors (the state, local governments and firms) and of several organisational variables (such as commodity chains, network linkages, production networks, *guanxi* networks and organisational learning and conventional social factors). This micro-regionalisation is not geographically self-contained but is sustained very much by certain crucial externalities (especially the supply of capital, technology and labour) and outside markets (especially those of the US and the EU).

Figure 8.1 Micro-Regionalisation: The Network Dynamics of Sub-National Government and Multinational Corporations



Source: The researcher

Host Country Governance: China

The strategic role of the state can be seen in the domestic and international domain. The three governments (China, Taiwan and Japan) have implemented different foreign economic policies. The effective implementation of government policies (domestic and foreign) is one of the reasons why micro-regionalisation among Guangdong, Taiwan and Japan has been able to develop so rapidly. China's efforts to create an attractive business environment are seen in the domestic and international arenas. Post-Mao China has abolished its relative isolationism and has actively sought to strengthen its diplomatic ties and economic relations with the world. The effective foreign investment policy of Chinese governments has contributed greatly to the rapid internationalisation of China. Since the 1980s China has established diplomatic relations with East Asian countries and has participated in various regional and world organizations. China is now a member of the WTO and is taking initiatives to enhance regional cooperation (i.e. with the ASEAN) (Chapter 3). On the one hand, China has implemented an ambitious domestic economic reform programme and experienced a tremendous transformation during the past two decades. The rescaling of political economy of China (in particular in terms of central-local relations) in this period has very important implications for understanding the success and failure of creating conditions to attract foreign investment. The key reform process has been the decentralisation of many decisions in economic management to local government (Chapter 4).

The Rise of Sub-National Governments

Because of the way in which micro-regionalisation is perceived in China, the domestic adaptation of Chinese politics and the change of foreign economic policy are very important. At the provincial level, Guangdong has promoted its own internationalisation strategies through para-diplomatic activities. Strong leadership in the implementation of economic reform has helped to support Guangdong's open economy. At the sub-provincial level, the Dongguan city government has promoted proactive dynamic developmental strategies. Moreover, beneath the city level, sub-municipalities (townships) have also launched ambitious strategies for attracting FDI. Thus, the central government was an initial promoter and provider of the Open Door Policy, but local governments have been key practitioners within this policy framework. Chinese local governments are not only devices for the implementation of national policies within national territorial boundaries;

they are also key entrepreneurial economic agents interacting with other economic actors across borders. Domestic political adjustment can be seen in the redefinition of central and local relations and the emergence of a fluid system of MLG. The changing role of local governments in China has thus reflected the interplay between their responsibilities as agents of the central government and their interest in promoting regional economic development.

Home Country Governance: Japan

The role of the Japanese government in the development of micro-regionalisation is not entirely clear because of the emerging variations in response by different levels of government and the continuing impact of ministerial fragmentation on foreign economic policy. There have also been different initiatives in the domestic and international arenas. Although MITI's (now METI: Keisanshō) 'developmental state' concept and the 'flying geese' model were at first able to explain the path of development of East Asia and Japan's role as a leader of development, they can no longer accommodate the rapid shift of Japanese production sites in China. Although state intervention has helped Japan's electronics industry, there can be no doubt that Japan's 'developmental state' model needs to be revised. Japan has not succeeded in producing a new export industry to follow the electronics industry. Indeed, the Japanese electronics industry may be the last example of Japan's successful home country governance led by cooperation between the government and business.

In the international domain, initially Japanese ODA undoubtedly helped Japanese firms' re-entry into East Asia. Under the impact of economic recession, Japan has not developed an alternative concept of its economic role in East Asia. Although the FTA concept emerged as the new basis of Japan's regional policy toward East Asia in the late 1990s, this initiative has also been hindered by Japan's domestic political situation. In the late 1990s the FTA principle was finally endorsed, but this was by now entirely a reactive move intended to avoid domestic problems. Thus, the role of the Japanese central government in micro-regionalisation across Guangdong, Taiwan and Japan can be seen as the indirect effect of Japan's engagement in East Asian regional cooperation and the development of bilateral relations with China. At the same time, the role of Japanese SNGs has become

much more important as part of the multi-layered diplomatic processes. Though the growth of micro-regionalisation has been dominated by firm-led industrial integration processes across borders, this has had a profound effect on local economies in Japan. Japanese local governments have therefore had to respond to changes of production, in particular the shift to offshore production led by Japanese electronics firms. Thus, Japan's home country governance is fragmented and less consolidated in coordinating the relationship between firms and the different levels of government in the rise of global competition.

Home Country Governance: Taiwan

Taiwan's home country-governance environment has played a major role in promoting micro-regionalisation. For Taiwan, given the small size of its territory and economy, economic relations with mainland China are crucially important. The Taiwanese government has been a strong supporter of the Taiwanese electronics industry in an effort to overcome the limitations imposed by Taiwan's limited size. Its government-funded research projects have resulted in the birth of many electronics firms. Also, through OEM/ODM/EMS production networks with foreign firms, Taiwanese electronics firms have become world-class electronics producers. The government has implemented innovative FDI policies to attract advanced technologies, and has made a determined effort to upgrade technology. However, the Taiwanese government has failed to improve political relations with mainland China. Moreover, the majority of Taiwanese SMEs have not had any government support, and most of them have independently (often secretly) set up offshore production sites in mainland China. Ironically, the fact that these Taiwanese SMEs do not expect support from the government has directly encouraged the agglomeration of Taiwanese firms. Thus, the Taiwanese government has tacitly encouraged the development of cross-border production networks across the Taiwan Strait.

The Strategies of MNCs: Japanese Electronics Firms

Foreign firms have played a vital role in developing an export-oriented manufacturing-based economy in the Pearl River Delta in Guangdong. They have inevitably been influenced by the specific characteristics of their home (i.e. national) system of production and innovation.

Japanese manufacturing FDI in East Asia varies according to the specific approach of each firm. However, empirical evidence suggests that most Japanese manufacturing FDI in East Asia is on the basis of export-oriented strategies which use offshore production for export to the US, EU and Japanese markets. This approach originally derives from the successful experience of Japanese export-oriented strategies. Japan's centralised and relatively closed production system, based on the *keiretsu*, has provided a distinct form of Japanese production networks. The investment strategy based on the *keiretsu* system has major implications for the development of a characteristically Japanese pattern of trade and investment in East Asia. In the electronics sector, with the supply of Japanese electronics technology and components, East Asian countries have successfully transformed themselves into electronic products-exporting economies. Thus, in the 1990s, when Japanese FDI started to enter China, it was natural that the initial priority was to set up offshore production targeting sales in third countries (especially Japan, the US and the EU). Japanese locational strategies in China derive from such exporting considerations, and thus the coastal area was chosen for its geographical advantages for exports. In particular, the preferential treatment offered by Guangdong succeeded in attracting a high level of Japanese investment.

With the restructuring of production in the electronics industry, the reform of the *keiretsu* system has had a dramatic impact on Japanese SMEs. They are now faced with the revision of conventional inter-firm relations with Japanese lead firms. This movement has caused the emergence of variations of production networks by Japanese firms. The business performance of Japanese firms in China encompasses both export-oriented strategies and domestic sales. Exporting from offshore production sites in China has been more beneficial than domestic sales for Japanese firms. Thus, because of lower labour costs, improved quality of production as well as industrial agglomeration, many Japanese manufacturing firms (including many SMEs) have further targeted China as an export base for third countries. Undoubtedly, the continuous expansion of offshore production by Japanese manufacturing firms in China will continue to develop production networks between Japan and China.

The Strategies of MNC's: Taiwanese Firms

Taiwanese firms have effectively linked Guangdong, Taiwan and Japan by responding to China's Open Door Policy and creating cross-border production networks (CPNs). The pattern of development of networking linkages across Guangdong, Taiwan and Japan is conducted through various strategic interactions between different levels of political and economic activity. The strategies of Japanese firms (using Taiwan as an export base) and of Taiwanese firms (seeking to gain technology with no sales networks) have complemented each other. Taiwanese firms have thus succeeded in undertaking OEM production from Japanese lead firms. Japanese electronics firms have developed various production networks with Taiwanese firms (through OEM/ODM/EMS). As a result of the increase of OEM production, Taiwanese electronics firms have become more capable of producing contract-made-to-order memory chips (EMS).

Taiwanese firms have emerged as the major investors in the mainland, ordering the assembly of manufactured goods. They have extended their activities across the Taiwan Strait despite the continuing political antagonism between China and Taiwan. Taiwanese firms enjoy a range of preferential treatments provided by Chinese local governments. The highly flexible Taiwanese inter-firm division of labour, which tends to concentrate in one area, is extended to the international division of labour using production sites in China. Industrial agglomeration in the electronics industry in Dongguan largely derives from the concentration of Taiwanese firms.

Building Network Relations between Foreign Firms and SNGs

Building network relations between foreign firms and SNGs is an essential – but previously under researched – part of micro-regionalisation. Economic reform in China has been carried out under rigid budgetary limits. The self-responsibility of local governments has meant that they have had to assume a more entrepreneurial role in the economic sphere (Chapter 4). The economic restructuring of the state sector has contributed to the rise of local economic elites (often Party cadres) and local entrepreneurs in local government. The Chinese SNGs are increasingly in control of their own resources and firms and depend less on financial support from central government. Thus, foreign firms have become especially important sources of local economic dynamism.

For foreign firms, good relations with Chinese SNGs are vital in terms of gaining favourable business conditions (i.e. regulations and licenses). The local government elites have played a highly significant role in protecting foreign firms because their economic interests are the same as those of foreign firms. In the case of Guangdong, the local government-fund firms often undertake processing and assembly production under contract with foreign firms. Many foreign firms have established joint ventures with Chinese local government-funded firms (EJVs and CJVs). As far as the mutual benefits between foreign firms and Chinese SNGs are concerned, the local institutional setting plays a tremendously important role in circumventing regulations imposed by the central government.

8.3 How Do Networks of Multi-Level Governance (MLG) Operate to Facilitate Micro-Regionalisation? (Research Question 3)

Chapter 7 presented a detailed case study of the development of cross-border sub-national government networks among Guangdong, Taiwan and Japan with particular reference to the example of the city of Dongguan (in the province of Guangdong) and its emerging relations with Japanese and Taiwanese electronics firms. The emergence of economies of agglomeration in Dongguan illustrates the successful growth of a 'region' through the combination of political, economic and technological spatialities, coming together within an emergent system of multi-level governance.

Our research shows that various strategic actors are involved in the development of local networks in Dongguan. In terms of different levels of Chinese sub-national government, the provincial level (Guangdong), the city level (Dongguan) and the sub-municipal level (districts/townships) all play important roles. This is illustrated in Chapter 7 by the specific case of the electronics industry. In this sector, the Guangdong provincial government has worked hard to develop an active foreign economic diplomacy, and has introduced a number of measures to create an attractive host environment for foreign firms. At the city level, Dongguan has taken advantage of the increased scope for autonomy in economic development matters, including both domestic improvements (such as physical infrastructure), the flexible regulation of labour costs, and relations with potential investors, including foreign firms. It has benefited in this respect from the advantages offered by the

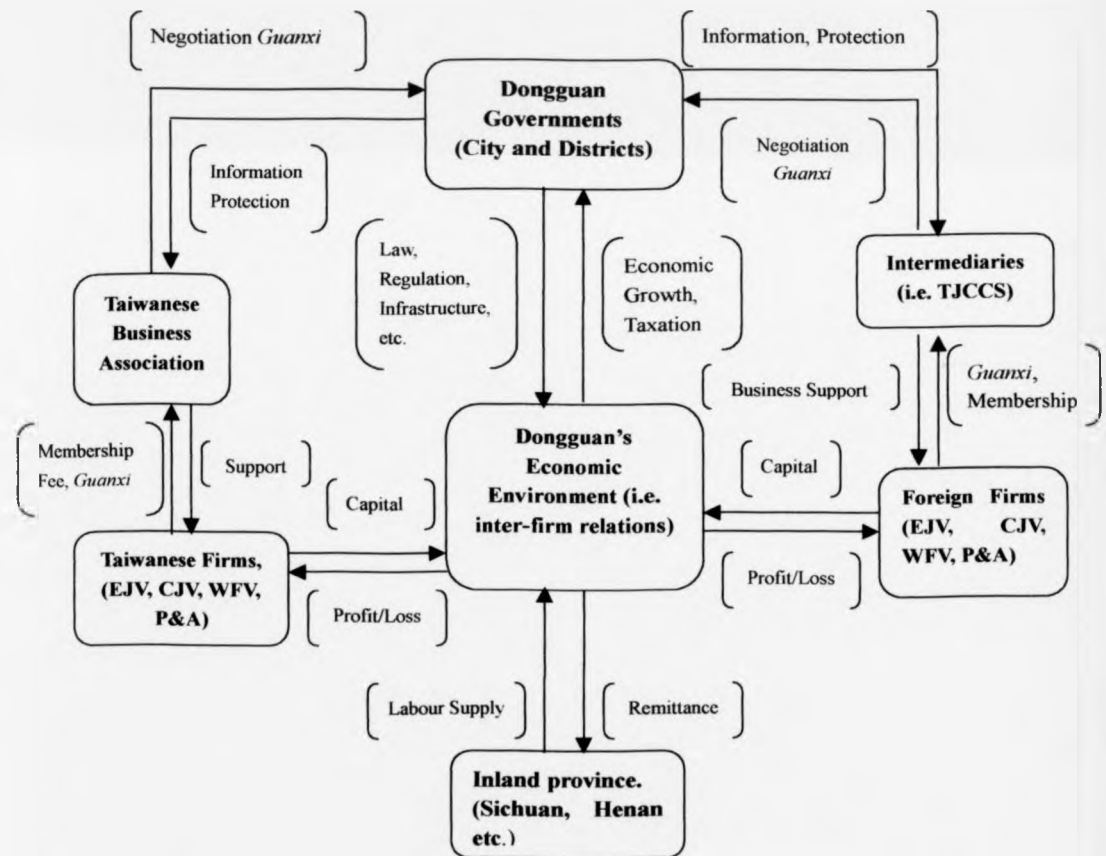
city's geographical location (between Guangzhou and Shenzhen, and close to Hong Kong) and its access to an abundant supply of low-cost immigrant labour. At the sub-municipal level, there is considerable scope for Dongguan's 32 districts/townships to attract foreign investors by offering a range of incentives and by cultivating successful networking arrangements with foreign firms. Changan, Humen, Shijie and Qingxi have been the most successful sub-municipalities in terms of attracting inward investment. This is undoubtedly because they have adopted a proactive, entrepreneurial style of leadership in their relations with foreign firms.

The importance of *guanxi* as a basis for the development of relations between local governments and firms is also a key issue. Figures 8.1 and 8.2 offer the opportunity to compare the strategic processes of micro-regionalisation through the development of cross-border networks and the inter-related dynamics of local networks. G. Yeung (2001a) concludes that Dongguan's economic, social and environmental endowments owe much to the privileged treatment offered through *guanxi* network relations. The Dongguan government is a provider of regulation, law and physical infrastructure for the business environment, and also offers firms attractive investment concessions. This has been to the advantage of Dongguan, because as its economy has grown there has also been a growth of revenue through taxation.

Although Yeung's study distinguishes foreign firms *with guanxi* from those *without guanxi*, this research reveals that *guanxi* relations are *not* an unchanging entity; rather through business practices these relations are constantly reshaped and created. Thus, in the business practices of Japanese and Taiwanese firms in Dongguan, the intermediaries (the Taiwanese Business Association [TBA] and the Tōkan-Japan Consulting Support Service [TJCCS]) have played a critical role. These intermediaries support foreign firms in negotiating with local governments, the exchange of information, and the protection of firms. For example, the expansion of the production sites of Taiwanese firms to China inevitably highlights political factors. However, practical interactions in the micro-regionalisation process are almost entirely carried out by local governments in China on the basis of the autonomy they have been granted within the merging system of MLG. These intermediaries help to make up for the lack of political relations by creating *guanxi* relations between firms and

local officials. Also, the sub-municipal levels of government have developed their own strategies for attracting foreign firms. In particular, they have developed networking relations with foreign investors through various channels such as trade fairs (e.g. the 3C EXPO) and other informal contacts. Dongguan's local network is also linked to the inland area, which provides an abundant source of migrant labour. In turn, the remittance from the migrant workers in Dongguan accounts for a very important part of the local economy (e.g. in house-building).

Figure 8.2 The Variety of Dongguan's Local Networks



Source: The researcher's elaboration of G. Yeung's model

The system of MLG studied in the case of Dongguan and the electronics industry involves three vertical levels (four, if we include the central government) and 32 horizontal divisions of the city of Dongguan. Obviously, this raises the question of overall control and co-ordination of emerging, unplanned governance arrangements. There is increasing competition among territorial units (cities and sub-municipalities) to attract foreign investment. The provincial government of Guangdong and the central government both seek to establish economic areas and zones for privileged treatment. Dongguan has benefited because it is at the heart of the Pearl River Delta, which has been targeted by both the centre and the provincial levels of government as an economic priority area. Dongguan is one of several 'open economic areas' within the Pearl River Delta, and the city government has been able to select areas within its own boundaries for economic development purposes. Undoubtedly, there is a growing need for more effective coordination of these trends and of the various types of areas designated for economic development, because without such coordination the consequence will be an extremely uneven pattern of internationalisation (with its accompanying social problems) among and within China's provinces. This in turn will hinder the overall integration of China with the world economy.

8.4 Theoretical Implications for the Study of Micro-Regionalisation

This thesis demonstrates the usefulness of inter-disciplinary investigation to gain an understanding of the development of micro-regionalisation. In particular, the analysis of micro-regionalisation has drawn on three theoretical constructions which, when taken together, offer a systematic framework for theorising the micro-regionalisation process. These concepts are: multi-level governance (MLG), international commodity chains (ICCs), and cross-border production networks (CPNs).

Multi-Level Governance in East Asia

Changes in cross-border economic relations among Guangdong, Taiwan and Japan have been greatly facilitated by the emergence of fluid MLG. This case also serves to demonstrate the analytical value of the concept of MLG beyond the example of EU governance. The pattern of China's micro-regional integration with the world economy is

closely linked to the emergence of a system of MLG, with hierarchical arrangements giving way in many areas to non-hierarchical, local co-operative and intra- and inter-firm networks of governance. The MLG approach thus helps us to understand the increasingly complex relations between the fluidity of domestic governance and the development of production networks.

Most importantly, the transition to MLG is a highly political process that is both stimulated and constrained by power relations. Although the centre is the initial promoter and provider of reform processes, the forms of governance are being continuously reproduced and reshaped according to the practices of the key participant actors (the centre, localities and firms). The result is an increasing fluidity, complexity and diffusion of authority that does not fit neatly into the formal territorial patterns of China's 'official' political and administrative structure.

The processes of MLG at the micro-regional level are shown to be the result of both a deepening economic interdependence and the restructuring of the state. The state, SNGs and firms are the primary strategic agents of MLG in micro-regionalisation. It is essential therefore to design new roles for SNGs in the field of international economic activity, to equip SNGs with the necessary capabilities and resources, and to formulate a more flexible interpretation of territoriality and sovereignty. This study shows that in the case of the re-articulation of China into the global economy, the domestic adjustment of networks of governance and the learning processes for MLG are being carried out by both the Chinese central and sub-national authorities. However, the pace of the spread of *de facto* regionalisation, as revealed by the case of the electronics industry, is extraordinarily fast, and the ambiguous allocation of authority among central, provincial and sub-provincial governments remains a major obstacle to efficiency. The problems of corruption, smuggling and widening regional economic disparities reveal very clearly the basic structural defects and limitations of state-led institutionalisation and economic reform from above. MLG in China is indeed premature in terms of its underdeveloped accountability, transparency, legitimisation and institutionalisation. It is therefore important to acknowledge the increasing role of the SNGs and to activate the sub-national level to strengthen the institutional support of the central authority and the international community.

International Commodity Chains

Perspectives drawn from the international division of labour approach and international commodity chains (ICCs) analysis help us to understand the *de facto* processes of regionalisation inducing industrial transformation. Industrial agglomeration in Guangdong is the result of the interplay of several economic variables. The foundation of industrial agglomeration is transplanted from outside, from Hong Kong, Taiwan and Japan. The ICCs approach highlights the deepening relations between industrial change and the external economic effectiveness of intra- and inter-firm relations, and the way in which the cities in the Pearl River Delta in Guangdong have become closely linked to Taiwan and Japan as well as to the broader global economy. The Japanese electronics industry has expanded its production sites in East Asia in order to overcome cost competition in production. In order to reduce the transaction costs, local procurement is critical and this induces the agglomeration of the suppliers of parts and components. Taiwan is the pivotal production site that cuts across the borders among China, Taiwan and Japan. Japanese electronics firms use the flexibility of Taiwanese firms. But Japanese firms also use Taiwan as their operation centre in China. According to research by the Nomura Institute, 76.7% of Japanese firms that have established subsidiaries in Taiwan perform a supply and guidance role in China (*Gekkan Ajia*, July 1998).

Taiwan was the original the production site for Japanese manufacturing firms. In this context, it is especially important to understand the roles of East Asian NIEs (Hong Kong, Taiwan, Singapore and South Korea) in relation to commodity chains, in particular through their links with Japan. East Asian NIEs have undertaken a number of key roles: (1) a commodity-export role; (2) a commercial-subcontracting role, using imported components from Japan; (3) an export-platform role, using Japanese FDI; (4) a components supplier role, acquiring OEM (original equipment manufacturing) from Japanese manufacturers; and (5) an independent exporter role, using original brandnames (Gereffi, 1992: 106). In the case of Taiwan, it shifted from a commodity export role to a commercial-subcontracting role, using imported components from Japan. Then, it began to play an export platform role, using Japanese FDI. It has also become a components supplier, acquiring the OEM for the firms in advanced countries. OEM production has helped technological transfer from the advanced countries. Taiwan has now emerged as the

major investor in Guangdong through ordering the assembly of manufactured goods. Taiwan has extended commodity chains across the Taiwan Strait in order to meet the demand of low-cost production. The role of Taiwan as a recipient of Japanese FDI and a supplier of investment to China is crucial for the further development of Guangdong's industrial agglomeration. The highly flexible Taiwanese inter-firm division of labour is replacing the conventional mechanism of the international division of labour based on national economies. In this respect, Gereffi (1996) correctly predicted the pattern and change of the relations between the NIEs and Japan. However, in the case of electronics industry, Taiwanese electronics firms have not yet achieved, or have strategically decided not to undertake, original brandname manufacturing (OBM). The major Taiwanese electronics firms still undertake OEM production and now the major production form is becoming the EMS type of production system, which also contracts manufacturing with the lead firms.

This study has sought to determine how far and in what ways the ICCs approach can explain the pattern of micro-regionalisation across Guangdong, Taiwan and Japan. According to Gereffi's assumptions, Guangdong's key roles with Taiwan and Japan are: (1) a commodity-export role; (2) a commercial-subcontracting role, using imported components from Taiwan and Japan; (3) an export-platform role, using Japanese and Taiwanese FDI; (4) a components supplier role, acquiring OEM (original equipment manufacturing) from Japanese and Taiwanese manufacturers; and (5) an independent exporter role, using original brandnames (OBM). Gereffi's assumption of the shift of commodity chains is correct up to and including stage (4). But Guangdong has not achieved the stage (5) role, nor is it likely to in the near future, given the present inadequacies of its education and training provision, which have led to a critical shortage of engineers, especially in the electronics sector, and other skilled workers.

However, we can identify the role of Guangdong and Chinese firms from the perspective of ICCs. Chinese firms can use Guangdong's industrial agglomeration in the electronics industry, mainly in a commercial-subcontracting role, using imported components from Taiwan and Japan. As they have expanded the sales share of the domestic market and increased exports, they have gradually upgraded to the export platform role and the

components supplier role. Clearly Guangdong has not yet achieved an independent exporter role. In some cases (e.g. Konka), OEM production has become an important part of the Chinese electronics industry. However, in PC-related OEM production, Taiwanese electronics firms are dominant and supply OEM products not only to foreign firms but to Chinese electronics firms. Thus, the role of Guangdong as a components supplier and OEM production site remains somewhat ambiguous, and the effectiveness of the ICCs approach based on regional linkages needs to be supplemented by a more detailed analysis of firms' production networks.

Cross-Border Production Networks

In most industries there is usually a specialisation of activities, with each individual organisation being linked to, and playing its role in, the wider production and distribution system. With the rapid development of liberalisation, deregulation, information technology, and communication in the 1990s, the pace of the globalisation of production networks accelerated. These networks encompass the inter- and intra- firm relationships through which the firms organise the entire range of their business activities.

The concept of cross-border production networks (CPNs) highlights the fact that the strategies of each firm vary and the characteristics of the home environment affect the pattern of CPNs. Hong Kong firms' 'front-shop, back-factory' (intra- and inter- firm relations) model across Guangdong and Hong Kong has become the foundation of the CPNs between these two areas. With flexible interpretation and the support of local government, the increasing profit of Hong Kong manufacturing in the Pearl River Delta has quickly attracted foreign, especially Taiwanese, manufacturers.

Our analysis of the CPNs of Japanese electronics firms reveals considerable variation among those firms' strategies and the influence of the home governance. In the Japanese electronics production system, the *keiretsu* and the sub-contracting role of SMEs based on long-term relations have played an important role in sustaining competitive advantage. The appreciation of the Japanese yen since the late 1980s has had a profound effect on this closed and centralised system. Japanese electronics firms have tried to develop a *mini-keiretsu* system in East Asia. In the NIEs and ASEAN, these strategies of Japanese

manufacturing firms are common because of the lack of local suppliers of parts and components. Japanese manufacturing FDI is often undertaken together with group companies. However, they now face the new challenge of massive change in the technology of electronics and consequent changing demands in the consumer markets. This industrial- technological upgrading has greatly accelerated competition in order to achieve quicker development cycles and technological upgrading as well as the rationalisation of procurement in the electronics industry. The outsourcing of manufacturing and the formation of international alliances became popular strategies among Japanese electronics firms in the 1990s. This inevitably involved the revision of inter-firm relations. This perspective helps us to understand the emerging variation in the impact of changes of governance in production networks on the shift of Japanese electronics firm into East Asia.

The CPN model also highlights the networking linkages of Taiwanese electronics firms. Taiwan is a small country faced with unresolved political tension across the Taiwan Strait. Due to the proliferation of SMEs, Taiwanese firms have developed close inter-firm relations. The complementary inter-firm division of labour can be seen to correspond to the producer-driven, international, regional and hierarchical division of labour. Many Taiwanese SMEs link up with foreign firms in different ways (in sub-contracting, OEM, EMS, etc.). Taiwanese inter-firm relations are thus moving to the mainland while maintaining the structures of networks in Taiwan. Much of the offshore production of Taiwanese PC-related products is concentrated in south China (Dongguan). Taiwanese companies are integrated in a large number of different national production systems. Taiwanese SMEs, however, can respond to market change quickly. This is very different from Japanese SMEs, which have served as parts and components suppliers for the lead firms.

Although there is a limited university spin-off effect in Guangdong, there are many private ventures and TVEs, set up by entrepreneurs who previously had work experience with foreign firms. To maintain the new product information and quality of technology for assembling, it is important for local firms to link up with foreign firms and obtain OEM orders from advanced countries. This enables firms to further attract local firms which are willing to participate in electronics production. Thus, with the rise of global competition,

industrial agglomeration in Guangdong has become the leading production site for the electronics industry in China. The dramatic growth of China's electronics products is bound to the spread of CPNs across Guangdong, Taiwan and Japan.

Theorising Micro-Regionalisation

One of the main aims of this study is to refine and extend the theorisation of micro-regionalisation in order to enhance IPE perspectives on processes of regionalisation and globalisation. Micro-regionalisation is a world-wide phenomenon that is emerging in more geographical areas than ever before as a manifestation of fundamental changes in cross-border economic and political relations.¹ The study of IPE presumes that states, multinational corporations and other powerful actors attempt to use their power to influence the nature of international relations. One of the major themes in the study of IPE is the persistent clash between the increasing interdependence of the international economy and the desire of individual states to maintain their economic independence and political autonomy. Thus many political economists acknowledge the need for some minimal rules or institutions to govern and regulate economic activities among states. Although the departure from the state-centric approach toward more pluralistic approaches, taking into account the role of SNGs, NGOs and MNCs in the processes of international economic governance, is evident, there are still no comprehensive theories of micro-regionalisation in IPE. In the present study, micro-regionalisation has been conceptualised in terms of networks of governance in order to provide a sufficient explanation of the interactions among the different types of institutions, organisations and movements across national boundaries. This approach permits us to explore more deeply the development of the interpenetrative relationships involved in cross-border governance in terms of both economic behaviour and political representation.

To begin with, the distinction between regionalism based on deliberate, purposive state-led projects and regionalisation promoted largely by market-driven processes is important if we are to understand the various processes involved in restructuring of a regional order. Regionalisation and globalisation must also be distinguished from internationalisation, which refers to a process of intensifying connections between national domains. As a result of internationalisation, states may come to have deep effects on each other, but they remain

distinct separate territorial spaces. Although the micro-regionalisation approach accepts the continued existence of nation-states and the importance of different political and economic systems among states, the processes of micro-regionalisation do not always depend primarily on state actors or on state-to-state relations.

It is important in any theory of micro-regionalisation not to concentrate simply on the relations within the micro-region. We also need to assess the roles of external actors and their interactive dynamism. This approach reflects the logic of the market system to expand geographically and of the processes of restructuring a regional political and economic space at the sub-national level. IPE scholars often focus exclusively on the international political and economic system without considering the domestic political economy. It has become obvious that the roles of domestic economies in the international affairs and of the external actors in the domestic arena have become significant determinants of both domestic and international affairs. In such transformational processes, the various state and non-state actors are struggling over the redefinition of identity, profit and power. Different levels of state and non-state actors have different levels of capability to shape and respond to globalisation. As we have seen in the present study, micro-regionalisation among Guangdong, Taiwan and Japan highlights the result of an integrated system of global production and trade (international division of labour, international commodity chains, and cross-border production networks), supported by new forms of investment and financing, and promoted by specific local government policies. One consequence of this new pattern of multi-layered governance is the creation of more participatory forms of international political economy. This represents a shift from the concept of order based on a largely state-centred and international-domestic divided territorial basis to the new shared responsibility between political and economic dimensions. In analytical terms, an understanding of the relationships of these actors both across national boundaries and within individual states is especially important. The major engine of change behind this linkage is the interactive multiple dynamism over intense industrial competition among firms and among local governments. The reliance on one level of analysis (i.e. state-to-state relations, or the state versus MNCs) or on vertical domestic inter-governmental relations can explain only a part of the picture. As this study shows, Chinese local governments do not necessarily stand in opposition to the centre in a

zero-sum relationship, but they form direct transborder links with firms and have enhanced their capability to bypass the central government.

The theorisation of micro-regionalisation also helps to explain how micro-regionalisation is socially constructed, i.e. how social relations become relatively delinked from territorial geography (*detritorialisation*). The socially integrated analysis of regionalisation is discussed in Section 2.7. The New Regionalism Approach/Theory (NRAT) examines three levels of analysis: (1) the structure of the world system as a whole; (2) the level of inter-regional relations; and (3) the internal pattern of the single region. Further elaboration is suggested by the development of global social theory, which suggests that the concept of 'regionness' embraces five elements: regional area, regional complex, regional society, regional community and region-state. Micro-regionalisation involves processes of social construction through the interactions among the different levels of regionalisation. This is an example of the declining influence of territory on our social life with the emergence of multiple and complex political and economic interactions across borders. Thus, as this thesis has sought to show, the theorisation of micro-regionalisation can fruitfully be based on a combined analysis of the processes of social political and economic strategies within and across national boundaries.

Undoubtedly, theorising micro-regionalisation calls for a more pragmatic approach towards on-going active region-building processes based on political and economic factors. The formation of cross-border governance builds up the thickness of regularised practices and rules across national boundaries. This effort to create new political and economic spaces at the sub-national level requires us to take into account the importance of cities and regions in the study of IPE. Cities and regions have become significant arenas in which a variety of political and economic interventions occur. Practically, the theorisation of micro-regionalisation addresses the features of multi-level governance, cross-border production networks and international commodity chains, which together facilitate an in-depth analysis of emerging patterns of multi-layered interactive governance in the world economy. This is an aspect of IPE that has previously received little attention. This neglect is, however, especially important in the case of the regionalisation processes in East Asia, where state territoriality, government legitimacy and supra-state governance still involve

much uncertainty. In East Asia there is a very fluid and variable pattern of decision-making involving both quasi-public and quasi-private actors, especially in the area of foreign economic management. This thesis complements the conventional theories of regionalisation and globalisation, based on paradigms of state territoriality, institutional development, the international-domestic divide, and the state-market dichotomy, by raising the issues of the dynamics of multi-layered interpenetrative pattern of regionalisation and linkages both within and across national boundaries. Thus, theorising micro-regionalisation based on three approaches (multi-level governance, international commodity chains, and cross-border production networks) adds a valuable critical perspective to contemporary IPE analysis.

8.5 Implications for China's Future Policy Agenda

Japanese and Taiwanese FDI has been a powerful catalyst in the development of cross-border economic relations among Guangdong, Taiwan and Japan, and this has had a major impact on the local economic environment, including human capital endowment, social and physical infrastructure, local technology, local industrial structure, and even the local political system. Without foreign investment, industrial agglomeration in Guangdong would not have been possible. At the same time, China's domestic reform process was a crucial factor, resulting in the increase of Dongguan's economic power over management. The inflow of capital into Dongguan was very rapid and did not allow enough time for local leaders to create consolidated regional developmental strategies. Dongguan's flexibility is outstanding (through *guanxi* networks); however, the abundant inflow of capital and the continuous supply of migrant workers from the inland area have delayed the systematic and careful consideration of how an effective and sustainable regional economic structure should be built. Certainly, without Dongguan's indigenous developmental strategies (stressing the key roles of education, local ventures and technological upgrading), it will not be possible for Dongguan to transform itself into a high value-added electronics production site. The danger for Dongguan is that production networks are being reproduced and innovated according to MNCs' changing strategies in the face of global competition. Japanese and Taiwanese firms themselves keep revising their production strategies in response to fluctuations in the global market. What this case study suggests is

that there are several key issues that need to be addressed by Chinese policy-makers in the future.

The Policy Agenda

The phenomenon of micro-regionalisation among Guangdong, Taiwan and Japan has been understudied and is much less familiar than the so-called 'Greater China' perspective. The three China's economic relations are undoubtedly developing, but the real integration cannot be captured by the model of a group of regions. On the other hand, there is a danger in 'reducing' the study of regionalisation to the dynamics of economic and technological space. The role of government, political institutions, political processes, and political culture in shaping, limiting and encouraging new forms of regional activity is also of vital importance. The three sets of bilateral relations (China, Taiwan and Japan) are all politically sensitive, and bilateral perspectives (stressing relations between the central governments) are still dominant for policy makers. What is needed is a greater acknowledgement by the leaders of the importance of regional linkages beyond these bilateral relations, and of the effort needed to co-ordinate support for these linkages. Most importantly, new structures of MLG are required to link the central governments, SNGs and MNCs across borders. China-Taiwan-Japan relations have entered a new phase of linkages through the organisation of production and the regional division of labour. SNGs are assuming more and more direct responsibility for maintaining business conditions. But MLG in China needs to be more firmly anchored in relation to the development of CPNs in East Asia.

Cross-Strait Relations

Despite continuing political conflicts across the Taiwan Strait, one part of China and Taiwan are now deeply integrated. On the Chinese side, with the rise of competition among local governments in attracting foreign investments, foreign firms are able to enjoy better concessions and preferential treatment. Dongguan's innovative local networks are successful examples of cross-border economic governance at the micro level. Local governments and firms act to create networks of cross-border economic governance in line with their own strategies for economic development. In general, effective economic contacts between China and Taiwan are strictly limited to the micro-regional level. While

the priority of the national government of China is the unification with Taiwan, the regional and business initiatives may affect the development of a political framework between China and Taiwan. This is a good example of how micro-regional integration is linked to the relationship between the national levels of political interactions. Although micro-regionalisation itself has played a minor role in cross-strait *political* relations, Taiwanese business communities are emerging as key actors in leading the change of Taiwan's foreign policy toward China. Thus, the cross-strait relations economic agenda has increasingly become linked to the global business environment. As long as mutual economic benefits from these relations are regarded as essential for national economic development, it is unthinkable to take any further political action which will break down micro-regionalisation. On the other hand, any future political instability in China, e.g. within the ruling party, could have a detrimental effect on business confidence.

Sino-Japanese Relations

Since the end of the Second World War, economic interactions have been the key to the development of Sino-Japanese relations. This economic interdependence has been shaped by political factors, especially the changing ideological and governmental outlook of China's ruling Communist Party (CCP). Today, there is a high level of mutual economic interdependence between the two countries. With the sharp increase of Japanese FDI and the shift of production sites into China, PTAs have become a major factor linking the two countries. Almost one quarter of the materials and components for China's PTAs are imported from Japan. For China, Japan is a key source for the further development of micro-regional integration with the world. For Japan, China is the crucial link in ensuring the survival of the Japanese manufacturing industry in the face of ever-intense global competition.

From an East Asian regional economic perspective, Japan has been a major economic power and China is emerging as a latecomer with both political and economic ambitions in the East Asia region. Despite their deepening interdependence with each other, we need to pay attention to the power struggle over the leadership role in East Asia, which greatly affects the processes of development of East Asian regional cooperation. China and Japan, as political rivals, have both moved to formulate East Asian economic cooperation on their

own terms. The main problem here is that regional cooperation is regarded as a politically constructed process based on the central government. However, economic contacts and interaction have already existed and developed at a micro level, and mechanisms of economic exchange have already been put in place. The national economic perspectives on Sino-Japanese economic relations are still too strong in decision-makers' minds in both countries. What is needed is to understand the real economic contacts and interactions carried out at further disaggregated levels.

A Divided China? (Guangdong's Relations with Other Regions)

This study highlights the inter-relationship between the degree of foreign investment and regional differentiation in China. The gap between the rich and poor is increasing. The involvement of foreign firms in local political space may point to China's eventual disintegration. Certainly, the impact of micro-regionalisation among Guangdong, Taiwan and Japan has not yet contributed to China's national economic integration. Rather, it is continuing to pull Guangdong, in particular the Pearl River Delta, towards the outside world. However, the processes of micro-regionalisation is sustained by deepening links with neighbouring provinces such as a huge supply of labour force. Although there are interesting debates concerning the possibility of a federal China emerging in the future, a formal federal system might not be capable of accommodating the fluid and asymmetrical nature of the processes of China's micro-regional integration, which depend on the wider processes of regional and global processes. The emergence of MLG in economic space in China suggests that there is already a kind of embryonic federalism in existence. The main issue at present is the lack of synchronisation between the relations of economic governance and the formal political framework.

8.6 Limitations of the Present Research

Though this study furnishes data concerning the structures, functions and operations of cross-border micro-regional networks of governance among Guangdong, Taiwan and Japan, it has obvious limitations. First, the study examines only one single sector (the electronics industry) and there is no cross-sector comparison. The pattern and processes of micro-regional networking in other sectors may be different.

Secondly, the area analysed in this study is one specific geographical area (Guangdong and Dongguan) in China. Considering the huge regional differentiation in economic development in China, the cases of successful MLG in Guangdong and Dongguan may be exceptional.

Thirdly, the periodisation of the study (focusing on the 1990s) also restricts the generalisation of the research findings. For instance, the period of China's entry into the WTO (2001) is excluded. Moreover, the field research was conducted within very limited time constraints. It is difficult to judge whether the experience of the 1990s in Dongguan will be a prologue to the full-scale reintegration of China with the world economy or only a temporary and contingent phenomenon affecting a specific geographical area.

Fourthly, the MLG approach concentrates on China's domestic system. Japan and Taiwan have different forms of MLG. Finally, as the FTA projects promoted by the state have not yet reached maturity in East Asia, the consequences of future interactions between regionalisation projects and the 'lower' level of micro-regionalisation are still uncertain.

8.7 Future Research Directions

This study must be seen as an initial, limited study which needs to be expanded further in the future. In order to complement the findings of this study, further cross-sector and cross-locational research is especially important. China and Taiwan are now members of the WTO. China has also moved towards the establishment of a FTA with ASEAN, and Japan has moved towards a FTA with Singapore. The local governments in China, Taiwan and Japan have also emerged as more autonomous economic actors than ever before. Moreover, the continuous evolution of production systems and the increasing scale of the economy will continue to shape the pattern of micro-regional networking relations. From the viewpoint of MLG, the entry of China and Taiwan to the WTO has far-reaching implications for the strategies of actors involved in micro-regionalisation. The interactions among central governments, local governments, and firms have become more complex. These changing patterns need to be continually monitored and analysed. As explained in

Chapter 6, the concentration of Japanese and Taiwanese electronics firms in the Yangtze River Delta can now be observed. This has major implications in terms of China's entry into the WTO. Thus, the expansion of the research to include developments in the Yangtze River Delta would provide further opportunities to test the validity and applicability of the analytical framework (MLG, ICCs and CPNs) utilised in the present study. This would also strengthen the comparative understanding of the processes of micro-regionalisation in the same country.

8.8 Summary of the Research Contribution

This thesis is a study of the dynamics of micro-regionalisation among Guangdong, Taiwan and Japan from an international political economy perspective. It is the first study to integrate an analysis of economic and political-governmental factors in the development of this particular case of micro-regionalisation, and in so doing the thesis adds an important empirical study to the literature and also contributes to the development of a theoretical framework of micro-regionalisation utilising a combination of approaches: multi-level governance, international commodity chains, and cross-border production networks. It adds a new dimension to existing studies of political and economic change in China, and in particular shows how an awareness of political economy spatiality can add to the understanding of the changing roles of different levels of government, especially the sub-national levels. The study highlights the growing importance for micro-regionalisation of the network relations among SNGs, firms and intermediate associations. Finally, the study illuminates the particularly interesting case of the development of the electronics sector in Guangdong (and especially Dongguan), and shows how that development has been shaped by a combination of domestic and foreign influences stemming from globalisation and regionalisation. The processes of micro-regionalisation are closely linked to the wider processes of regionalisation and globalisation. In this respect, this case study also furnishes an empirical example of China's broader micro-regional integration with the world economy.

¹ For example, Breslin and Hook (2002).

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APPENDIX: THE CASE OF SANYO'S BUSINESS ACTIVITIES

Sanyo (established in 1950 and based in Osaka) is one of the pioneers of international production. Sales in the settlement accounts for the year ending March 2000 amounted to 1,952 billion yen (*Japan Company Handbook*, 2000). In the early 1970s, Sanyo developed the 'one-third' strategy for manufacturing capacity: one-third domestic manufacturing for the domestic market; one-third domestic manufacturing for foreign markets, and one-third foreign manufacturing. Sanyo focused its international production and sourcing on East Asia in the second half of the 1970s, much earlier than other Japanese rivals (Ernst, 2000a: 92).

Table A.1 shows the location of Sanyo's subsidiaries in the NIEs and ASEAN 4, and indicates the firm's locational and production strategy in East Asia. Sanyo has established a semiconductor factory in each country apart from Malaysia and Indonesia. The production of semiconductors is in the hands of 100% Sanyo-owned firms, which is different from the types of subsidiaries undertaking relatively low-tech production (e.g. air conditioning). Table A.2 indicates the reinvestment of subsidiaries and the role of the regional hub centres of Hong Kong and Singapore. Sanyo Semiconductors (Hong Kong) and Sanyo Asia (Singapore) have been involved in reinvestment in other East Asian countries. Sanyo Asia, for example, is a single investor in nine other Sanyo production sites (especially in the ASEAN 4). In the 1960s and 1970s, this expansion focused on the NIEs, and in the 1980s and 1990s Sanyo Asia set up subsidiaries in ASEAN.

Sanyo is also a pioneer in operations in China. By 1999, the company had established 29 subsidiaries in China (see Table A.3). Sanyo's geographical concentration in Liaoning (9) and Guangdong (14) is remarkable. Guangdong is a focus for high-tech electronics products, and Dalian is used for the production of home and business electrical appliances. Holding companies have been established in Beijing and Guangdong. Sanyo initially invested in Guangdong, and in the 1990s it concentrated on Guangdong and Dalian. In terms of the forms of investment, Sanyo favours 100%-owned firms in high-tech production. Table A.4 also reveals the pattern of Sanyo's expansion in China by presenting the shares of reinvestment. It identifies four cases of reinvestment by Sanyo Electric China

(Beijing), Sanyo Electric Hong Kong, Huaqing Sanyo Electronics, and Guangdong Huaqing. Sanyo also undertakes reinvestment in Sanyo's subsidiaries in China. Tables A.3 and A.4 also illuminate Sanyo's chronological strategy in China. Sanyo's FDI in China was concentrated in the mid-1990s: 24 projects out of 29 were set up between 1993 and 1997.

Table A.1 Sanyo's East Asian Operations

Country	Name of Local Body	Major Business or Production	Sanyo's Share of Local Body (%) (a)
Korea (4)	Korea Sanyo Electric	Audios	49
	Korea TT	VTRs, CD-ROMs	91.99
	Korea Tokyo Electronic	CD-related products	99.04
	Korea Tokyo Silicon	Semiconductors	100
Taiwan (4)	Chen Ho & Co.	Tape-recorders	43.5
	Sanyo Electric Taiwan	Air conditioners, refrigerators	46.57
	Sanyo Electronic Taichung	Semiconductors	100
	Sanyo Semiconductor Taipei	Sales of semiconductors	100
Hong Kong (4)	Sanyo Electric HK	Regional operation centre	100(b)
	Sanyo Energy HK	Batteries	100
	Tottori Sanyo Electric	Semiconductors	100
	Sanyo Semiconductor	Sales of semiconductors	100
Singapore (10)	Sanyo Air conditioners Manufacturing	Air conditioners	92.31
	Sanyo Air conditioners	Air conditioners	50
	Sanyo Asia	Colour TVs	99.9
	Sanyo Compressor Singapore	Compressors	90
	Sanyo Denso Industries	Boxes for air conditioners	86.67
	Sanyo Energy Corp	Batteries	98.57
	Sanyo Industries	Microwaves	95.62
	Sanyo Semiconductor	Semiconductors	100
	Sanyo Malaysia	Sales	24.5
Thailand (2)	Sanyo Semiconductor	Semiconductors	100
	Sanyo Universal Electric Public	Refrigerators, Colour TVs	30.2
Malaysia (3)	FMS Audio	Car Audios	66.7
	Sanyo Electric	Car Stereos, Mobile phones	100
	Sanyo Sales and Service	Air conditioners, colour TVs	27.7
Philippines (2)	Sanyo Semiconductor Manufacturing	Semiconductors	-
	Sanyo Philippines	Refrigerators	35
Indonesia (5)	P.T. Sanyo Compressor	Compressors	90
	P.T. Sanyo Electronics	Colour TVs	82
	P.T. Sanyo Energy	Batteries	90
	P.T. Sanyo Industries	Air conditioners	55
	P.T. Sanyo Jaya Compressor	VTRs, Tuners	65.9

Note: (a) includes affiliates and subsidiaries. (b) includes some unspecified shareholder

Source: Based on Toyō Keizai (2000) *Kaigai Shinshutsu Kigyō Sōran 2000* (Outlook of Japanese Firms Abroad 2000), Tokyo: Toyō Keizai Shinpōsha.

Table A.2 Reinvestment of Sanyo's Subsidiaries in East Asia

<i>Name of Local Body</i>	<i>Sanyo's Share of Local Body (%)</i>	<i>Share of Sanyo's East Asian Subsidiaries</i>	<i>Year of Foundation</i>
Korea Sanyo Electric	49	0	1985
Korea TT	91.99	0	1977
Korea Tokyo Electronic	99.04	0	1972
Korea Tokyo Silicon	100	0	1973
Chen Ho & Co.	43.5	Sanyo Electric Taiwan (14.09%)	1990
Sanyo Electric Taiwan	46.57	0	1964
Sanyo Electronic Taichung	100	0	1976
Sanyo Semiconductor Taipei	100	Sanyo Semiconductor HK (100%)	1982
Sanyo Electric HK	100	0	1960
Sanyo Energy HK	100	Sanyo Electric HK (5%)	1989
Tottori Sanyo Electric	100	Sanyo Electric HK (32%)	1990
Sanyo Semiconductor	100	0	1974
Sanyo Air Conditioners Manufacturing	92.31	Sanyo Asia (92.31%)	1986
Sanyo Air conditioners	50	Sanyo Asia (50%)	1984
Sanyo Asia	99.9	0	1973
Sanyo Compressor Singapore	90	Sanyo Asia (90%)	1988
Sanyo Denso Industries	86.67	0	1987
Sanyo Energy Corp	98.57	Sanyo Asia (98.57%)	1990
Sanyo Industries	95.62	Sanyo Asia (95.62%)	1967
Sanyo Semiconductor	100	Sanyo Semiconductor HK (100%)	1987
Sanyo Malaysia	24.5	0	1961
Sanyo Semiconductor	100	Sanyo Semiconductor HK(30.91%)	1992
Sanyo Universal Electric	30.2	0	1969
FMS Audio	66.7	0	1992
Sanyo Electric	100	0	1986
Sanyo Sales and Service	27.7	Sanyo Asia (25%)	1977
Sanyo Semiconductor M	-	-	1996
Sanyo Philippines	35	0	1971
P.T. Sanyo Compressor	90	Sanyo Asia (90%)	1994
P.T. Sanyo Electronics	82	Sanyo Asia (82%)	1996
P.T. Sanyo Energy	90	Sanyo Energy (Singapore) (90%)	1992
P.T. Sanyo Industries	55	0	1970
P.T. Sanyo Jaya Compressor	65.9	Sanyo Asia (65.9%)	1987

Source: Based on Tōyō Keizai (2000) *Kaigai Shinshutsu Kigyō Sōran 2000* (Outlook of Japanese Firms Abroad 2000), Tokyo: Tōyō Keizai Shinpōsha

Table A.3 Sanyo's Operations in China

Provinces	Name of Local Body	Major Business or Production	Sanyo's Share of Local Body (%) ^(a)
Beijing	Sanyo Electric China	Holding company	-
Tianjin	Tianjin Sanyo Telecommunication Equipment	Cordeless phone	-
Shanghai	Shanghai Sanyo Bubugao Cleaning	Cleaning	71.43
Liaoning (9)	Dalian Sanyo Air conditioner	Air conditioner	+
	Dalian Honjo Chemical	Chemicals	30
	Dalian Sanyo Home Appliance	Home appliance	55
	Dalian Sanyo Cold-Chain	Show cases	+
	Dalian Sanyo Compressor	Compressor	+
	Dalian Sanyo Food Systems	Food appliance	+
	Dalian Sanyo Refrigeration	Refrigerator	+
	Dalian Spindle Cooling Towers	Spindle Cooling Towers	5
	Shenyang Sanyo Air conditioner	Air conditioner	+
Jiangsu	Sanyo Electric Home Appliances	Cleaner, Motor	80
	Suzhou Sanyo Electro-Mechanical	Car electrical goods	50
Anhui	Hefei Sanyo Washing Machine	Washing Machine	-
Guangdong (14)	Dongguan Huaqing Sanyo Plastic Injection	Plastic for audio visuals	75
	Dongguan Huaqing Sanyo Electronics	Colour TVs	75
	Dongguan Huaqing Sanyo Motor	Micromotor	85
	Guangdong Sanyo Kelon Refrigerator	Freezers	+
	Guangdong Huaqing Sanyo Group	Holding Company	+
	Guangdong Sanyo Air Conditioners System Manufacturing	Air conditioner	50
	Huaqing Sanyo Electronics	VTR	50
	Sanyo Electric Shekou	Micromotor	100
	Sanyo Semiconductor Shekou	Semiconductor	100
	Shenzhen Huaqing Sanyo Technology	Design for audio visuals	+
	Shenzhen Sanyo Huaqing Energy	Battery	-
	Shenzhen Sanyo Huaqing Optical Technology	CD-ROM	60
	Tesonic-Tottori Sanyo Electric	Facsimile	70
	Tottori Sanyo Electric Shenzhen	LED	100

Note: (a) includes affiliates and subsidiaries.

Source: Based on Tōyō Keizai (2000) *Kaigai Sinshutsu Kigyō Sōran 2000* (Outlook of Japanese Firms Abroad 2000), Tokyo: Tōyō Keizai Shinpōsha.

Table A.4 Reinvestment of Sanyo's Subsidiaries in China

<i>Name of Local Body</i>	<i>Sanyo's Share of Local Body (%)</i>	<i>Share of Sanyo's China's Subsidiaries</i>	<i>Date of Foundation</i>
Sanyo Electric China	-		1995
Tianjin Sanyo Telecommunication Equipment	-		1995
Shanghai Sanyo Bubugao Cleaning	71.43		1996
Dalian Sanyo Air conditioner	-		1995
Dalian Honjo Chemical	30		1994
Dalian Sanyo Home Appliance	55	Sanyo Electric China (10%)	1996
Dalian Sanyo Cold-Chain	-		1995
Dalian Sanyo Compressor	-		1995
Dalian Sanyo Food Systems	-		1997
Dalian Sanyo Refrigeration	-		1993
Dalian Spindle Cooling Towers	5		1996
Shenyang Sanyo Airconditioner	-		1994
Sanyo Electric Home Appliances	80	Sanyo Electric China (17%)	1996
Suzhou Sanyo Electro-Mechanical	50	Sanyo Electric China (10%)	1994
Hefei Sanyo Washing Machine	-		1994
Dongguan Huaqing Sanyo Plastic Injection	75	Guangdong Huaqing Sanyo (10%) Huaqing Sanyo Electronics (40%)	1995
Dongguan Huaqing Sanyo Electronics	75	Guangdong Huaqing Sanyo (10%) Huaqing Sanyo Electronics (40%)	1995
Dongguan Huaqing Sanyo Motor	85	Guangdong Huaqing Sanyo (10%)	1995
Guangdong Sanyo Kelon Refrigerator	-		1997
Guangdong Huaqing Sanyo Group	-		1996
Guangdong Sanyo Air Conditioners System Manufacturing	50	Sanyo Electric (Hong Kong) (50%)	1984
Huaqing Sanyo Electronics	50	Sanyo Electric (HK) (50%)	1984
Sanyo Electric Shekou	100	Sanyo Electric (HK) (100%)	1983
Sanyo Semiconductor Shekou	100	Sanyo Semiconductor HK (100%)	1985
Shenzhen Huaqing Sanyo Technology	-		1996
Shenzhen Sanyo Huaqing Energy	-		1995
Shenzhen Sanyo Huaqing Optical Technology	60	Sanyo Electric HK (15%)	1993
Tosonic-Tottori Sanyo Electric	70	Sanyo Electric China (10%)	1996
Tottori Sanyo Electric Shenzhen	100	Sanyo Electric HK (50%)	1984

Source: Based on Tōyō Keizai (2000) *Kaigai Shinshutsu Kigyō Sōran 2000* (Outlook of Japanese Firms Abroad 2000), Tokyo: Tōyō Keizai Shinpōsha.

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