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FPC Briefing: Engaging with Inland China

Tim Summers

One little-noticed element of the Chinese government's latest Five-Year Programme, approved by the National People's Congress on 14 March 2011, was a short reference to speeding up the "openness" of China's border and interior regions.[1] The idea itself is not new: opening up western China to foreign investment was a part of the "Develop the West" policy framework announced in 1999, following internal discussions which began much earlier in the 1980s.

I argue in this piece that the idea has taken on a new form and importance over recent years, and that it has particular implications for businesses or governments looking at future economic and commercial engagement with China.

Asking what this might mean also helps respond to the evolving geography of economic development in China; whereas ten years ago the fastest-growing parts of the country were all along the coast, by 2010 it was inland cities and provinces which were topping the growth league tables (eight out of the top ten in 2010). It appears that GDP growth has been moving inland.[2]

"Opening up" and China's geography

To understand this we need to go back at least to the geographical bias to the economic "opening up" of the PRC in the 1980s.[3] Deng Xiaoping himself said that it was right to "let some people and some regions get rich first, and in the end everyone will get rich", a sentiment which might not have been completely out of place on the lips of certain British or US politicians who came to power around the same time as Deng.

One of the consequences of this was a policy bias towards parts of coastal China. Shenzhen, Zhuhai, Shantou and Xiamen were the first four Special Economic Zones, established in 1980 on a model derived from export processing zones set up in Taiwan and South Korea from the mid-1960s onwards. These cities, especially Shenzhen given its proximity to Hong Kong, grew rapidly, and as the 1980s progressed, other coastal preferential policies were adopted.

However, it was not just Chinese policy, but importantly the coast's proximity to global shipping routes and markets which supported economic take off during the 1980s, and again after 1992 when Deng Xiaoping legitimized further "capitalistic" development.

This connection with the global economy is important. What we saw was not just – or even primarily – about what happened in China, but about the restructuring of global production networks to incorporate parts of China, or what can be called the globalization of the capitalist economy.[4]

[1] See chapter 50 of the Twelfth Five-Year Programme.
[2] This is a relative shift, and the picture for other development indicators, such as education levels, does not yet show the same trend. But I argue that the geography of the economy is definitely changing.
[3] In official parlance, 1978 marks the beginning of the "reform and opening up" of the Chinese economy. We shouldn't misread this as meaning that the country was completely closed beforehand (remember that Nixon's visit took place in 1972), and in many ways 1980 and 1992 are more significant dates (see subsequent references in the text of this article).
[4] Peter Nolan, *China and the global business revolution*, Basingstoke, Hampshire and New York: Palgrave, 2001.

The corollary of this was that provinces and cities away from China's coastal export zones did not enjoy the same economic and commercial opportunities. And in the 1990s – when the central government's finances were in poor shape – there was not much scope for domestic spending to address the growing imbalances.

These imbalances prompted the launch of "Develop the West" in 1999/2000, and subsequently of policy frameworks to boost the central regions of China, and to revive old industrial areas (particularly in the northeast).[5] By the early 2000s the centre's finances were in better shape, so spending on infrastructure projects and support for improving the economic climate was able to make some difference to these areas and reduce regional imbalances, or at least stop them growing so fast.

Trade, investment and inland China

One original element of "Develop the West" – as I hinted in the opening paragraph to this piece – was the idea that foreign direct investment (FDI) would also play an important role in closing regional imbalances. While FDI in provinces away from China's coast has increased (from 14% of the total in 1999 to 25% in 2009[6]), it has remained much less of a factor than on the coast. Instead, it has been a combination of official financial support (bank loans as well as central and regional government spending) and growing investment in interior provinces by domestic PRC enterprises which has helped boost the economies of interior provinces.[7]

Nonetheless, there are two important developments in international trade and investment relevant to China's interior. The first is that there have been a number of successful FDI ventures in central or western China, and that number is rising. Long-standing investors include BP and Ford, while more recent investments by HP, Dell, Intel, Acer and others in Chongqing and Chengdu have highlighted the potential for developing hi-tech clusters in western and central China.

However, there is no one-size-fits-all approach for foreign investors when it comes to this part of China. Issues of cost and time mean that for companies manufacturing or assembling lower value-added products for export, there is still much to be said for being near the coast (easier integration into global production networks), even though costs are rising there. For those whose target is the burgeoning Chinese domestic market, proximity to customers may be more important than ports; the massive urban populations of central Chinese cities, as well as improving logistics inland due to cumulated investment in transport infrastructure, give these potential as bases for servicing domestic consumers.

In this context, we tend to think of corporations from developed economies, but to look at the second part of the trade and investment story relevant to China's interior we need to shift our focus to relationships with other developing countries, and in particular China's Asian neighbours. As Adam Hug and Feng Zhang highlighted in their recent Foreign Policy Centre report on Kazakhstan,[8] the Chinese political and commercial establishment has put substantial effort into improving relations with its land neighbours. It is this which lies

[5] These policy frameworks underline the analytical division of China into four mega-regions, the eastern, northeast, central, and western regions.
[6] Based on provincial statistics for total utilized FDI.
[7] This is a domestic element to "openness" of the interior regions. Put together with the international element, this has been described as "double openness".
[8] Kazakhstan at a Crossroads: Kazakhstan and the World, London: Foreign Policy Centre, December 2010.

behind the growing importance of "opening" China's interior and border regions, mentioned at the start of this article.

There are key regional implications of this within the PRC. Back in the summer of 2010, when Hu Jintao reiterated the Party's commitment to policy frameworks to promote development of the country's western regions, there were specific references to opening up the western regions towards the western land border to be a "bridgehead" from China to the rest of Asia. And the twenty provinces which are currently permitted to use China's currency (RMB) for trade settlement include all the provinces with international land borders, as well as the traditional trading centres along China's east coast.

Developing infrastructure linkages, whether from the northwestern region of Xinjiang to Kazakhstan or from the southwestern province of Yunnan to mainland southeast Asia and even down to Singapore, provides the support for the growth of trade and investment, a growing element of which is outward Chinese investment. This does not just apply to bordering provinces either: the leadership of the central-western municipality of Chongqing has been working to build land routes for exports both through northwest China to Russia and Central Asia, and southwards through Yunnan and Myanmar (Burma) to the Indian Ocean.

Policy implications for commercial engagement with China

The implications of this will vary depending on where you sit. The most direct impact is already being felt by China's land neighbours from Kazakhstan to Laos. There are wider implications for global logistics and shipping industries of the development – albeit gradual at this stage – of new trade routes from China's west across land to the western reaches of Asia and beyond,[9] and some European companies are already working through how to respond to this dynamic.

These issues ought also to be integrated into corporate and investment strategies for China, as well as the activities of public bodies which support future economic and commercial engagement with China. Some of this is already happening. The UK opened a Consulate-General in Chongqing in 2000,[10] followed by France and Germany in Chengdu. The number of European trade missions and related activities has been rising.

From a commercial perspective, though, more clarity of purpose is needed. New investment, even in manufacturing, increasingly has the Chinese consumer in mind. But the discussion about shifts from coastal to inland China is often dominated by questions of cost reduction and based on assumptions that those thinking these issues through are the traditional exporters which have populated the trade and investment statistics since the 1980s or 1990s. Neither are many individual companies likely to be shutting existing operations on the coast and *moving* inland; rather, the issue is where to place expansion of production capacity or find new partners, or – for some later arrivals – where to enter the market.

In all of these cases, a much greater geographical choice has opened up for both exploring the Chinese market, and integrating China into global production networks. Doing the

[9] Use of the term "new routes" is not intended to ignore the long histories of "silk roads", which indeed provide rhetorical and ideational support for the thinking of many Chinese experts in these areas. But it should be clear that these are new routes in the context at least of the most recent phase of globalization.
[10] Declaration of interest: I ran this operation from 2004 to late 2007.

research and providing the supporting structures for this is an area where public bodies supporting trade and investment can make more of a difference. There is still a tendency (though not a universal one) to spend too much time in Beijing or Shanghai, at the expense of regional opportunities. Another weakness is to look at individual cities or provinces without giving sufficient weight either to their hinterlands or their economic and transport networks.

More attention paid to these areas would also be reinforced by the Chinese government's own policy agenda. As well as the centre's broad-brush frameworks for developing the interior, there are a number of specific policies designed to promote foreign investment in central and western China, and further revisions are expected in the near future.

Finally, although the focus of this piece has been on economic and commercial engagement, broader engagement at a political and social level is needed to gain the right understanding of the policy trends, and to deliver on the opportunities. This includes, of course, engaging with the Chinese authorities in these areas. The role of the state in China's economy may turn out to be one of the most debated issues of the next five years, but there is every sign that it will remain a strong presence for at least that period, and probably beyond.