Università
Ca'Foscari
Venezia

Master's Degree in
Language and Management to China

(D.M. 270/2004)

Final Thesis

The convergence of Chinese accounting standards with International Financial Reporting Standards (IFRS): effects on economic growth

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Academic Year
2018 / 2019

As you set out for Ithaka
hope your road is a long one,
full of adventure, full of discovery.

Keep Ithaka always in your mind.
Arriving there is what you're destined for.
But don't hurry the journey at all.
Better if it lasts for years,
so you're old by the time you reach the island,
wealthy with all you've gained on the way,
not expecting Ithaka to make you rich.

Ithaka gave you the marvelous journey.
Without her you wouldn't have set out.
She has nothing left to give you now.

And if you find her poor, Ithaka won't have fooled you.
Wise as you will have become, so full of experience,
you'll have understood by then what these Ithakas mean.

K. Kavafis

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引言

本文的目的就是评估对外直接投资 (Foreign Direct Investment, FDI) 的水平，并通过评价结果来阐述与分析中国会计准则与国际财务报告准则 (International Financial Reporting Standards, IFRS）的融合过程及其对中国经济增长的积极影响。

作为世界第二大经济体，中国经济近期正处于从“高速”到“高质”的转变过程中。不过， 中国的“经济奇迹”不仅令人惊叹，而且来得相对突然，因为中国经济的崛起是在过去四十年间发生的。

实际上，在 1979 年以后，也就是中国政府实行了“改革开放”的新政策，将计划经济逐渐转变为市场导向型经济之后，中国经济的各个领域才开始有了飞速的发展。

尤其是那些受到这些改革政策影响的领域，例如农业部门，工业部门，金融和银行部门以及商业部门。

实际上，1979 年被公认为中国经济发展的一个里程碑。这一年，中国的经济体制由“计划经济”转变为“市场经济”，同时对外开放、引进外资。

关于中国经济发展的讨论以及世界对这个国家的关注近年来不断增加。受到关注的的原因除了改革开放 40 周年以外，还有一个相当有意义的项目：即以 “促进中国对外投资，促进亚洲，欧洲和非洲之间的国际合作”为主要目标的“一带一路”倡议（Belt and Road Initiative, BRI）。

最初，中国经济的迅速发展并没有引起西方世界的重视，但情况很快便发生了改变，尤其是当中国为了推动其发展而开始出台一系列使该国对外国投资更具吸引力的政策之后。

这些政策包括投资者带来的好处、贸易税和关税壁垒的降低、贸易自由化的深入以及经济特区的开放。

中国一直大力支持和鼓励引进外资，因为中方通过外方投资也可获得利益：实际上，其重要性让中国领导人很快意识到：这样做不仅能以最小成本引进发达国家的先进技术和资源，也能为现代经济管理带来宝贵经验。

尽管如此，外国投资者仍然不愿意在中国投资：这不只是出于谨慎，也不仅是因为那些具有更大投资能力的国家通常更愿意在本国进行投资；更大的原因，是“在中国投资”意味着要面对很高信息处理成本、代理和翻译成本、不够令人满意的会计质量、以及由语言障碍和财务报表起草方式不同而造成的信息分析困难。

事实上，中国有一套对外国投资者来说可能难以理解的会计制度。因此，为了促鼓励外国投资、促进经济增长，中国政府实施了一系列旨在实现中国会计准则与国际财务报告准则的融合（IFRS）的改革政策。

融合过程开始于 1992 年，第一次改革于当年实施。随后，中国在 1998 年和 2001 年又进行了更多改革，直到 2005 年 11 月该过程才结束，中国会计准则委员会（Chinese Accounting Standard Committee, CASC）和国际会计准则理事会（IASB）签署了协议书，确认与 IFRS 融合。商务部于 2006 年 2 月 15 日发布的新版企业会计准则（Accounting Standard for Business Enterprises, ASBE），宣告了此次融合的最终阶段（所有上市公司将从 2007 年 1 月 1 日开始采用新准则）。

中国作为每一个发展中的经济体都认为有必要将自己的会计制度国际化, 以促进外国市场的进入和吸引外国投资者。

本修订标准的目的（修订标准的目的）是提高中 国会计准则的透明度，使中国财务报告更有效 。

但是，由于新的中国会计准则与 IFRS 并不完全一致，这次融合并不算“完整”，因为部分内容被调整以适应中国的经济环境与实际国情。不过，多年来，中国领导人也颁布了一系列旨在强调“于未来实现完全融合”的措施，比如说“中国企业会计准则继续全面融合国际财务报告准则”（2009 年）和“意见稿”（2015 年和 2016 年）。

融合进程对中国的投资产生了许多积极的影响。自 2007 年以来，外商直接投资流入量已大大增加。从 1999 年的 0.186 美元万亿增加到 2002 年的 0.217，再到 2007 年的 0.327（UNCTAD，不同年份）[1]。

事实上，数据表明融合直接影响了外商投资水平。

可惜的是，尽管该主题有着很大的重要性与意义，以“中国会计准则与 IFRS 融合与经济增长之间的关系”为主题的研究依然相当有限。

在为数不多而且更新缓慢的文献资料中，我们还是能找到以“外商投资水平”为评价标准、探讨“会计准则融合”与“经济发展”两者之间关系的研究。

在这些研究的基础上，本论文旨在通过分析外国直商投资量及其对三个研究领域的影响的数据，来证明这种融合对中国经济发展的影响。以已有文献资料为基础。

本文共分为四章。

第一章简要概述了中国自 1979 年实施以“计划经济转型至市场经济”为目标的“改革开放”以来所取得的经济发展成果。本章节也讨论了农业部门，工业部门以及“门户开放政策”对外贸和外商投资的影响。

第二章是对中国会计准则与国际财务报告准则融合过程的历史回顾，分为三个阶段：1992 年首次改革的引入，1998 年和 2001 年改革的统一阶段以及 2006 年的融合阶段。

[1] 1999 年、2002 年和 2007 年的数据都考虑到了每项会计改革之后的时期（1998 年，2001 年和 2006 年）。没有 1997 年之前的数据。

第三章是对发达国家和发展中国家 （包括中国）在与 IFRS 和 FDI 融合，FDI 与经济增长之间以及与 IFRS 融合与经济增长之间的关系进行的主要研究的综述。

第四章也是最后一章，首先阐述了“外商直接投资”的定义，然后则更具体地描述了中国外商直接投资的主要特征（来源，决定因素和部门分布。紧接着，该章节通过研究三个与经济增长密切相关的主要领域：出口促进、收入分配和城市化，继续讨论外国直接投资对经济增长的影响。

但是，鉴于参考文献中提供的部分结果仍存有争议，可以说，有关“中国会计准则与国际财务报告准则的融合对经济增长是否有影响”的全面而可靠的研究依然缺乏；此外，考虑到以此为主题的研究数量相当有限，该主题有待进一步研究，尤其是对发展中国家而言。

Introduction

The aim of this thesis is to describe and analyze the process of the convergence of Chinese accounting standards with International Financial Reporting Standards (IFRS) and its positive effects on the economic growth of China, through the evaluation of the level of inward foreign direct investment (FDI).

Being the second-largest economy in the world, China's economy has been lately transforming from high-speed to high-quality growth.

However, the "miracle" of economic development in China has been as great and rapid as relatively recent, since it only took place over the last forty years. In fact, it is only since 1979, when the Chinese government introduced new policies of economic reforms aimed at opening to international trade, moving from a socialist economy to a market oriented system, that China began to develop notably and quickly all the economic sectors, in particular, those affected by these reforms, such as the agricultural sector, the industrial sector, the financial and banking sectors and the commercial sector.

In fact, the year 1979 is universally considered as a milestone for the starting of the economic development in China, when it moved from central planning to market exchange, simultaneously with opening up to international trade and investment.

Debates on Chinese economic development and, consequently, a growing attention to this country have increased particularly in recent years, not only for the 40-years anniversary of economic reforms, but also for an interesting project: the Belt and Road initiative (BRI), aimed at facilitating Chinese outbound investment and promoting international cooperation among Asia, Europe and Africa.

Its boosting economic development was initially ignored by the western world, but soon it began to gain attention, especially when China, in order to further promote its development, began to introduce a series of policies aimed at making the country more attractive for foreign investments, such as benefits for investors,

reduction of trade taxes and tariff barriers, further liberalization of trade, opening of special economic zones.

This process had been strongly encouraged because China, through foreign investments, could gain profits: in fact, due to its importance, the Chinese leadership soon realized it could have been not only an effective way to acquire advanced technology and resources from foreign developed countries at a minimal cost, but also an opportunity to provide valuable experience of modern economic management skills.

However, foreign investors were still reluctant to invest in China: this was not only due to caution, or because those countries with greater investment possibilities were often more interested in investing in their own territory but, above all, because investing in China meant facing high information processing costs, agency and translation of financial statements costs, extremely low accounting quality, difficulty in analyzing information due both to language barriers and to different ways of drafting financial statements.

In fact, China had its own accounting system, which was particularly difficult to interpret by foreign investors. For this reason, in order to facilitate foreign investments and to boost economic growth, the Chinese government introduced a series of reforms aimed at converging the Chinese accounting standards with International Financial Reporting Standards (IFRS).

The convergence process began in 1992, when the first reform was issued and, after further reforms in 1998 and 2001, it ended only in November 2005, when the Chinese Accounting Standard Committee (CASC) and the International Accounting Standard Board (IASB) signed a memorandum confirming the convergence with IFRS. On the 15th February 2006, a new version of accounting standards for business enterprises (ASBE) was issued by the Ministry of Commerce, announcing the last stage of convergence (new standards were to be applied by all listed companies from the 1st January 2007).

However, it can be considered as an almost complete convergence, since the new Chinese accounting standards are not completely converged with IFRS, because of a few adjustments due to the Chinese unique environment and circumstances but, over the years, a series of documents have been published

with the aim of underlining the intention to achieve complete convergence in the future, such as the “Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards” in 2009 and “Exposure Drafts” in 2015 and 2016. The convergence process had many positive effects on investments towards China because since 2007 a strong increase of the level of inward FDI had been registered, from 0.186 USD trillion in 1999, to 0.217 in 2002, to 0.327 in 2007[2] (UNCTAD, various years).

In fact, data show that convergence influenced the level of FDI.

Unfortunately, despite the importance and interest of the topic, few studies have been conducted on the relationship between the process of convergence of Chinese accounting standards with IFRS and economic growth. In literature, though, although little-updated, there are studies that considered the relationship between these two factors, through the evaluation of FDI.

Based on these studies, this thesis aims at giving evidence to the hypothesis according to which the convergence had effects on the economic development in China, through the analysis of the data of the level of the FDI and its effects on three research areas, on the base of the pre-existing literature.

The thesis is divided into 4 chapters.

The first chapter serves as a general introduction on the Chinese economic growth from the economic reforms of 1979, aimed at transforming China from an isolated economy to a market-oriented system, until today. The agricultural, industrial sector and the effects of the “open door policy” on foreign trade and foreign investment are discussed.

The second chapter is a historical overview of the process of convergence of Chinese accounting standards with IFRS, divided into three phases: the introduction of the first reform in 1992, the harmonization phase with the 1998 and 2001 reforms and the convergence phase in 2006.

The third chapter is a review of the main studies conducted on the relationship between the convergence with IFRS and FDI, between FDI and economic growth

[2] Data for 1999, 2002 and 2007 were taken into account as the periods after each accounting reform (1998, 2001 and 2006). Data before 1997 were not available.

and between convergence with IFRS and economic growth both in developed and developing countries, including China.

The fourth and final chapter firstly focuses on the definition of FDI in general and then, more specifically, on the main characteristics of FDI in China (sources, determinants and sectoral distribution). It secondly continues with the discussion of the impact of FDI on economic growth, by taking into account three main research areas: export promotion, income distribution and urbanization, that resulted to be strongly correlated to economic growth.

List of abbreviations

AAB: Accounting Affairs Bureau

ABC: Agricultural Bank of China

ASBE: Accounting Standards for Business Enterprises

ASEAN: Association of Southeast Asian Nations

BOC: Bank of China

BOP: Balance of Payments

BRI: Belt and Road Initiative

BRIC: Brazil, Russia, India, China

CASs: Chinese Accounting Standards

CASC: China Accounting Standards Committee

CEIC: Global Economic data, Indicators, Charts & Forecast

CICPA: Institute of Certified Public Accountants

CITIC: China International Trust and Investment Corporation

CBRC: China Banking Regulatory Commission

CCB: China Construction Bank

CJV: Cooperative Joint Venture

CPC: Communist Party of China

CSRC: China Securities Regulatory Commission

EJV: Equity Joint Venture

FCLS: Foreign Invested Companies Limited by Shares

FDI: Foreign Direct Investment

FIE: Foreign-invested enterprises

FTC: Foreign Trade Corporation

GAAP: Generally Accepted Accounting Principles

GFC: Global Financial Crisis

GDP: Gross Domestic Product

HDI: Human Development Index

HRS: Household Responsibility System

IAS: International Accounting Standards

IASB: International Accounting Standards Board

IASC: International Accounting Standards Committee

IFRS: International Financial Reporting Standards

IMF: International Monetary Fund

IPO: Initial Public Offering

M&A: Mergers and Acquisitions

MNCs: Multinationals

MOC: Ministry of Commerce

MOF: Ministry of Finance

NBS: National Bureau of Statistics

NAIS: National Accounting Institutes

NSOEs: Non-state Owned Enterprises

NUP: New-type Urbanization Plan

OECD: Organization for Economic Cooperation and Development

OLI: Ownership-Location-Internalization Advantages (“eclectic theory”)

SASAC: State-owned Assets Supervision and Administration Commission

SC: State Council

SEZ: Special Economic Zone

SHSE: Shanghai Stock Exchange

SOEs: State Owned Enterprises

SZSE: Shenzhen Stock Exchange

PAS: Practical Accounting Standards

PBC: People's Bank of China

PCI: Per Capita Income

PRC: People’s Republic of China

SEC: Securities and Exchange Commission

TRIM: Agreement on Trade-Related Investment Measures

TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights

TVEs: Township and Village Enterprises

UAS: Uniform Accounting Standards

UNCTAD: United Nations Conference on Trade and Development

WFOE: Wholly Owned Foreign Enterprises

WTO: World Trade Organization

Chapter 1: An overview of the Chinese economic growth

Due to its geographic extension and physical and cultural inhomogeneity, China has always been a very controversial country, hard to administrate and control, yet a solid leadership and a strong political structure have always made it possible, under any aspect. However, the economic development, which is considered to be a “miracle” due to its rapid pace and big scale, is relatively recent and it seems to have no historical precedents.

The year 1979 is universally considered as a milestone for the starting of the economic development in China. The International Monetary Fund considered it as the beginning of China’s economic take off: after the death of Mao Zedong in 1976, chairman of the Communist Party of China (CPC), the Chinese government, under the leadership of Deng Xiaoping, started to abandon the soviet planning system by returning into a more market-oriented economy. During the 3rd plenum of the 11th Central Committee of the CPC (18-22 December 1978), the foundation for economic reforms (Gâigé kāifàng 改革开放) and opening up were established. China initiated the change from central planning to market exchange, simultaneously with opening up to international trade and investment.

In the last 40 years, more precisely from the introduction of economic reforms which, among industrial, agriculture and financial reforms, allowed the opening of the country to the international economy, China's economic development has always been growing.

China goes from being a backward country, to the limits of poverty and economic closure to achieve living conditions above the world average, getting closer and closer, through the years, to the model of the most developed countries. China moved from an almost total economic isolation, during the Maoist era, to be the world's largest trading economy, the first largest destination for foreign direct investment (FDI) in the developing world and the second largest importer of goods (NBS, various years).

After the fortieth anniversary of the introduction of economic reforms, China is now such a strong economic power that the pace and the character of its growth

may affect the economies of other countries and, at the same time, it is itself affected by the way by which developed countries interact with each other.

China's gross domestic product (GDP), i.e. the monetary value of all finished goods and services within a country during a specific period, the most important indicator for the scale and growth of the economy, grew during the last four decades, rising from 0.44 USD trillion in 1993 to 2.29 in 2005, 2.75 in 2006, 3.55 in 2007. Nominal GDP in China in 2017[3] is 12.24 USD trillion (UNCTAD, various years).

In the last decades, obviously other factors have contributed to the rapid economic development of the country, such as a great deal of rural labour force transfers to non-agricultural industries, the speeding up of urbanization, the implementation of export-oriented open-up policies, the improvement of human capital [4], high savings and investment and continuously improved economic structures.

Although there have also been external events negatively affecting the speed of the development of the economy in China, resulting in a slower pace of the economic growth -such as the Asian Financial Crisis in 1997 or the collapse of global trade during the Global Financial Crisis (GFC) in 2008- other factors indirectly led to an increase of the economic development, such as the convergence of Chinese accounting standards with International Financial Reporting Standards (IFRS) that promoted FDI as it reduced information processing costs for foreign investors[5].

However, in order to better understand how the rapid economic development took place in China and the reasons behind its success, it is necessary to analyze which reforms and policies made it possible, through the last decades, proceeding sector by sector, by taking into account four of the major areas on which the economic reforms of 1979 have been implemented and the

[3] Data for 2018 and 2019 are not available yet.

[4] Since reforms of 1978, the level of people's education and health condition has improved, resulting in a human capital accumulation.

[5] The convergence of Chinese accounting standards with IFRS will be further discussed in chapter 2, while the relation between the convergence and the increase of FDI (and the economic growth) will be further discussed in chapters 3 and 4.

development of each sector overtime: the agricultural sector, the industrial sector, the banking and financial sector, the foreign trade and investment system.

1.1 The agricultural sector

Agriculture has always played a dominant role in the Chinese economy, since the very beginning: being China largely composed of arable land, this sector has always been considered a source of livelihood, therefore particular attention has always been given to this sector.

Deng Xiaoping's economic reforms of 1979 began with agriculture and two important reforms were implemented: (i) higher prices for agricultural products; (ii) the adoption of the "household- responsibility system (HRS)".

As far as the latter is concerned, before its adoption, the Commune system, i.e. the collective farming, introduced by Mao in 1958 during the Great Leap Forward Movement, was being practiced: farmers used to work and produce in units and no farmer would gain extra reward for hard work. The new reform was introduced when the Party realized that if farmers worked on different lands, the team could produce more in total and still deliver the same amount of output required by the system for government distribution (Chow, 2004). Under the household responsibility system, a fixed quota of grains was given to each household to be sold to the government at fixed prices but, at the same time, any surplus of production could have been sold by the household at a market price. The right of use belonged to each farmer and it was guaranteed on a permanent basis and it was also transferable (Lin., 1988). The adoption of this reform not only led to a rapid growth of the total factor productivity in the agriculture sector[6], but also to a strong increase of China's agricultural output. The success had a strong impact not only on the ideology of the Party itself that started to realize the inevitability of a market economy, but also resulted in a more availability of food, allowing the start of a particular structural transformation that moved workers from agriculture to industry.

[6] Between 1978 and 1984, total factor productivity grew 5.62 percent per year.

The introduction of this system and its consequences characterized China with an initial period of economic prosperity and growth in several sectors, while the government kept increasing incentives without, however, trying to invest in technological production. This limit led to a settlement of growth in the second half of 1980, when the repeated use of the same technology caused a general discontent among farmers and it resulted in a static condition of both the agricultural productivity and the structural transformation. Agriculture diversification took place at the beginning of 1980s: first, government gave farmers more autonomy over production decisions, therefore, once reached the amount of the fixed quota of grains, they were free to decide what to produce. In addition, more and more investments were made on irrigation and new technologies, in order to obtain both a better production and to meet the requests of farmers (Fan and Zhang, 2002). The consequences of this shift were many but, first of all, the diversification of China's agricultural economy managed to solve the problem of underemployment.

At the beginning of 1990s, after a decade of diversification that made agriculture strongly specialized, mechanization begun but another important change took place: markets for agricultural inputs and outputs began to be gradually liberalized[7] and the government began to exert less power by reducing its interventions. Market liberalization was characterized by less trade restrictions and the possibility for non-state actors to access agriculture markets.

According to Anderson et al. (2004), <<after these initial moves, tariffs were steadily reduced. From the 1990s until China's accession to the World Trade Organization (WTO) in 2001, the average import tariff for all agriculture products was reduced from 42.2 percent, in 1992, to 23.6 percent in 1998 and 21 percent in 2001. Tariffs rates fell to 12 percent in 2004, making China one of the most free agriculture trading nations in the world.>>

Due to this development in the agricultural market, this sector kept growing, also due to the introduction of new technologies, the incentives given to the farmers but most of the success of the development of agriculture was due to institutional innovations, market reforms and investments.

[7] The liberalization of international trade started in the early 1990s (see paragraph 1.4).

In recent years, since the 2000s, rural economy became more and more specialized: these developments changed the idea of traditional farming since households even started to rent their lands, while most of the traditional farmers felt the urge to move to other sectors, such as industrial sector.

Nowadays, however, China's agriculture is still facing many left unsolved problems: in 2017, it adopted a strategy on rural revitalization that aims at leading at a new agriculture transformation; the goal is to set a brand new institutional framework and government management in order to monitor the revitalization of the sector by 2020. This project commits China to modernize agricultural system by 2035 and to complete it by 2050.

1.2 The industrial sector

Along with the introduction of reforms in the agriculture sector, a great importance was given to the so-called "non-agricultural sector", in particular, to the renewal and change in the industrial system, with a strong emphasis on those reforms aimed at reducing government control over state owned enterprises (SOEs): before the reforms, the main purpose of the SOEs was to meet the government's objectives regarding production and distribution of goods. The role of the government was almost absolute, while the SOEs had minimal autonomy in determining what and how much to produce, deciding to use the surplus or profits and organizing the workforce.

These policies allowed, in a 40-year perspective, the rise of the private sector which started to play a dominant role in the economic transformation in China, while the state sector had been drastically reduced.

The first phase of the development of industrial sector (1978-1992) saw the rise of the non-state sector and a greater autonomy of SOEs.

Industrial reforms began in 1978, when Yao Yilin, chairman of the State Planning Commission, announced a first experimental phase, at a regional level[8], aimed

[8] Experiments started with six pilot enterprises in Sichuan province and, by the end of 1981, 80% of SOEs were involved in the reform experiment.

at giving SOEs more autonomy and competition on the market. Two market reforms were introduced: (i) a “dual track system”; (ii) a “fiscal contracting system”. The first reform consisted in giving quotas to SOEs for both production inputs and outputs and the goods were sold at official prices, but they were also allowed to buy inputs and sell outputs at market prices (Zhu, 2012)

With the second reform, the central government lent its decisional power to lower-level government, by providing them with fiscal incentives. A new reform was introduced in 1987: the “contract responsibility system”, under which each enterprise had to pay a fixed annual tax to the government, but it was free to administrate any remaining profit. This new system pointed out the need for industrial product markets and competition among SOEs. An immediate consequence was the encouragement and fast development of non-state enterprises, mainly township and village enterprises (TVEs)[9] and foreign-funded firms, especially from Hong Kong, Macau and Taiwan (Garnaut et al., 2011). Despite a slower development, SOEs maintained a fundamental role throughout the first phase, remaining an essential source for non-state enterprises' access to equipment, technical information, management skills.

The second phase (1992-2003) was characterized by ownership transformation, aimed at the privatization of SOEs. The 15th Congress of the Chinese Communist Party in 1997 is to be considered another milestone in China’s economic history: it sanctioned ownership reforms of SOEs and legalized private enterprises. In the early 1990s, other complementary reforms were introduced, mainly regarding fiscal and trade policy that, aimed at the joining of China to the World Trade Organization (WTO), were another important key for SOEs privatization process. Under these new reforms, by reducing legal barriers, the development of private enterprises was fast. Collective enterprises, such as TVEs, lost their attractiveness and power (Garnaut et al., 2006). Therefore, under the policy of “*grasping the large, letting go of the small*”, many of them were closed or privatized. The underlying principle of this policy was simply that it was necessary

[9] The number of TVEs increased from 1,520,000 in 1978 to 18,880,800 in 1988 (National Bureau of Statistics of China, 1999).

to safeguard large companies because they performed better than the smaller ones, which therefore had less importance in the economy.

The third and last phase (2003-present) saw the restructuring of large SOEs, internationalization, renewed mixed ownership reforms and latest challenges to be faced. The State-owned Assets Supervision and Administration Commission (SASAC) was established in March 2003. It was under the authority of the State Council and its main task was to preserve and increase the state-owned assets of SOEs. Together with the establishment of SASAC, the Chinese government wanted both to develop the size and importance of SOEs and to increase its control. In the early 2000s, SOEs had more benefits compared to other enterprises: preferential access to bank loans and credits, public listing on domestic and international stock exchanges and the possibility of being acquired through mergers and acquisitions, a strategy that allowed them to expand under the "go global policy" (Rawski, 1994).

New important reforms were issued during the 18th National Congress in 2013 regarding SOEs governance and structure: based on its functions, determining the state of ownership, introducing mixed ownership, moving from asset management to capital management.

In 2015, for the first time, SOEs were classified into two categories: *public*, assessed by cost control ability, quality, competence, performance and *commercial*, aimed at market competition and improving financial performance (Central Committee of the CPC and State Council 2015).

In 2017, the State Council set the goals for the SOEs, with the aim of building a modern industrial system by the end of 2017. By 2020, the goal is to strengthen the control of the Party over the SOEs, regarding corporate governance. Anti-corruption measures continue to play a fundamental role, to be applied together with the reforms.

1.3 The banking and financial sector

After the onset of economic reforms in 1979, in order to ensure greater control suitable for the new market economy, a modernization in the banking system was necessary. Before the reforms, there was only one bank, the People's Bank of China (PBC), its functions were to extend loans to SOEs (but it had no authority over this decision) and to issue currency.

With the reforms of the banking system in 1983, the PBC became a central bank, controlling industry and trade market, and other three specialized banks[10] were established: the Bank of China (BOC) for monetary transactions, the China Construction Bank (CCB) for real estate investments and the Agricultural Bank of China (ABC) for the rural credit. These banks were given autonomy to extend credit, but they were subjected to central government direction.

During the following years, an excessive expansion of credit led to inflation in 1985, 1988, 1993 (The World Bank). In order to solve this problem and to try to avoid it in the future, some measures were taken: during the 3rd Plenum of the 14th Central Committee of the Communist Party, in November 1993, the government realized the urge to give more independence to the PBC and, by accelerating financial reforms, to transform specialized banks into commercial banks (Douglas et al, 2013). Therefore, the People's Congress drafted two important banking laws: the Law of the People's Bank of China (effective immediately) that confirmed the power of the PBC as a central bank and reduced the power of local governments on the decision of allocations of credit; and the Commercial Banking Law (effective on July 1, 1995) that officially defined the once specialized banks as commercial banks, putting them in the direction of commercial activities based on market principles instead of on loans.

In 1994, in order to reduce the pressure on the Big Four on the issue of credit, three policy banks were established: the State Development Bank, the Agricultural Development Bank and the Import-Export Bank. Their function was to provide loans to SOEs in order to carry out economic development policies. Since the beginning of 1990s, new commercial banks were gradually established, in the form of corporations, they had more autonomy and they were similar to modern commercial banks.

[10] Together with the PBC, they are also known as "The Big Four".

After China joined the World Trade Organization (WTO), new reforms in the banking system were called. In 2003, the China Banking Regulatory Commission (CBRC) was established in order to monitor the system, given the gradual increase of foreign investors (Douglas et al., 2013).

Although the progresses made in this sector have been many, fast and functional, also considering the relatively short time both for the issue and application of reforms, the Chinese banking system only served some basic functions for financial intermediation, even if not efficiently. This system can be expected to improve in time, even if slowly.

However, the reforms of the banking system, in order to maximize their effectiveness, must be issued along with equally effective reforms in the financial sector. When China started its development towards a market economy, it realized that it was necessary to reform also the financial system, in order to make it able to manage more capital to loan to investors.

In 1981, the China International Trust and Investment Corporation (CITIC) were established in order to attract foreign capital.

The Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchanges (SZSE) were officially opened respectively in December 1990 and in June 1991, even if during the 1990s they were only used as vehicles for the sale of shares of SOEs to private interests. Over the years, they began to list more and more firms, and they were regulated by the China Securities Regulatory Commission (CSRC).

However, despite some factors that caused the slowdown of the development of the sector, such as shadow banking[11], corruption, a still strong control of the government, China made a great progress in creating a financial system suitable for a market economy. The main limitation remains that the Chinese government and the Party and its Organization Department will never substantially reduce their role in the control and management of the system, unlike the high-income market economies that usually remove the government from direct control over the sector, by leaving an indirect control of monetary and fiscal policies.

[11] "The term refers to a range of informal financial vehicles aimed at attracting saving funds that were seeking higher returns than could be achieved at the low state-fixed interest rates on deposits paid by the banking system" (GARNAUT R., et al., "China's 40 years of reform and development", *Australian National University Press,* 2018, p 147).

1.4 Open-door policy

Over the past four decades, China has become a fully integrated international economy and an active actor in global markets. The “open-door policy” was an important part of the economic reforms, aimed at encouraging and developing foreign trade and investment, by opening the country to foreign imports and the promotion of export, by issuing new reforms and removing restrictions in order to facilitate this process.

The economic reforms in China took place in a period of strong globalization, in which the exchange of goods, capital, people and technology was particularly advanced, and it consequently allowed an easier opening to international trade, also due to a rapid reduction in transaction cost after the development of transport, means of communication and technology.

This process involved two main sectors: foreign trade and foreign investment.

1.4.1 Foreign trade

In 40 years, the total value of imports and exports in 1978 was 206 billion of US dollars, while it was 4.1 trillion of US dollars in 2017. In general, the average annual growth rate of foreign trade in China was 14.1 % (NBS, various years).

Since the adoption of the open-door policy in 1978, the process of international trade and liberalization can be divided into three phases: administrative decentralization of trade planning and increase of exports, first real moves towards trade liberalization, liberalization and integration with global trade.

During the initial phase (1978-1991), the reforms were aimed at administrative decentralization: the national foreign trade corporations (FTCs) lost its authority by giving to the provincial branches the opportunity to become financially and operationally autonomous. In particular, in July 1979, regulations that legally allowed foreign-funded enterprises to import capital goods and raw materials and, at the same time, to export their products directly were enacted. An important event was the opening of four special economic zones (SEZs)[12] in 1979, in order

[12] SEZs were established in the cities of Shenzhen, Zhuhai, Xiamen, Shantou.

to further promote international trade. During this first phase, the trade regime adopted by China experienced great success, but it could be described as a "protected system" since China, despite trying to promote exports in every way, also offered, at the same time, domestic protection (Koves and Marer, 1991).

The event that marked the beginning of the second phase (1992-2000) was a memorandum of understanding signed by China with the United States, giving commitments of reducing import restrictions and tariffs[13] (Li and Wang 2009). Therefore, this period saw the continuous reduction of tariffs on an increasing number of products.

The third and last pahse (2001-present) was characterized by the accession to the WTO in December 2001: this event can be considered as the recognition by the international community of the validity of the economic reforms and the inevitable adoption of international standards and regulations in the Chinese market (Garnaut et al., 2018).

Along with joining the WTO, China had to implement its commitment in various ways:

-*regulations and laws,* a large number of regulations and law were not suitable with the WTO, therefore there was the need to modify them in order to remove inconsistencies. All enterprises had the legal right to trade, with the only exception of those whose production was monopolized by the state, such as grain, cotton, coal, oil and metal minerals. These adjustments strongly improved transparency and reliability of trade laws and regulations;

- *tariffs,* tariffs on taxable items have strongly been reduced since the beginning of the second stage;

- *trade-related investment measures,* according to the WTO Agreement on Trade-Related Investment Measures (TRIM), trade balances, export performance requirements in foreign capital laws and regulations have been cancelled[14];

- *trade-related intellectual property rights,* according to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), copyright,

[13] The memorandum of understanding was signed in October 1991, but it was effective on the 1st January 1992, therefore it is included in the second stage since its performance and effects took place since 1992.

[14] World Trade Organization (WTO) Secretariat, *Trade Policy Review: China,* 2016.

trademark and patents were amended in 2001 and laws for the protection of intellectual property rights were issued[15].

Since 2006, liberalization of trade continued and, even if there are still few barriers and limitations in sectors like banking, insurance, telecommunications, transportation, changes in China's trade policy have contributed to a rapid expansion and economic growth.

1.4.2 Foreign investment

Foreign investment can be regarded as one of the most important features of the economic reforms and it can also be considered as an index for the evaluation of economic growth. By the end of 2017, FDI stock in China reached 1.49 trillion of US dollars, while it was only 1 million of US dollars in 1980 (UNCTAD, various years), making China the largest recipient of FDI in the developing world and one of the most significant contributions to the economic growth of modern China. Due to its importance, the Chinese leadership soon realized it could have been not only an effective way to acquire advanced technology and resources from foreign developed countries at a minimal cost, but also an opportunity to provide valuable experience of modern economic management skills.

In the first phase (1979-1991), after the Equity Joint Venture Law was passed, during the 2nd session of the 5th National People's Congress in July 1979, after giving FDI legal status in China, the Chinese government proposed some strategies in order to liberalize FDI policies and attract FDI inflows. First of all, according to new laws, such as the Equity Joint Venture Income Tax Law, the Foreign Enterprise Income Tax Law and the Industrial and Commercial Provisions, special tax incentives were offered to foreign investors. In addition, the introduction of other laws encouraged FDI inflows, such as the Regulation for the Implementation of the Law on Chinese-Foreign Equity Joint-Venture in 1983, the Law on Enterprises Operated Exclusively with Foreign Capital and the Provisions of the State Council on the Encouragement of Foreign Investment in

[15] Idem

1986 and the Law on Chinese-Foreign Contractual Joint Ventures in 1988 (Yuan and Tsai, 2000).

However, during this early stage, Chinese government appeared very prudent, therefore, also foreign investors were cautious (Garnaut et al., 2018).

In the second phase (1992-2001), there was a further attempt by the government to encourage FDI and this was possible through the amendment of further laws aimed at liberalizing FDI. Moreover, 52 new cities were opened to foreign investors, as well as new service industries that were previously closed, such as aviation, telecommunications, banks, even if only in a limited and experimental way. At the same time, more duty-free zones were established, and the government allowed businesspeople, aimed at setting FDI firms, to buy land use rights in order to build infrastructures facilities (Wei, 1994). Throughout this phase, China managed to establish a more consistent FDI regulatory framework.

The third and last phase (2002-present) began after China's entry to WTO and it was characterized by the implementation of further laws, both aimed at enforcing and encouraging FDI and at adapting to international policies to fulfill its commitments to the WTO. An important law was passed in March 2002, the Enterprise Income Tax Law that unified tax rates for foreign and domestic enterprises. It took effect on the 1st of January, many tax incentives for foreign investors were changed or eliminated (Zhu, 2012).

Another important characteristic of this last stage, that contributed to the increase of the level of FDI over the past few years, is the convergence of Chinese accounting standards with IFRS.

However, especially for the early period of this phase, soon after the global economic crisis of 2008, western economies were looking for new investments in Asia, when China was moving from being "interesting" to being "important". However, these investments were under the form of "reverse merging", i.e. a process allowing a private firm to go public much faster, and with lower legal and accounting fees. In this way, a private company merges with an existing, smaller company, already listed on an exchange stock exchange. Chinese firms could easily be listed on American stock exchange and, according to the "value investing", banks and investing companies gained profits, working on companies

like “Longwei Petroleum”, L&L Energy Inc., Puda Coal Inc., China Agricolture”. However, these were not foreign direct investments, but they helped the Chinese economic growth in the early years.

For the last two decades, China tried to develop accounting standards that would be in line with international standards and, thereby, more globally accepted. These new accounting standards played an important role in the process of China moving towards globalization of its financial reporting, since the main reasons behind this process were not only to improve the accounting regulatory framework, but also to facilitate the Chinese development towards a market-oriented system, to make Chinese companies able to build stronger relationships with multinational firms and to attract foreign investors in the Chinese market. Mentioning the development of the accounting information when speaking about foreign investment is necessary, since it is considered highly important not only because of its main goals[16], but also because it aims at presenting more comparable and comprehensible reports and at preventing foreign investors from having to spend time and face difficulties in converting Chinese financial reports to their own standards and measurements.

The convergence increased the understanding between foreign investors and domestic Chinese companies, and therefore attracted more FDI to the Chinese economy, specifically through the enhanced transparency and comparability, which lower risks for foreign investors.

With increased FDI[17], the Chinese economy grew faster.

In addition, financial accounting systems may contribute to improve efficient capital allocation, by facilitating the control of financial statements. Therefore, the governments soon tried to remove and adjust legal barriers and regulatory obstacles, such as accounting standards, to foreign capital inflows and focus on building financial institutions to promote an attractive environment for foreign

[16] The main goals of accounting information are: 1) to provide the information that could aid investors and creditors in making financial decisions in an effective way; 2) to supply evaluations and timings on the expected return of firms to investors and creditors; 3) to serve information on the economic resources and liabilities of business firms; 4) to reflect the financial achievements of business firms in any given financial cycle (Kordlouie et al., 2014).

[17] Inward FDI rose from 0.27 trillion USD in 2005 to 1.49 trillion USD in 2017. (UNCTAD).

investors (Hussain et al. 2012). That is why many studies[18] in literature have investigated the relation between convergence and economic growth, by evaluating the level of FDI, demonstrating that the improvement of financial reporting in emerging market economies, like China, resulted in a stronger attraction of FDI.

It is important to note that, still today, there are still some categories on which investment is prohibited. In February 2002, China issued the Provisions on Guiding the Orientation of FDI, setting four categories: encouraged, permitted, restricted and prohibited. Therefore, in order to guide FDI into the targeted industries in accordance with China's strategy, the Catalogue for the Guidance of Foreign Investment Industries was amended in 2004, 2007, 2011, 2015 and 2017.

However, this phase shows a continuous opening to foreign investors and an overall trend of liberalization, which are still the main characteristic of the modern Chinese economy but there are still some barriers to foreign investment, such as the complicated procedures involved and the unfamiliarity with the Chinese ways of closing business transactions[19].

[18] See chapter 3.

[19] In China, in doing business, more importance is given to personal relations rather than signing formal contracts.

Chapter 2: The process of convergence with International Financial Reporting Standards (IFRS) in China

One of the goals of financial accounting information is to help many parties, both internal and external, such as investors, employees, suppliers and creditors in the decision-making process. Due to the vastity of different demands and several parties in need for financial accounting information, it is often hard to present financial reports able to satisfy the need of everyone, but it is necessary that financial reports sufficiently meet the common information needs. Further difficulties arise with the ongoing globalization that created a bigger need for accounting standards for investors across borders (Deegan and Unerman, 2011). International accounting standards help improving comparability, reducing information processing costs, improving high quality accounting and increasing market-efficiency and investments (Mizra and Ankarath, 2013). In almost every country, financial accounting is usually regulated through accounting standards, aimed at governing how transactions must be measured and displayed (Deegan and Unerman, 2011). However, due to political, legal and historical differences, a diversity in accounting systems and standards occurs among countries, making the comparability difficult across borders.

Under the decision of Australia, Canada, France, the Netherlands, United Kingdom, United States, Germany, Ireland and Japan, on the 1st of April, 2001, a common board was established: International Accounting Standards Board (IASB) aimed at issuing the International Financial Reporting Standards (IFRS)[20]

[20] <<IFRS are accounting rules issued by the International Accounting Standard Board, an independent organization based in London, UK. They purport to be a set of rules that ideally would apply equally to financial reporting by public companies worldwide. Between 1973 and 2000, international standards were issued by the IASB's predecessor organization, the International Accounting Standards Committee (IASC), a body established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, UK and Ireland and US. During that period, IASC's rules were described as International Accounting Standards (IAS). Since April 2001, IASB issues IFRS, though it continues to recognize the prior rules (IAS) issued by the old standard-setter (IASC)>> (Ball, 2006).

and promoting accounting standards that can be acceptable worldwide in order to improve financial reporting across borders[21].

Since China has a unique political, social and cultural condition, the accounting system has always been a delicate field: almost every sector has always been strictly controlled by the government and the accounting system made no exception.

Before the reforms, Chinese accounting system was entirely governed by the laws and regulations issued by the State Council (SC) and by the Ministry of Finance (MOF)[22] and they were specifically developed for each industry, but they were often issued without going through any legislative process [23]. The accounting system was based on Uniform Accounting System (UAS), basically a system of bookkeeping but, with the ongoing economic reforms of the late 1970s, it started to be considered too different from international accounting practices.

In fact, after the economic reforms and due to the revolutionary change in the economic policy of China, there was a greater need for a high-quality accounting: a system of new accounting standards was necessary to integrate with the new economic market and to attract foreign investors and investments.

Another driver for reforms in accounting system was the growing difficulties for foreign investors to interpret financial statements provided by Chinese companies, in particular, after the establishment of Chinese stock markets in the early 1990s. During this time, the government also introduced non-governmental ownership in SOEs (Peng and Smith, 2010). Therefore, in order to make it easier for investors, markets were divided into A-shares and B-shares[24], to be able to attract foreign investors but also to control foreign exchange. A-shares were denominated in Chinese Yuan and were traded by domestic investors, while B-shares were

[21] Some countries decided to adopt directly IFRS, while other countries converged their own reporting standards with IFRS.

[22] <<The MOF is a governmental body and it is the only entity authorized to promulgate Chinese accounting standards. It determines the composition, timing and implementation methodology for accounting standards>> (Peng and Smith, 2010)

[23] <<All business enterprises were nationalized work units which relied on the state to provide all financing, control related investments and manage all operating decisions. As such, profits were remitted to the state, which also covered loss. The stakeholder was the government and the principal duty of accounting practices was to assist the governments in planning and controlling economic activities. >> (Yuen L., Lu Y., 2010)

[24] Initially, companies were only allowed to issue A shares.

denominated in US dollars in SHSE and in Hong Kong dollars in SZSE and were only traded by international investors, until 2001. Differences were also in the compliance: firms issuing A-shares were required to comply with Chinese Generally Accepted Accounting Principles (GAAP)[25], while firms issuing B-shares were required to comply with IFRS. Those firms issuing both A- and B- shares were required to prepare two sets of financial statements, one in accordance with IFRS and one in accordance with Chinese GAAP (Peng and Smith 2010).

After these innovations in the Chinese accounting system, some problems arose, such as the difficulty for foreign investors in interpreting the financial statements of Chinese firms and the costs for restatement of financial statements were high. These reasons also led to the desire to list companies overseas, to build a credible accounting profession, to reduce the cost of information processing and the cost of preparing multiple sets of financial reports (Peng S., Bewley K., 2010). Therefore, accounting professions tried to develop a worldwide common accounting system: International Financial Reporting Standards (IFRS), previously known as International Accounting Standards (IAS), in order to address the need for high quality accounting principles.

Ever since 1992, the Chinese accounting reform has progressed, with gradual convergence with IFRS.

This condition especially occurred in emerging markets: among the countries that adopted IFRS for listed companies, 80% are from emerging markets[26] (Deloitte and Touche, 2005).

Therefore, the accounting practices had to meet three main objectives:

1- to play a critical role in building up the economic institution;

2- to facilitate the transitional accounting to international accounting;

3- to induce potential domestic and foreign investments.

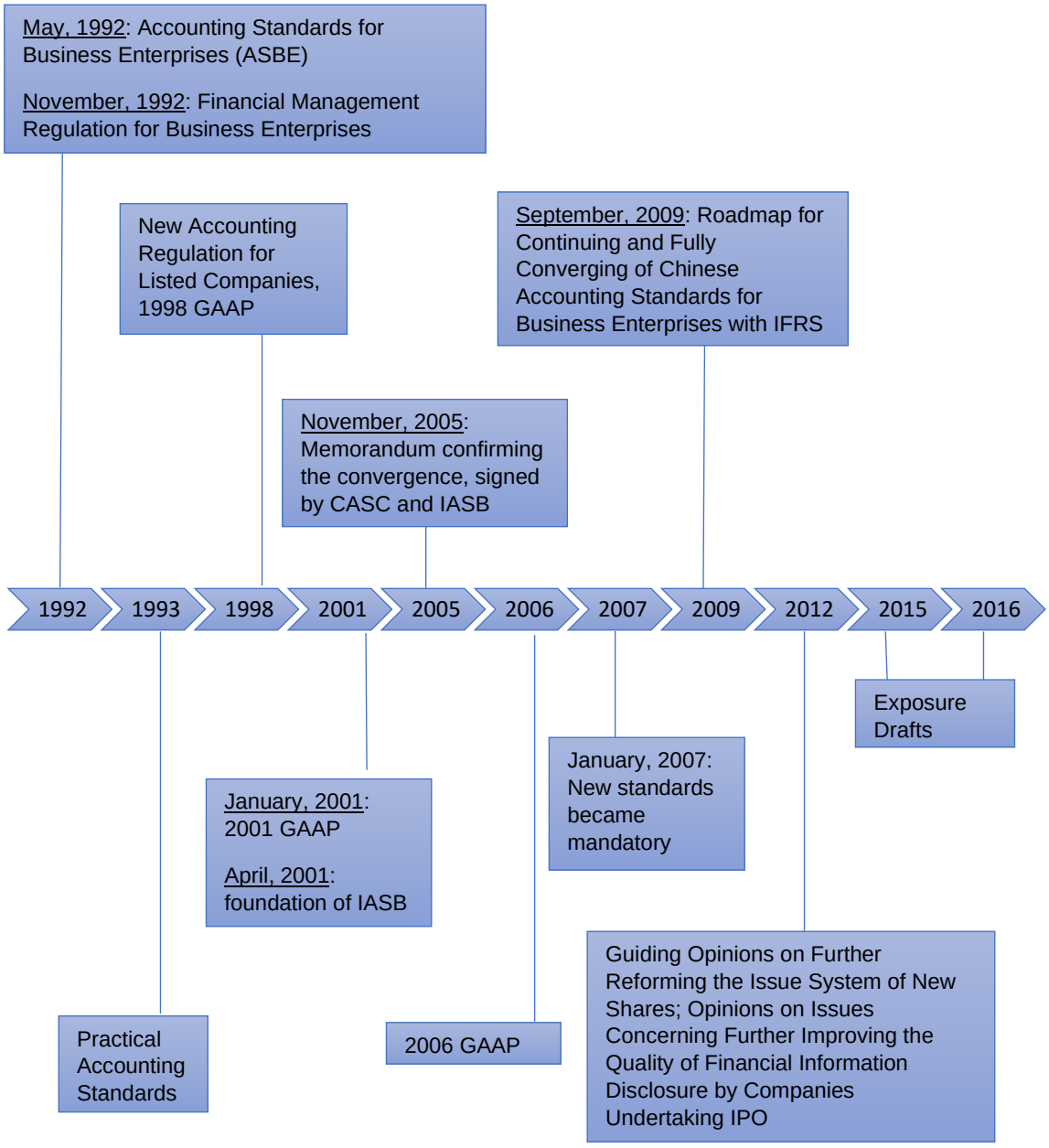
[25] <<Generally Accepted Accounting Principles (GAAP) is a common set of accounting principles, standards, and procedures that companies use to report their financial statements. GAAP are a combination of respected standards and are the commonly accepted ways of recording and reporting accounting information>> (Cellucci R., 2015).

[26] China was the first among the large emerging economies known as BRIC- Brazil, Russia, India, China- (it later became BRICS, after the inclusion of South Africa) to converge to IFRS.

According to literature, Chinese accounting convergence process can be divided into three main phases, based on the four accounting regulations issued by MOF in 1992, 1998, 2001 and 2006, each one replacing the previous one with greater conformity to IFRS.

The process of convergence of Chinese accounting standards with International Financial Reporting Standards is outlined in Fig 1.

Fig.1: time axis of the process of convergence in China



The first phase was characterized by the introduction of the first reform in 1992 (1992 GAAP), it was a preliminary phase and it was considered a revolutionary shift in Chinese accounting due to the introduction of a market-oriented accounting model. It comprised the Experimental Accounting System for Joint Stock Limited Enterprises (1992 Accounting System) and the Accounting Standard for Business Enterprises (basic standards).

The second phase can be considered as a harmonization period, that can be divided into two stages. The early stage was characterized by the issuance of the Accounting System for Joint Stock Limited Enterprises (1998 Accounting System), which replaced the 1992 Accounting System and ten specific Chinese Accounting Standards (CASs), issued by the MOF. The second stage was more a stage of development, and it was characterized by the issuance in 2001 of the Accounting System for Business Enterprises (2001 Accounting System) and 16 CASs[27].

The third and last phase (2006 GAAP), leading to a complete convergence with IFRS, was characterized by the issuance in February 2006 of the Accounting Standards for Business Enterprises[28]: it consisted of revised Basic Standards, 38 CASs and 16 previously issued CASs (Peng and Smith, 2010).

In order to better understand the whole process of convergence of Chinese accounting standards with IFRS, it is necessary to proceed phase by phase, by analyzing each reform, its peculiarities and effects on the accounting system.

2.1 The preliminary phase: 1992 GAAP

The entire accounting reform started from the early 1990s, followed by reforms in almost any sector of the Chinese economy[29]. This first phase was characterized by the issuance of two main principles: Accounting Standards for Business Enterprises (ASBE)[30] in May 1992, and Financial Management Regulations for Business Enterprises in November 1992[31]. Two important features of this first

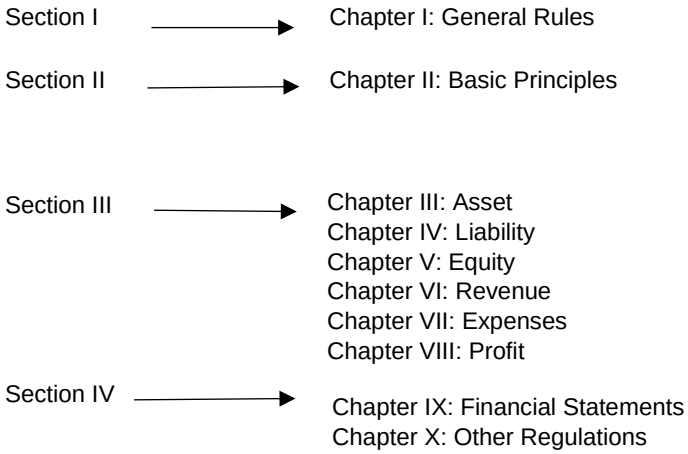
[27] 6 newly issued standards, 5 revised standards, 5 original standards.
[28] Effective on January 1, 2007.
[29] See Chapter 1.
[30] Also known as Old PRC GAAP.
[31] They both became effective on the 1st July 1993.

phase are a less direct control of the government and the fact that accounting becomes a means for external use, due to the opening to foreign investors.
The main goal of ASBE was to introduce a common conceptual framework[32] into a fragmented accounting system, such as the Chinese one, which should serve as model to follow for all companies. This type of conceptual framework has been defined in the literature as "mixed" (Xiao and Pan, 1997): Miller (Miller, 1985) recognizes three different motivations for its establishment, connected to three distinct "natures":

- *descriptive nature*, to describe existing practice;
- *prescriptive nature*, to prescribe future practice;
- *constitutive nature,* to define key terms and fundamental issues.

The Basic Standard stipulates accounting assumptions, accounting elements and the general requirements for the preparation and presentation of financial standards (Peng, 2005). They were composed of 10 chapters, any chapter dealt with a specific matter (Fig.2).

Fig. 2: 1992 ASBE



(source: elaborated by the author)

[32] <<The term "conceptual framework" is not explicitly stated in China's "Accounting Standards". Although many of the essential components of the conceptual framework are contained in the "Accounting Standards", such as statement of objectives, qualitative characteristics, assumptions, elements of financial statements and the concept of capital maintenance, others are not explicitly stated and must be inferred from other sources>> (Davidson et al., 1996).

In the first section, there are the four macro-accounting principles internationally accepted: going concern, accounting period, monetary measurement, accounting entity.

The second section consists of 12 basic principles: objectivity, relevance, comparability, timeliness, consistency, understandability, accrual basis, matching principle, conservatism, historical cost, separation of revenue and capital expenditure and materiality.

The third section includes six chapters dealing with accounting elements: asset, liability, equity, revenue, expenses and profit.

The fourth and last section lists the financial statements that must be issued by any company: balance sheet, profit and loss statement, statement of change of financial affairs.

The issuance of these standards can be considered as a milestone for Chinese accounting, since it proscribed a broader scope of general principles of accounting based on international practices. All enterprises, no matter what field they were operating in nor the type of their ownership, had to comply with the Basic Standards. However, there was a difference between these standards and those of more developed countries: the latter focus on the interests of investors and creditors, while the Basic Standards did not state clearly whether the interests of investors and creditors are preferable to the interests of government and management (Peng, 2005).

An important difference with the conceptual framework developed by IASB was the concept of “accounting conservatism”[33]: it did not formally exist before the reform because, due to the strong control of the State and the centralized economic system, there was no place for uncertainty. Accounting conservatism can be translated into “prudence”.

Another changing aspect was the valuation method: the new standards follow the criterion of historical cost, rather than the market one, this aspect was also related to the absence of a free market, since there was no real value of asset being evaluated.

[33] <<Accounting should calculate possible losses and expenses rationally according to the requirement of conservatism>> Art. 18.

The main differences are shown in the following comparison table between the conceptual frameworks based on ASBE and the one based on IASB[34] (Table 1).

Table 1: differences between the conceptual framework of ASBE and IASB

TOPIC	ASBE	IASB
Mixture of framework and standard: yes/no	Yes	No
Prime user group: a) investors and creditors b) investors c) government and management d) not specified	C	D
User information needs (difference acknowledged): yes/no	No	Yes
Objectives: a) decision usefulness b) stewardship c) unclear	C	A, B
Prime qualitative characteristics: a) understandability b) relevance c) reliability d) comparability e) objectivity	E	A, D
Qualitative characteristics: a) hierarchically layered b) sequentially listed	B	A
Qualitative characteristics (trade-offs acknowledged): yes/no	No	Yes
Qualitative characteristics (cost as constraint recognized): yes/no	No	Yes
Qualitative characteristics (operational definition provided): yes/no	No	Yes
Recognition and measurement (approach):		

[34] IASC at the time.

a) asset and liability view b) revenue and expense view	B	A
Measurement (bases): a) historical cost b) value to the business c) no preference	A	C
Capital maintenance: a) various concepts discussed b) no concept discussed c) current practice described	B	A

(source: Xiao et al, 1995)

Together with ASBE, MOF also issued Financial Management Regulations for Business Enterprises (Table 2) in November 1992, composed of 46 articles divided into 12 chapters. It was aimed at standardizing ASBE, by making them easily applied by companies.

Table 2: Financial Management Regulations for Business Enterprises

Chapter 1	General provisions
Chapter 2	Raising funds
Chapters 3-8	Financial Management of assets, expenditure and profit
Chapter 9	Foreign currency
Chapter 10	Liquidation of enterprises
Chapter 11	Financial reports
Chapter 12	Supplementary provisions

(source: elaborated by the author)

A further step in the development of Chinese accounting system was a three-years project for the enactment of more specific standards for each sector, the Practical Accounting Standards (PAS). The project started in February 1993 through a collaboration among Accounting Affairs Bureau (AAB), MOF, Chinese academics and accountants and the Deloitte Touche Tohmatsu International.

The project resulted in the issuing of 30 standards applicable to all the economic sectors in China.

The innovative aim of the ASBE and the effort of the MOF towards accounting harmonization were undoubtedly positive and the effects on the intelligibility of the Chinese balance sheets are obvious. Despite the positive response to the introduction of the new accounting system, the MOF, aware of the still existing differences and aiming at continuing the process of economic internationalization, continued with further revisions in 1998, 2001 and 2006.

2.2 The harmonization phase: 1998 GAAP and 2001 GAAP

The period from 1998 to the following accounting reform of 2001 is known as a "harmonization period", since Chinese system was trying to harmonize (rather than fully converge) its accounting standards with IFRS. It can be considered as an attempt to harmonize not only in its conceptual framework but also in the detailed formulation of specific standards (Chen and Chen, 2008).

In fact, despite the complexity of the reform and its positive effects, there were still substantial differences between the two conceptual frameworks. Therefore, in order to try to reduce the still existing gaps, aware of the eventuality of the need for another reform in the future, the MOF proposed a new reform in 1998: New Accounting Regulation for Listed Companies, with the intention of harmonizing the Chinese accounting practices of listed companies with the IFRS. A comparison among 1992 GAAP, 1998 GAAP and IAS/IFRS is provided by Table 3 (Chen et al, 2002).

Table 3: comparison of seven accounting methodologies of 1992 GAAP and 1998 GAAP with IAS/IFRS

Method	**1992 GAAP**	**1998 GAAP**	**IAS/IFRS**
Provision of risk fund on receivables	Established by the Government with % variables between 0.3%-0.5%	Established by the Company	Established by the Company
Valuation of inventories	Historical cost	The lower between the purchase cost	The lower between the purchase cost

		and the realization value	and the realization value
Investments valuation	Historical cost for both fixed and current investments	The lower between purchase cost and market value	The same, but with the possibility of making revaluations to increase in equity (reserve)
Valuation of equity investments	Equity method if investments exceed 50%	Equity method if investments are between 20-50%	Equal
Plant costs	Depreciable over 5 years	Can be amortized up to 5 years	Can be amortized up to 20 years, but commonly up to 5 years
Revenue recognition	At the time of shipment and payment (or payment promise) of the goods	At the time of the transfer of the risk, advantaged and control connected to the goods, payment received, and the cost is measurable	Equal
Consolidation Area	When the company owns more than 50%	When the company owns more than 50%, including joint ventures	Equal

(source: Chen et al., 2002)

The major differences (Xiao et al, 2004) between the new accounting system and the previous one were:

- the accounting principle of substance over form;
- separation between financial accounting and tax accounting;
- mandatory cash flow statements;
- for changes in accounting policies, companies had to adopt retrospective methods;
- the recognition of provisions for the impairment of eight types of assets was required.

However, the real innovation was the introduction of the use of fair value[35] for the valuation of assets and liabilities. Before this reform, property, plant and equipment could not be classified as investment properties, therefore the amount

[35] Among the 10 standards issued during 1997-2000, three required the use of fair value measurement: 1) debt restructuring (1999), 2) non-monetary transactions (1999), 3) investments (2000).

was evaluated as the initial cost minus accumulated depreciation and impairment. Under this reform, properties were evaluated at historical cost and then by using a fair value model. Initially, it was perceived as a natural consequence of China's economic development but, later, its use in financial reporting gained more and more support from leading standard setters, such as IASB, major market regulators, such as Securities and Exchange Commission (SEC) and Accounting Academia.

Another important difference was the equity adjustment: gains from government subsidies were considered as capital reserve, while they were considered as net profits under international standards.

In addition, the beginning of a new phase needed the establishment of a new organization: the China Accounting Standards Committee (CASC) was established, its main focus was not only on the planning, structuring and development of accounting standards, but also on their implementation.

It must be noted that this phase was still a transitory one: the aim of convergence was clear, but the process was still difficult and long.

In 1998, Chinese accounting system was still quite conservative and little flexible. A possible reason may be found in the fact that the passage from a planned economy to a market economy was still recent, resulting in a young and weak accounting system.

During the last years of this phase, between 2001 and 2006, China made a further effort to become more and more comparable with IFRS, by issuing supplementary standards to make accounting system more flexible, by lessening difficulties for foreign shareholders and foreign investors (Ding and Su, 2008) and affecting positively the comparability of financial statements. It is important to note that a further reform was not only linked to the awareness of the still existing gap between Chinese accounting standards and IFRS, but also to China's will to become part of the WTO. This further development was made possible also thanks to the Accounting Reform and Development Project, a fund allocated by the World Bank in 1999. The new reform, 2001 GAAP, was effective from the 1st of January 2001.

The 2001 GAAP was composed by sixteen CAS: six new Specific Accounting Standards (Intangible Assets, Borrowing Costs, Leases, Interim Reporting, Inventories, Fixed Assets), five of the old ones were further revised (Cash Flow Statement, Debt Restructuring, Revenue Investment, Changes in Accounting Policies, Estimates and Correction of Accounting Errors) and five standards remained unchanged.

Table 4 shows the differences among the previous reform of 1998 GAAP, 2001 GAAP and IAS/IFRS.

Table 4: differences 1998 GAAP, 2001 GAAP, IAS/IFRS

Topic	**1998 GAAP**	**2001 GAAP**	**IAS/IFRS**
Inventory valuation	Historical cost or the lower between the cost and the realization value (LCM)	LCM*	LCM
Short-term investment assessment	Historical cost or the lower between the cost and the realization value (LCM)	LCM	Fair value
Bad Debt	% approved by MOF (0.3-0.5) or determined by the company	Determined by the company	Determined by the company
Ongoing construction	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment of fair value
PPE evaluation	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment of fair value
Valuation of intangible assets	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment of fair value
Real estate	Amortized cost	Amortized cost and impairment test	Amortized cost and impairment of fair value
Plan costs	Can be amortized up to 5 years	Capitalized until the start of the activity and subsequently considered as costs	Considered as costs

* LCM: Lower of cost or market (source: Peng et al, 2008)

Despite the efforts of the MOF in the harmonization process, a step back was also made with the prohibition of the use of fair value. Xiao et al (2004) hypothesized that this decision was due to the fact that in an immature or still growing market, it was difficult to establish the real market value of an asset. In addition, there were also a series of scandals that led to this decision. In fact, during the second phase, about two thirds of the major Chinese SOEs had falsified their financial statements through an abuse of the fair value that had allowed them to manipulate profits and transfers proceeds to majority shareholders, often collaborating illegally with the administrative supervisors (Far East Economic Review, 2003). That, obviously, forced the MOF to abolish these assets and liabilities measurements while the fair value method, after a first introduction in 1998, will be prohibited until next reform in 2006.

2.3 The convergence phase: 2006 GAAP/ NEW PRC GAAP

Between the 7th and 8th November 2005, the CASC and the IASB[36] signed a memorandum confirming the convergence of ASBE/PRC GAAP and IFRS. This statement focused on three main points:

- the importance of convergence given by the establishment of a single set of high-quality accounting standards;
- NEW PRC GAAP was issued with the aim of convergence with IFRS, although some differences still occurred (financial reporting on transactions with related parties, valuation at fair value and business combination);
- IASB pointed out issues regarding Chinese Accounting, but this is due to the unique condition and economic environment of China.

On the 15th February 2006, a new version of ASBE was issued by MOF, announcing the last stage of convergence of Chinese accounting standards with IFRS. New standards were to be applied by all listed companies from the 1st January 2007, and A- and B- class of shareholders had to prepare financial statement under the new Chinese GAAP (Wu and Lin, 2014). Therefore, not only

[36] China's Vice Minister of Finance and Secretery-General of CASC, Wang Jun, and the IASB Chairman, David Tweedie signed the memorandum.

the final step of convergence meant a greater understandability and reliance of financial statements, but also had a great impact on investors. This was a big step in China's transition, <<bringing companies with domestic investors in line with those companies already accustomed to reporting to its international investors through standards based on IFRS>> (Liu et al., 2016).

The Chinese minister of Finance, Jin Renqing, in a speech for the presentation of the new standards, used the expression "*bringing in, going out"*, referring to the possibility for foreign investors to better understand Chinese financial statements after the reform and, at the same time, the possibility for Chinese companies to have more familiarity with financial statements of foreign companies.

The reform consisted in the introduction of 22 new standards and the revision of 16 standards (Table 5).

Table 5: the list of new and revised ASBEs principles

N°	ASBE basic standards	New/Revised
1	Inventories	R
2	Long term equity investments	R
3	Investment property	N
4	Fixed assets	R
5	Biological assets	N
6	Intangible assets	R
7	Exchange of non-monetary assets	R
8	Impairment of assets	N
9	Employee compensation	N
10	Enterprise annuity fund	N
11	Share-based payment	N
12	Debt restructurings	R
13	Contingencies	R
14	Revenue	R
15	Construction contracts	R
16	Government grants	N

17	Borrowing costs	R
18	Income taxes	N
19	Foreign currency translation	N
20	Business combination	N
21	Leases	R
22	Recognition and measurement of financial issue	N
23	Transfer of financial assets	N
24	Hedging	N
25	Direct insurance contracts	N
26	Re-insurance contracts	N
27	Extraction of petroleum and natural gas	N
28	Changes in accounting policies and estimates and correction of errors	R
29	Events after the balance sheet date	R
30	Presentation of financial statement	N
31	Cash flow statement	R
32	Interim financial reporting	R
33	Consolidated financial statement	N
34	Earnings per share	N
35	Segment reporting	N
36	Related party disclosures	R
37	Presentation of financial instruments	N
38	First time adoption ASBE	N

(source: Heng and Norohna, 2011)

Some additional documents were also provided, aimed at clarifying and explaining the usefulness and application of some points and they must be considered as an “operational guide”.

These documents were:

- the Application guidance, explaining the contents, providing further information and including instructions on the preparation of the balance sheet, the chart of accounts, financial statements;
- China Accounting Standards bulletin;
- the interpretation guidance of CAS.

One of the characteristics of the reform was the reintroduction of the concept of fair value: the MOF soon realized that it would have not been able to prevent fraudulent reporting by eliminating fair value, especially considering that fraud and corruption were unfortunately at the base of the Chinese economic context, since the 2001 annual report had however recorded an improper use of accounting standards. Its reintroduction was a big step towards development that allowed Chinese infrastructures and companies to develop and bring local financial users closer to market reality.

Together with the reform, a program of “awareness raising” took place, aimed at educating companies, academic community and accounting agencies about the new standards, their meaning, their use and, most of all, their importance in the accounting environment. All the main organizations were involved: China Securities Regulatory Commission (CSCR), National Accounting Institutes (NAIS), the Institute of Certified Public Accountants (CICPA).

The convergence of Chinese accounting standards with IFRS represented an important leap forward for Chinese accounting and Chinese economy in general. A series of documents were issued after the convergence in 2007 in order to monitor and report the status of Chinese accounting standards. First of all, the “Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards”, published in September 2009 by the MOF, aiming at declaring the effort made by China to continue the convergence process. In 2012, the CASC issued the “Guiding Opinions on Further Reforming the Issue System of New Shares” (CASC 2012), aimed at improving basic rules for share issues of joint stock limited companies and listing and trading of their shares, at promoting the real value of a company through its share prices, at realizing a fair development

of markets. Again in 2012, in May, CASC also issued the “Opinions on Issues Concerning Further Improving the Quality of Financial Information Disclosure by Companies Undertaking an Initial Public Offering (IPO)“ (CASC, 2012), aimed at further improving the quality of financial information.

According to these documents, the process of convergence is to continue through the years: in fact, in 2014, the Chinese MOF issued three new ASBE (CAS 39 Fair Value Measurement, CAS 40 Joint Arrangements, CAS 41 Disclosure of Interest in Other Entities) and revised 5 of them already existing. It also issued several Exposure Drafts in 2015 and 2016, aimed at continuing the convergence process. In order to reaffirm once again the goal of a full convergence, the MOF and the IFRS Foundation signed a joint statement, enhancing the continuation of the cooperation.

Chapter 3: Literature review

Starting from the first years after the signing of the joint statement on the convergence of the accounting principles with IFRS, the effects on the economy began to be evident. Before the convergence, many benefits had been hypothesized, including more efficient cross-border transactions, greater transparency, greater comparability of financial data, better asset prices, lower cost of capital. However, there were a large number of effects hypothesized by accounting firms, politicians, administrators, academics, standards setters, analysts, most of them involving the efficiency of markets. The main effects that affected the field of investment were on:

- the asset markets, a greater transparency of the financial statements resulted in a higher quality of information, leading to a reduced information risk for shareholders and, consequently, also for lenders. These benefits can be presented in two ways: directly, by providing more information in financial statements or indirectly, by reducing costs or increasing the credibility of information[37];
- the reduction of the cost of capital to public corporations. Since more and more information were available, investors started to perceive their investments less risky, therefore they will require a lower return from investing (Ball, 2016);
- markets, convergence reduced the cost of cross-border contracting with lenders, customers, suppliers but, most of all, with investors leading to an increase of international transacting.

Although the convergence process was concluded more than 10 years ago and despite the growing interest towards China in recent years (in particular, due to an incredibly attracting investment atmosphere) resulted in a deep study of the sectors that interested economic growth, the literature on the connection between the converge of Chinese accounting standards with IFRS and its effects on the

[37] Standardization of accounting rules reduced the cost of analysts' research and increased comparability across firms in different countries, reduced the cost for the creation of standardized international financial databases.

economic growth, with the only exception of some reviews, is rather limited. Moreover, among these reviews, some of them hypothesized the lack of such connection. In fact, it is easier to find in literature reviews on the connection between the convergence and the increase of the level of FDI and reviews on the connection between the increase of the level of FDI and economic growth.
Since the aim of the present dissertation is to analyze the relationship between convergence and economic growth by using the level of FDI as an index, it will be more productive for the literature review of the main studies of this chapter to proceed in the following way, by separating the analysis into two: the relationship between convergence and the level of FDI in the first paragraph and the relationship between the level of FDI and economic growth in the second paragraph. In fact, literature offers reviews that satisfy these requests, and both for China and for the rest of the world. The third paragraph will be left for the analysis of the reviews discussing the core topic of this dissertation that, even if limited and little updated, remain an excellent starting point for the continuation of the study.

3.1 Review of studies on the relationship between the IFRS convergence and the level of FDI

After the introduction of IFRS, studies trying to investigate whether there was a relationship between the convergence with international standards and the increase of the level of FDI have emerged. These studies argued that an inevitable consequence of the introduction of IFRS was the enhancing of a locational attractiveness of a country to foreign investors, impacting positively the level of FDI in the adopted countries. Since one of the main features of IFRS is to be of higher quality than domestic accounting standards, countries that adopted these standards provide more transparent and understandable financial information. Here lies the relationship: foreign investors often prefer investing in countries where financial reporting disclosure requirements are high and the accounting information they provide is better. On the contrary, in those countries that did not converge to IFRS, there is a strong information asymmetry for

investors, higher costs of processing information and doing business is more expensive. This results in a high cost of investing, making investors more likely to invest either in some other countries or in their own.

Chen et al. (2011) were among the first researchers to consider accounting standards as <<a component of the institutional infrastructure of a location>> (Chen et al, 2011) and they hypothesized that the convergence of accounting standards with IFRS promoted FDI, since it helped reducing information processing costs for investors, making it easier for them to invest abroad. The study was conducted on 30 Organization for Economic Cooperation and Development (OECD) countries. They also tried to demonstrate that the impact was stronger in those countries that were using completely different accounting standards before convergence. Results showed that FDI flows are positively associated with IFRS, FDI-IFRS conformity was more evident in those countries with greater institutional differences.

This is one of the most significant studies focusing on this topic, but other researchers started to become interested in the subject overtime. In particular, in 2013, Dong (2013), in a discussion on the study conducted by Chen et al, stated that, although the innovation and importance of the study were evident, there were still some limitations. In fact, there was no evidence that the findings could be generalized to other no-OECD countries, especially to developing countries[38] and there was no indication whether IFRS convergence had the same effect on FDI inflow and outflow.

Defond et al. and Ball (2006; 2018) investigated the relationship in different ways. The study conducted by Ball aimed at underlining the pros for investors in doing business abroad after the convergence, suggesting that investors preferred IFRS, due to the information efficiency and reduced information cost. He listed direct and indirect pros for investors: direct pros were more-informed valuation in equity markets and lower risks for investors, reduced cost of processing financial information, a stronger efficiency of stock markets, reduction of barriers to cross-

[38] In some developing countries, there are no accounting professionals sufficiently qualified to apply standards in an efficient way, or they do not have developed national institution infrastructure able to ensure the efficiency of IFRS (Dong, 2013).

border acquisition; indirect pros were increased share prices due to a reduction in firms' costs of equity capital (making new investments by firms more attractive), increased transparency that made managers act in more in the interests of investors, earnings more informative, reduced agency costs and more efficiency in contracting between firms and managers, firms and lenders.

Defond examined the effectiveness of IFRS convergence in China and its effect on foreign institutional investors from 2005 to 2008, divided into a pre-convergence phase (2005-2006) and a post-convergence phase (2007-2008). This last study showed that foreign institutional investment did not increase after the convergence. Like other previous studies confirmed, Defond suggested that this may be caused by a weak institutional infrastructure, concluding that <<convergence with IFRS does not help China achieving its goal of attracting more foreign investors>> (DeFond et al., 2008). In addition, he found that the association between earnings and returns tend to decline after the convergence, while foreign institutional investors' returns also decreased.

Louis and Urcan (2012) examined the effects of IFRS on FDI, by analyzing whether the adoption of international accounting standards led to an increase in cross border acquisition[39]: <<We focused on M&As because they involve the valuations of existing reporting entities and are therefore the type of FDIs that are most likely to be affected by reporting standards>> (Louis and Urcan, 2012). Their study was innovative for two main reasons: first, it was one of the first studies to investigate the relationship between IFRS and FDI; second, it used the exogeneity of the listing status of a firm to evaluate the effects of IFRS on FDI. The study was conducted on a randomized sample of developed countries after the mandatory adoption of IFRS. Results showed a significant increase of cross-border acquisitions of listed firms in countries that adopted IFRS, while <<change in cross-border acquisitions of unlisted firms is insignificantly different from zero and significantly lower than the change of cross border acquisition of listed firms, which suggest that the increase in FDIs around the adoption of IFRS is due to IFRS>> (Louis and Urcan, 2012).

[39] FDI includes mainly mergers and acquisition (M&A) and greenfield investments.

Most developed countries are probably to have been adopting highly sophisticated accounting standards before adopting IFRS, therefore the impact of international standards in developed countries may be less significant compared to developing countries (Gordon et al., 2012; Ismail et al., 2013), yet the relation still exists.

As far as developing countries are concerned excluding China, it is important to note that most of the studies in literature focus on those countries whose political, financial and economic situation is still improving, in particular, on countries like Nigeria, Ghana, Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam and, of course, China[40].

Yousefinejad et al. (2018) was one of the first to conduct a study on countries belonging to the Association of Southeast Asian Nations (ASEAN)[41] between 2001 and 2006, since they considered the importance of the impressive economic growth of these countries over the recent years and they provided a good setting for studying the relationship[42]. The aim of the study was to investigate the casual relationship between IFRS and FDI inflows and results showed that IFRS adoption attracts more foreign investments into a country and a positive and significant relation. However, Indonesia and Vietnam, belonging to the ASEAN countries, also showed high level of FDI inflows, even if they did not adopt IFRS yet.

Ajibade et al., (2019) conducted one of the latest studies available in literature focusing on the association between IFRS and FDI in Nigeria and Ghana between 1984 and 2017, by taking into account exchange rates, FDI inflows, inflation rates and political influence because they considered that IFRS adoption alone would not lead to FDI inflows, and that FDI is influenced by the above factors. The study showed a positive association in Ghana, but a negative yet

[40] Although China, in terms of gross domestic product, is the second world economic power and the largest exporter and importer in the world, it is part of the G20, therefore it is still considered a developing country.

[41] The ASEAN was established in 1967: Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand were founding members. In the late 1990s, Vietnam, Laos and Cambodia also joined ASEAN.

[42] In 2016, ASEAN regional expansion by multinational firms resulted in inflows of 120 US billion, almost 16% of world FDI among developing countries (Yousefinejad et al., 2018).

insignificant relationship in Nigeria, probably due to the influence of political instability, demonstrating that also other factors are to be considered. In fact, they suggested that the adoption should not be applied as a stand-alone plan, but it must be coordinated with political and economic strategies, in order to ensure its success.

Despite above studies, Nnadi and Soobaroyen (2015) found no positive association between IFRS adoption and FDI after analyzing 34 African countries for over 20 years.

Owusu et al. (2017) analyzed the macroeconomic implications of the adoption of IFRS, in terms of FDI, in 116 developing countries between 1996 and 2013, revealing that IFRS adoption itself did not affect the level of FDI. This result can be explained by the fact that the accounting system of a country does not exist independently of the influences of institutions, level of corruption, stability of political environment, efficiency of governance, rule of law enforcement (Owusu et al., 2017), that resulted to be critical in the application and enforcement of accounting standards and a lower interest of investors.

3.2 Review of studies on the association between the level of FDI and economic growth

Over the past few years, due to the growing globalization that allowed a faster and better spread of people, technologies, money and products across borders, researchers and academics started to investigate the role and the eventual benefits of foreign investment, especially its potential effect on economic growth, by investigating the channels through which it operates.

In particular, a strong impact has been registered in developing countries: in fact, most of the studies available in literature have been conducted on South-East Europe, North Africa and East Asia[43].

The importance of FDI is recognized worldwide: it can be considered as the support of the economic development of a country, it influences the economy

[43] Studies on East Asia mainly focus on China and, in particular, on the differences of FDI level between central regions and coastal regions.

itself and it leads to increased productivity and competitiveness (Teodorescu, 2017).

The link between FDI and economic growth is based on the fact that FDI is a key factor of globalization of capital[44].

As Teodorescu stated in his review, after investigating the effects of FDI on economic growth in Europe, <<FDI generates a variety of effects on the economy, among which the most important are related to increasing labour productivity through transfer of know-how, technology, favoring at the same time, technological progress and long term economic growth. At the macroeconomic level, the main positive impact is the standard of living, reflected by higher disposable incomes, decreasing unemployment, diversification of products and services>> (Teodorescu, 2017).

In addition, FDI may affect economic growth in two ways[45]: direct and indirect. The “direct effect” refers to the net contribution that FDI makes to capital stock with the increasing of investments, savings and expanding the capital equipment. The “indirect effect” refers to the contribution of FDI to the knowledge stock of a country by spreading knowledge and innovation (Mehic et al., 2013).

Li and Liu (2005) and Lai et al. (2006) conducted similar studies on both developed and developing countries, both finding a strong relationship between FDI and economic growth, even if Lai et al. mainly focused on the relationship between international technology spillovers, the type of economy and higher human capitals.

Teodorescu (2017) analyzed the association between FDI flows and economic growth in the European Union from 2004-2015, finding that economic growth was the main result of FDI flows, but it is necessary to consider that the impact of FDI on the host economy may have different results, based on the country’s characteristics. These characteristics were mainly the existing concrete economic, social and political conditions. It is also important to note that this study, together with all the previous studies, considered, when evaluating GDP level,

[44] The history and the role of FDI will be further analyzed in Chapter 4.

[45] See the study conducted by Summer (Summer, 2005) for a more detailed discussion.

the eventual decrease between 2008-2009 due to the economic crisis[46], and that one in 2010-2015, post crisis. He also considered other factors, such as the increase of population and the trend of GDP increase-decrease in the rest of the world, finding a strong relationship.

Lee and Chang (2009) considered also the level of financial development of the country as a fundamental variable: they conducted a study on 37 countries, using annual data for the period 1970-2002. They explored the directions of casuality among FDI, financial development and economic growth, obtaining reliable evidence of a long-run relationship. In fact, they stated that the positive effects of FDI on growth can be realized only when <<an increase in FDI produces a rise in domestic credit and the financial development indicator crystallizes>> (Lee and Chang, 2009). There were three important findings in their study: the stronger the financial system is, the more the chances to gain benefits from FDI are; the healthy development of the financial system is a pulling force for FDI; if a well-developed financial system is supported by a solid economic policy, FDI is easier to attract.

As far as African countries are concerned, one of the most significative studies available in literature is the one conducted by Soumaré (2015). In the study, net FDI inflows and United Nations Development Program's Human Development Index (HDI)[47] were used as the principal variables. The study confirmed a strong relationship between net FDI inflows and economic growth in North Africa. However, it must be noted that differences occurred among African countries and FDI is mainly directed to few industries[48] and very few investments are for non-extractive primary industries or to the manufacturing sector. That is why it is very important to identify not only the source of the investment, but also the direction.

In 2011, two important studies were conducted on the effect of FDI on Asian economic growth. Kotrajaras et al. (2011) examined the impacts of FDI on 15 East Asian countries, concluding that a positive impact of FDI on the economy of

[46] The economic crisis of 2008-2009 resulted in a dramatic decrease pf annual GDP growth rate.

[47] It is a statistic index calculated by life expectancy, education and per capita income indicators.

[48] Petroleum, tourism, constructions.

those countries strongly depended by complementary factors that must be always considered, such as the level of financial market development, institutional efficiency, macroeconomic policies.

The study conducted by Tiwari et al. (2011), also investigated the effects of FDI on the economies of Asian countries, but it can be seen as more complete as it considered an additional growth factor: export, demonstrating that, together with FDI, enhances the growth process.

However, the studies conducted on China are few and often lead to contrasting results, therefore a greater attention and dedication to this type of study is necessary to fill this gap in literature. Liu et al. (2014) examined the channels through which FDI affects China's economic growth, and they found that it facilitated growth especially by enhancing physical and human capital accumulation, but it also had a negative effect on output growth by reducing domestic investment and local government revenue. They also investigated the imbalance of FDI inflows among Chinese regions, demonstrating that widened interregional growth gaps through its effects on both level of capital accumulation and technology progress but, at the same time, it reduced growth gap by affecting level of education, industrial structure, trade openness.

Gunby et al. (2017) and Zhao et al. (2007) hypothesized that the effect of FDI on Chinese economy was <<much smaller than one would expect>> and <<it was reduced to statistical insignificance>> (Gunby et al., 2017). Further studies are necessary in order to better understand the real effects of FDI on economy, in particular in China which, within the limits of my knowledge and of what is available in literature, are the only ones presenting different results and conclusions.

3.3 Review of studies on the effects of the IFRS convergence on economic growth

As already mentioned, despite the state of research on IFRS, the study on the economic consequences of convergence with IFRS has hardly been investigated, remaining a matter of empirical concern. However, even with a limited literature,

the massive impact of IFRS on the dynamics of business environment is undeniable.

However, the relationship may be intuitive: IFRS convergence increases transparency and disclosure of financial statements, reducing information processing costs, risks, asymmetry and uncertainty by enhancing comparability, investors and capital market efficiency (Zaidi and Huerta, 2014). This convinced investors of a higher quality of financial statements, attracting again more investors and promoting efficient capital markets and economic growth. Therefore, the adoption/convergence of IFRS should have a positive impact on the economic growth (Dogan, 2015).

The concern about the economic consequences of accounting policies started in the late 1970s, when the accounting profession started to consider the growing influence of external forces in the standard-setting process and their potential economic impact (Hebert and Tsegba, 2013).

Also in this case, studies available in literature are limited and discordant: some studies showed positive effect, with evidence that IFRS adoption/convergence improved quality accounting information (Barth et al, 2008) and reduced cost of equity capital (Daske et al., 2008; Li, 2010), others showed a partial impact on economic growth, others showed no association at all.

Larson (1993) conducted a study on 35 African countries, aiming at analyzing the difference in economic growth between countries that adopted IFRS and countries that did not. Results showed a larger economic growth in adopting countries rather than non-adopting countries.

Again in 1995, Larson and Kenny (1995) analyzed the effects of adoption on equity market and economic development on 27 developing countries, but results showed a negative relationship.

In 2013, Herbert and Tsegba (2013) analyzed the economic consequences of the adoption of IFRS by Nigeria, considering the main obstacles of the adoption and implementation, its benefits and the effects it caused. They found that the major obstacles to IFRS adoption in Nigeria were the lack of education and experience by preparers of financial statements with IFRS, lack of coverage of IFRS in financial accounting and auditing textbooks, high cost of adoption. As far as

benefits were concerned, it created uniformity in global financial reporting, it increased comparability and better information, it made IFRS a more globally accepted language and this overall consensus contributed to a higher trust by investors and, consequently, higher inflows of investment after the adoption.

Another important study, taking into account a new factor, i.e. the level of enforcement of the adopting countries, was the one conducted by Zaidi and Huerta (2014), showing a partial relationship between IFRS adoption and economic growth rate. Their study was based on a sample of 51 countries that adopted IFRS and 51 countries that did not adopt IFRS yet, showing that economic growth was much faster for those adopting countries, gaining more economic benefits when a high level of enforcement occurred.

Another innovative point of view was in the study conducted by Klibi and Kossentini (2014) that investigated the effects of IFRS adoption on stock market development. The study sample consisted of 14 Middle Eastern and African countries, by using a balanced panel data analysis: results showed a significant correlation.

A few years later, in 2016, Ozcan (2016), with a sample of 41 IFRS adopting countries and 29 non-adopting countries, from 2005 to 2015, found significant evidence of the relationship between IFRS and economic growth.

In fact, he stated that countries that adopted IFRS were much more successful in attracting foreign direct investment than non-adopting countries. However, he also clarified that other factors such as <<education policy, human capital, geographical factors and political structure>> also influenced the economic development rate (Ozcan, 2016). In fact, the results of univariate analysis implied that adopting countries were characterized by a higher level of education, being education a key factor for the accumulation of human capital that positively influences economic growth. Other important factors were a high level of law enforcement, political stability and a well-established legal system (Ozcan, 2016). This study may be considered as a supportive argument that IFRS enhances economic growth.

Woolley in 1998 (1998) investigated the effect of IFRS on economic growth in Asia, but results showed no substantial differences between the mean economic growth rate of adopting and non-adopting countries.

Most of these studies suggested that the only adoption or convergence with IFRS does not influence economic growth. Other important factors, such as enforcement and political stability are necessary. In fact, enforcement as the act of enforcing rules and laws, implies that the financial statements that companies report meet the regulations. It also plays a crucial role in the implementation of standards. If a country adopts IFRS or it converges with IFRS but, at the same time, does not enforce them, the reliability of the financial statements reported can be doubtful (Zaidi and Huerta, 2014).

From the present review of main studies, it is clear that little importance has been given to this area of research, therefore, since the results and conclusions of these studies do not always find complete agreement with the others, they must be considered within their limits and each study should be analyzed per se. For this reason, even if the studies on the Chinese situation are limited, one can still consider the studies already mentioned in paragraphs 3.1 and 3.2 on both relationship between IFRS and FDI and between FDI and economic growth, trying to fill in this way the existing gap in the literature on the topic, waiting for further studies.

Chapter 4: The effects on the economic growth

After illustrating -in the first chapter- the stages of the last forty years of the rapid economic development of China, analyzing -in the second chapter- the phases of the convergence of the Chinese accounting standards with IFRS and, finally, -in the third chapter- reporting the results of the main studies available in literature on the relationship between the convergence with IFRS and the effects on economic growth, this fourth and final chapter will firstly focus on the definition of FDI in general and then, more specifically, on the main characteristics of FDI in China (sources, main determinants and sectoral distribution); it will secondly continue with the discussion of the impact of FDI on economic growth, by taking into account three main research areas: export promotion, income distribution and urbanization.

4.1 The Foreign Direct Investment (FDI)

The Foreign Direct[49] Investment (FDI) is defined[50] as <<an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy ("foreign direct investor" or "parent enterprise") in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence[51] on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the business issuer and trader receiver and all subsequent

[49] Based on the type of relationship established between the two entities, there are two types of investments: direct and indirect. Foreign investment is direct when the issuer has the option to make managerial decisions and control over investment and foreign portfolio investment, otherwise the foreign investment is indirect (Teodorescu, 2017).
[50] This general definition of FDI is based on two sources: OECD, Detailed Benchmark Definition of Foreign Direct Investment, fourth edition (OECD, 2008) and International Monetary Fund, Balance of Payments Manual, fifth edition (IMF, 1993).
[51] IMF defines the owner of 10% or more of a company's capital as a direct investor (IMF, 1993).

transactions between them and among foreign affiliates, both incorporated and unincorporated. FDI may be undertaken by individuals, as well as business entities>> (OECD, 2008; IMF, 1993). The World Bank defines the FDI as <<the sum of equity capital, reinvested earnings, other long-term capital, and short-term capital as shown in the balance of payments[52]>> (World Bank).

In order to determine the eventual benefit for a company to pursue FDI and <<to determine if a particular approach provides greater overall value than other available national or international choices for the production of goods or services>>, a series of theories have been developed, the most famous of which is the "eclectic theory", by John H. Dunning in 1979 (Dunning, 1993).

This theory, also known as "eclectic paradigm", "ownership, location, internalization (OLI) model" (or framework), is a model that should be followed by any company interested in international markets.

For FDI to be beneficial, three advantages are needed:

1. *ownership advantage* (trademark, production technique, entrepreneurial skills, returns to scale): it is specific of a company, it includes proprietary information and various ownership rights of a company and it is considered as "ownership advantage" anything that gives a competitive advantage, such as reputation for reliability, quality. When the ownership advantage is the only advantage of the company, export is suggested.

2. *location advantage* (existence of raw materials, low wages, special taxes or tariffs): it is specific of the host country. Companies determine whether there is a comparative advantage in performing specific functions abroad. If the company has both ownership advantage and location advantage, licensing[53] is suggested.

3. *internalization advantage* (advantages by own production rather than producing through a partnership arrangement such as licensing or a joint venture).

[52] The sum of equity capital, reinvested earnings and other investment capital are also known as *direct investment capital,* i.e. "the capital provided (either directly or through other related enterprises) by a direct investor to a direct investment enterprise and the capital received by a direct investor from a direct investment enterprise" (Duce, 2003).

[53] <<A licensing, or license agreement, is basically a legally binding contract between the owner of a right (licensor) and another who is authorized to use such rights (licensee), by which the licensor gives the licensee certain rights or permission for the use of its right, which would not otherwise be available to the licensee>> (Ramachandran, 2009).

Companies move the production of their core competencies abroad since it is more beneficial to engage in foreign production themselves rather than licensing the right. If the company has all these three advantages, FDI is suggested (Dunning, 1993).

Table 6: the eclectic theory

The eclectic theory		**Categories of advantages**		
		Ownership advantage	Location advantage	Internalization advantage
Form of market entry	Export	Yes	No	No
	Licensing	Yes	Yes	No
	FDI	Yes	Yes	Yes

(source: Dunning, 1993)

The importance of FDI has significantly increased over the last few years, in particular, over the last two decades. It was made possible by some factors, such as growing globalization and increased international trade, lower transport costs and tariff costs, better and higher technology.

In fact, the decision whether to direct invest in a particular country is based on a deep analysis of factors, such as the social and political conditions of the host country, its economic situation, the benefits the investors may gain, the access of investors on the regional market, the access to natural and human resources, for example, by taking advantage of proximity to raw materials (rather than to

transport them around the world), the lower labour costs[54] but, most of all, the possibility to avoid tariff barriers and other non-tariff barriers to trade (Teodorescu, 2017).

It must be noted that the impact of FDI on host countries and the advantages and disadvantages of the investing countries is not always the same and, sometimes, it is hard to predict them in advance, since it depends not only on the existing economic, social and political conditions, but also on the degree of penetration of foreign capital (Teodorescu, 2017).

In fact, as already mentioned, the major effects on the host countries may be direct or indirect:

1. *direct,* such as the increase of labour productivity through the spread of know-how, increased level of employment, increased volume of commercial transaction;
2. *indirect,* such as technology transfer, management skills to the local firms. Indirect effects are also the main reasons to attract FDI (Teodorescu, 2017).

Therefore, the advantages of FDI for the host countries are many and significant. Except for the already mentioned advantages[55], it is important to note that, if necessary, capital inflows may also finance an eventual account deficit and long-term capital inflows are more sustainable than short-term portfolio inflows[56]. In addition, investment from abroad could lead to higher wages and improved working conditions for the poorest countries, especially if the multinationals pay attention to the public image they give and are actively engaged in the struggle against poverty, discrimination and improvement of working conditions (Lasserre, 2012).

Together with advantages, it is necessary to note that FDI could also be harmful and dangerous for the host country, as an economic control by an economically and politically stronger country may result in undesirable control also over other sectors. Unfortunately, these disadvantages are often overrated, leading to huge problems between the two countries. One of them is that FDI gives multinationals

[54] For example, India is one of biggest recipients of FDI, where labour costs are much lower than in other countries (UNCTAD).
[55] Increased employment, improved knowledge and expertise from the foreign multinational, increased labour productivity.
[56] For example, in a credit crunch, banks can easily withdraw portfolio investment, but capital investment is less prone to sudden withdrawals (Lasserre, 2012).

(MNCs) controlling rights and it has been argued that some of the most powerful MNCs often use their financial clout to influence local politics in order to gain favorable laws and regulations (Banerji, 2013). In fact, FDI may be a convenient way to bypass local environmental laws. Another important factor that is considered as a benefit for the investing country, yet a problem for the host country, is that FDI enables foreign multinationals to gain ownership of raw materials, with little evidence of wealth being distributed throughout society. In addition, even if this problem is less and less present, multinationals have been criticized for poor working conditions in foreign factories and, in many cases[57], legal actions were carried out.

4.1.1 The Foreign Direct Investment (FDI) in China

As already stated in Chapter 1, FDI has been one of the most significant features of economic development and opening in China. By the end of 2017, China attracted 1.49 trillion USD in FDI stock (UNCTAD, 2017). China is officially the largest recipient of FDI in the developing world[58]. In this section, collected data, sources, main determinants and sectoral distribution of FDI will be presented.
After having collected inward FDI data, it is possible to trace the trend of the level of FDI in China over the years (Table 7), observing how the level increased, in particular, in the years following the convergence with IFRS.

[57] For example, the case of Chinese workers at Apple.
[58] It is the second largest recipient of FDI in the world, after U.S.A. (UNCTAD).

Table 7: Inward FDI stock data from 1997 to 2017 (US$ trillion[59])

1997	0.154	**2008**	0.378
1998	0.175	**2009**	0.473
1999	0.186	**2010**	0.588
2000	0.193	**2011**	0.712
2001	0.203	**2012**	0.833
2002	0.217	**2013**	0.957
2003	0.228	**2014**	1.085
2004	0.245	**2015**	1.221
2005	0.272	**2016**	1.355
2006	0.293	**2017**	1.491
2007	0.327	**2018**	n.a.

(source: UNCTAD, elaborated by the author)

For the analysis of the level of the inward FDI, it was chosen to use the inward FDI stock, available on official website of the United Nations Conference on Trade and Development (UNCTAD)[60].

The choice to use FDI stocks, instead of FDI flows, was given by two reasons:

1. FDI stocks measure the total level of direct investment at a given point in time, usually the end of a quarter or of a year, while FDI flows record the value of cross-border transactions related to direct investment during a given period. (UNCTAD). Therefore, for research purposes, it was important to record the level at the end of the year in order to make the comparison possible;
2. according to existing literature, FDI stocks were always evaluated.

First of all, it is important to point out that the inward FDI stock level was 0 until 1979, which is the year that marks the end of China's isolationism and the opening up to foreign trade after the economic reforms[61] , but in 1980 the index rose from 0 to 1074 million dollars (UNCTAD, various years). By analyzing Table 8, the strong increase of the level of FDI in the period immediately after the convergence is evident. Although, as shown in Table 7, the level of FDI is always

[59] UNCTAD expressed data in US$ million. In the conversion from million to trillion, the third decimal has been rounded up.
[60] https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.
[61] See Chapter 1.

increasing from year to year, it should also be noted that, in the years before the convergence, the percentage of increase is not as significant as from 2007 onwards, when increase is considerably noticeable.

However, some factors may have influenced the increase or decrease of the level of FDI during the years, which are not related to the convergence with IFRS.

First of all, it is important to recall the global financial crisis of 2007-2008, started with the collapse of the “Lehman Brother” investment bank, which resulted in the famous period called "Great Recession"[62] , characterized by a general economic decline. Despite China, along with other countries such as Poland, Slovakia, Australia, India, South Korea, Uzbekistan and Iran, managed to be only slightly affected by this event, it experienced a slower economic growth, but it never entered recession.

However, having the crisis affected other potential direct investors, the level of FDI could have been negatively affected by this event, even if it kept increasing[63].

One of the factors causing the increase of the level of inward FDI from 2005 to 2006 was a change in the methodology underlying Chinese FDI statistics: data on inward FDI released by the Government of China before 2006 did not include FDI in financial services[64]. Therefore, the data reported by UNCTAD for 2004, 2005 and 2006 are not directly comparable.

While the opening-up of the banking industry to FDI has happened gradually, it is only starting from 2005[65] that foreign banks have rapidly entered the Chinese market by acquiring ownership stakes in Chinese banks (UNCTAD Investment Brief, 2007).

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[62] This period goes from the late 2000s to the early 2010s.

[63] Another important crisis was the Asian financial crisis of 1997, during which China was affected, even if only slightly. However, since it was before the year of the convergence, it was not necessary to list it among the influencing factors because its effects had already vanished in the period taken into consideration by the present dissertation.

[64] <<The amount of FDI in financial industries reported by the Government is based on data collected separately by China's three financial watchdogs: the banking, insurance and securities regulatory commissions. According to the China Banking Regulatory Commission, however, its data on foreign investment are not based on the standard balance-of payments (BOP) definition of FDI and do not include greenfield investments. Accordingly, some uncertainty remains as to whether the released data reflect the actual size of FDI in the financial sector>> (UNCTAD Investment Brief, 2007).

[65] By the end of 2005, 18 foreign financial institutions had invested in 16 banks and the largest deals involved four of the five top Chinese banks.

Another influencing factor, as emerged from the review of the main studies in the third chapter, could be politics.

Although China has a long history of solidity and political integrity, the strong influence of the PCC on economic issues could have influenced the investment decisions by countries that do not share the same policy.

Recently, even if data of 2018 are not available yet, there could be a slight decrease due to the recent events of the tariff war between China and the United States, in particular, after the economic attacks by the American president Donald Trump. This event does not obviously concern only these two countries, but also countries like Canada, Australia, but also European countries such as France, U.K and Germany which, having always been supporters of the United States and having always had commercial relations with them, could have reduced their investments in China.

a) Source of FDI in China

As far as sources of FDI in China are concerned, Table 8 presents the top 10 nations with investments in China, as per actual input of foreign capital, in 2018: Hong Kong is at the first place, followed by Singapore, Taiwan, Korea, UK, Japan, USA, Germany, the Netherlands, Macao. These 10 investors accounted for 95.2% of the total actual use of foreign investors in the country (MOC, 2018).

Table 8: the top 10 FDI investors in China (Jan/Oct 2018)

Countries	**US$**[66]
Hong Kong	74.65b
Singapore	4.38b
Taiwan	4.33b
Korea	4.18b
U.K.	3.46b

[66] Data are expressed in US billion, with the only exception of Macao, expressed in US million.

Japan	3.43b
U.S.A.	3.02b
Germany	2.75b
Netherlands	1.05b
Macao	970m

(source: MOC, 2010)

Considering the growing interest of countries in investing in China, it is necessary to make a list of the reasons that increased inward investments, making China more and more attractive.

b) Determinants of FDI in China

OECD (OECD, 2000) listed six main determinants of inward FDI in China:

1. *Size and growth of the Chinese economy.* Since China has a population of 1.39 billion, with a vast potential for consumption, it was considered <<the last enormous market that has not been developed in the whole world>> (OECD 2000). In addition, its rapid economic growth and increased purchasing power has made China attractive to market oriented FDI;

2. Human resources endowments-cost and productivity of labour[67]*.* China has rich resources of high-quality labour (with average low salaries) and rich of energy reserve (oil, coal, electric power supply, land, iron and other minerals);

3. *Physical, financial and technological infrastructure.* The availability of physical infrastructure, such as highways, railways and interior transport waterways attracts FDI. In addition, provinces with a developed level of telecommunication services and technological infrastructure are more likely to attract investments. In fact, in China, the development of high-tech industry has always been a top priority;

[67] Recently, due to globalization of the world economy and the liberalization of international trade, the advantage of cheap labour force lost gradually its *attractiveness power* (OECD, 2000).

4. *Openness to international trade and access to international markets.* China, after the economic reforms and open-door policy, managed to promote international trade. However, several administrative and legal barriers to free-trade still occur;

5. *Development of regulatory framework and economic policy coherence.* China introduced a more transparent and business environment, by amending a series of laws and regulations, by liberalizing further areas of some restricted investments [68], by keeping encouraging FDI policies, by restructuring and reducing the state-owned sector. At the same time, the rate of economic growth, although at a slower pace, remains stable and therefore attractive, because the investments are considered “safe”;

6. *Investment protection and promotion.* The Contract Law, which came into effect in 1999, aimed at promoting FDI, by protecting the legal rights of all parties and by making foreign companies meet their obligations in the Chinese market. In addition, the opening of special economic zones, the promotion of incentives[69] and benefits for investors are also a way to promote FDI. The convergence of Chinese accounting standards with IFRS, in order to protect investors and to make financial statements more comprehensible, may be considered a step further in this direction.

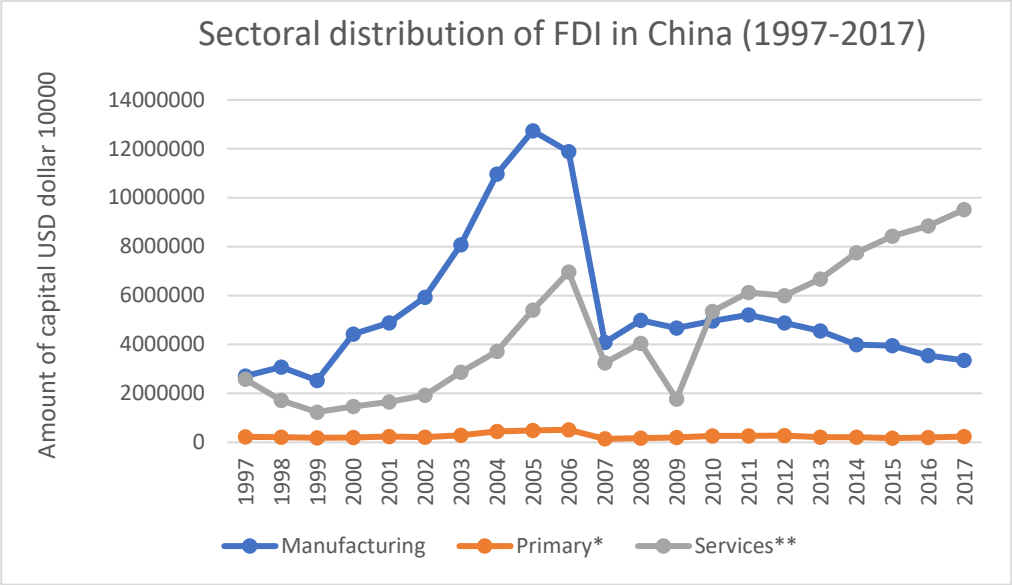
c) Sectoral distribution of FDI in China

Given the restrictions and limits in the sectors in which foreign investment is allowed in China, it would be also useful for the purpose of this analysis to identify in which sectors, over the years, foreign investments have been directed (Fig.3).

[68] Since 1995, the Chinese government has issued the Catalogue for the Guidance of Foreign Investment Industries, in order to convey foreign investments to certain sectors. The latest version is of 2019. All the sectors are classified as "encouraged" (extraction of oil and natural gas, food production, infrastructure, high technology industries), "restricted" (car production, telecommunications) and "prohibited" (movie production, press agencies), (Catalogue for the Guidance of Foreign Investment Industries, 2017).

[69] The incentives available include significant reductions in national and local income taxes, land fees, import and export duties, priority treatment in obtaining basic infrastructure services.

Fig 3: FDI inflows into China, by sector (1997-2017)



(*: Primary sector includes farming, forestry, animal husbandry, fishery, mining and quarrying.
**: Services include electric power, gas and water production and supply, geological prospecting and water conservancy, transportation, storage, postal and telecommunication services, whole-sale retail trade and catering services, real estate management, development and operation, social services, health care, sports and social welfare, education, culture and arts, radio, films and television, scientific research and polytechnical services, banking and insurance, households services, sports and entertainment, scientific research, environment and public facilities, financial intermediation, leasing and business services, information transmission, computer services and software, public management and social organizations.)
(source: NBS various years, elaborated by the author)

As shown in Figure 3, FDI overwhelmingly flowed into the manufacturing sector before 2006. However, since 2006, FDI inflows into the manufacturing sector started to decline, yet to increase again in the following years. FDI inflows in services had an unstable trend, especially after 2006. It started to increase at a stable pace after 2009, surpassing inflows into the manufacturing sector in 2010. On the contrary, the primary sector has never received consistent investments over the years.

It is important to note that in the data available on the China Statistical Yearbook (NBS, various years), as far as the FDI inflows by sector is concerned, there was a difference in the data collection: up to 2007, the data were reported as "total

amount of USD 10,000", while from 2008 onwards, data were reported as "investment actually utilized", therefore the data up to 2007 and those from 2008 onwards are not directly comparable.

4.2 The impact of FDI on China's economic growth

According to Dunning's "ownership advantage, location advantage and internalization advantage framework", FDI involves a significant amount of capital, technology, know-how, management skills, information and other intangible assets. Therefore, all these elements contribute to the economic development of the host country in many ways. In particular, this paragraph will discuss how FDI, whose level consistently improved after the convergence with IFRS (UNCTAD, various years), had effects on China's economic development. Based on the study conducted by Chen (2017), the evaluation was conducted through the analysis of three research areas: export promotion, income distribution and urbanization.

4.2.1 Export promotion

FDI plays a fundamental role in China's export expansion and in economy as well, since exports have always been considered as an engine of economic growth for a long time: the level of exports in total trade in goods[70] and services[71] in China has significantly increased over the years, from 0.77 trillion dollars in 2005, to 1.66 trillion dollars in 2009, to 2.68 trillion dollars in 2018 (UNCTAD, various years) and FDI firms have rapidly become a major exporting group.
There are conflicting theories on the relationship between FDI and export, and

[70] Goods include general merchandise on a balance of payment (BOP) basis, goods under "merchanting" and nonmonetary gold. In order for a transaction to be recorded under "goods", a change of ownership from/to a resident of a local country to/from a non-resident in a foreign country has to take place (UNCTAD).
[71] Trade in services results from intangible actions such as transportation, travel, maintenance and repairs, business services, royalties or licensing (UNCTAD).

with trade in general. Principally, FDI affects the host country's exports through direct and indirect channels.

The direct effect depends on whether foreign invested enterprises[72] (FIEs) resort to resources in host country and search for exports to other countries (vertical FDI[73]), or for the market of host country (horizontal FDI[74]), (Gu et al, 2008).

The indirect effect depends on host country's local companies, whose exports may be influenced by FIEs. It is important to note that the effect of FDI is positive when the main purpose of FIEs is vertical FDI: they target markets at lower costs, aiming at exporting abroad.

However, it may also happen that FIEs are attracted to a country for its potential market, willing to sell products in that market, rather than to export (Gu et al, 2008).

In China, both cases may occur due to its lower labour cost and relatively rich raw materials, as well as huge potential markets.

However, it can also happen that FDI decreases the level of exports of local firms, by increasing FIEs' purchase of inputs locally. Some products that were to be exported by local firms may instead flow to FIEs, in which these products are used as inputs and processed to export, or to penetrate the market in the host country (Gu et al., 2008).

Another significant feature of FDI in the promotion of Chinese international trade is the role it plays in the processing trade.

In China, processing trade refers to <<the business activity of importing all, or part of, the raw and auxiliary materials, components and parts, accessories and packaging materials from enterprises abroad to enterprises within China to carry out the manufacturing process. The finished products after being processed or

[72] FIE is a legal structure under which a company can participate in foreign economy. In China, many legal entities can be considered FIEs, including equity joint ventures (EJV), cooperative joint ventures (CJV), wholly-owned foreign enterprises (WFOE) and foreign-invested companies limited by shares (FCLS).

[73] Vertical FDI is based on relative endowments, attracted by factor cost differentials and repelled by trade costs.

[74] Horizontal FDI is mainly market-seeking investment and aimed at penetrating the domestic market.

assembled by the enterprises within China will be re-exported to the foreign enterprises that are responsible for selling them>> (EU SME, 2018).

In fact, many foreign companies often tend to take advantage of lower labour costs as well as tax concessions in China. Over the years, processing trade has played a vital role in China's economy and export trade, accounting for approximately 70% of China's total export trade (EU SME, 2018).

It is also important to note that Chinese coastal and border regions are more likely to have industrial structures and infrastructures more suitable for export trade than inland regions (Leichenko and Erickson, 1997). The coastal areas in China have always been more attractive to FDI and processing trade because of their closer international connections, favorable tax privilege, better physical infrastructure, and stronger agglomeration economies (Zhang and Song, 2009).

In fact, many FIEs gained benefits from the optimal position of coastal and border regions by starting a massive export process, which was also a result of the establishment of a program of export processing.

The fundamental factor explaining the expanding exports by FIEs is strongly connected to China's export promotion regime: a different set of institutions and regulations compared to those applying to most domestic enterprises, the most important of which is the duty-free processing of imported materials and components into exports. It is necessary to make a distinction between two types of duty-free processing trade: processing materials and processing imports. The processing materials may take place under a contract in which a foreign business ships material to Chinese firms to make them processed or assembled, and subsequent reexport. In the processing imports, Chinese factories import materials and organize production, and then export (Zhang and Song, 2000).

Moreover, FDI has also had significant impact on the export of Chinese domestic firms.

In fact, FDI firms produce export spillovers to domestic firms in three ways.

First, FDI firms may reduce costs of export of domestic firms through knowledge spillovers, in this way they encourage domestic firms to promote export, by increasing the level of export trade (Aitken et al., 1997; Greenaway et al., 2004).

Second, FDI firms may produce technology spillovers, making domestic firms increase productivity, leading to an increase of competitiveness and exports (Barrios et al., 2003).

Third, by strengthening domestic industrial linkages, FDI firms may promote involvement in international production specialization, through the supply and purchase of intermediate inputs. This factor leads to the enhancing of the possibility for domestic firms to export (Kneller and Pisu, 2007).

However, it must be noted that Chinese firms had huge problems, especially at the beginning, in setting up a distribution network, monitoring changes in consumer tastes, mastering industrial and safety norms and building up a new product image. In modern markets, design, packaging, distribution and quality of products have the same importance as the ability to produce them at, or below, ruling prices in world markets. The lack of such skills has been an important key barrier for China to enter the world markets, especially in the early stages (Zhang, 2001).

FDI has therefore positive effects on Chinese export promotion since it provides competitive assets[75] for export-oriented production in technology-intensive and dynamic products in the international trade (Zhang and Song, 2000).

These assets are transferred through training, skills development and knowledge diffusion to Chinese firms by foreign affiliates or non-equity partners, resulting in a further dissemination to other enterprises, both domestic and international (Zhang, 2000).

Therefore, it is also thanks to FDI that China can gain access to new and larger markets[76].

Furthermore, it is interesting to note that China also benefited from the lobbying activities of the MNCs in their own countries, by receiving favorable treatments of exports from their affiliates abroad (Zhang, 2000). In fact, the export-oriented foreign affiliates managed training of local labour force, as well as technical and

[75] Such assets are often firm-specific, costly and it would be difficult for the Chinese firms to acquire them independently.

[76] This involves foreign affiliates' privileged access to not only MNCs' international production systems, but also MNCs' intra-firm markets and access at arm's length to MNCs' customers in global, regional and home-country markets.

managerial development. In particular, China was able to benefit mainly of advanced technological skills.

However, the strategic challenge facing China is that its future competitiveness is strongly connected with the government's ability to boost the human capital and technological infrastructure. In turn, <<MNCs feed benefits back into local skill and technology systems, providing information, assistance and contracts>> (Zhang, 2000).

In conclusion, the contributions of foreign affiliates to China's exports can be summarized into four aspects:

1. *Exports through processing and assembling*. Data confirm that China managed to become a dominant exporter of labour-intensive products [77] and some technology-intensive products[78] (UNCTAD, various years).

2. *Exports through converting import-substituting industries*. A feature of many developing countries is that they apply restrictions on the import of manufacturing products, allowing however FDI in these sectors. China, among them, started and increased exports of the import-substituting products[79] by combining its cheap labour with advanced technology embodied in FDI (Zhang, 2005; Zhang, 2000).

3. *Exports of new labour-intensive final products*. Over the last few years, some Chinese brands of light consumer goods successfully entered international markets also because of the role of FDI, able to provide links to final buyers, especially in the US markets.

4. *Exports of local raw materials processing*. In the processing of locally produced raw materials, it happens that sometimes foreign affiliates have great export potential, better than that of indigenous firms. This may be due to better and more solid international business contacts, marketing skills, higher technology, both in products and processes.

[77] Products like toys, shoes, clothes, and sporting goods.

[78] Products like machinery and equipment, including electronic circuits, automatic data-processing machines, and mobile phones.

[79] This has been happening in home appliances (TV sets, VCD, DVD players, cameras, refrigerators, and washers) and the automobile industry.

In addition to FDI, domestic investment, firm size, labour cost, exchange rate, gross sectoral product and world demand could also be important factors affecting export (Gu et al., 2008).

4.2.2. Income distribution

Over the past 40 years, China managed to improve living standards and achieve higher and higher per capita income (PCI), i.e. the average income earned per person in a specific area, and these successful results have often been attributed to the economic growth. However, it is necessary to consider how income inequality has worsened over the years. In fact, while the Gini coefficient[80] was 0.49 in 2008, considered as an all-time high record, it considerably fell to 0.46 in 2015 and 2016, which was considered to be another record for being so low, and it increased again in December 2017 by reaching 0.47 (CEIC, 2018).

It is obvious that FDI contributes to economic growth, but it also has a significant effect on the income distribution of a country, both because it changes the resource endowments and because it has a strong impact on employment and wage structures (Garnaut et al., 2018).

However, the introduction of FDI had both direct and indirect effects on income distribution. As far as the direct effects are concerned, the FDI introduction expanded China's urban-rural income inequality, but the influence was not exaggeratedly severe; for the indirect influence, FDI expanded urban-rural income inequality through affecting China's industrial structure, as well as the structure of employment and the import-export trade condition.

The main mechanisms through which FDI affects income distribution are:

1. *Impact on industrial structure.* FDI is mainly used in the secondary sector, while the investment proportion in the primary and tertiary sector is relatively low. As a result, most of the domestic enterprises with massive technologies and economic potentiality fell into difficult positions, and it helped increasing disparity

[80] The Gini coefficient is an index that measures the inequality among values of a frequency distribution (for example, levels of income). When the value is 0, it expresses perfect equality, when the value is 1, it expresses inequality.

between the industrial sector and the primary and tertiary sector, resulting in a strong impact on differences in income distribution.

2. *Creation of employment.* The influence of foreign direct investment on employment is multi-dimensional and complex; in addition, the creation of new employment often results in a consistent amount of surplus labour. According to the models elaborated by Heckscher-Ohlin and by Stolper-Samuelson (Krugman and Obstfeld, 1991), if a developing country has a significant amount of unskilled labour, FDI is often concentrated in activities that use that unskilled labour more intensively (Lee and Vivarelli, 2006; Ucal et al., 2014). Therefore, FDI causes an increase for unskilled labour, resulting in a further increase of incomes of unemployed workers and in a raise of wages for unskilled workers, rather than for skilled ones.

3. *Promotion of trade.* As already discussed in the previous paragraph, the introduction of foreign capital had great positive effects on foreign trade in China, but it also contributed to the increase of China's urban-rural income inequality of east, central and western regions.

However, according to the hypothesis of the inverted-U curve elaborated by Kuznets (Kuznets, 1995; Garnaut et al., 2018), the relationship between income distribution and economic growth is not as linear as it may seem: while income inequality increases during the first period of development, it tends to decrease when economic development becomes stable. Therefore, income inequality declines as FDI increase. In fact, the study conducted by Jalil (2012) on factors increasing income inequality in China found that income inequality is higher when economic openness increases, but it decreases as soon as economic development reaches a critical point.

Therefore, despite FDI contributes to an initial inhomogeneity in the distribution of the income, it subsequently leads to a spread of economic development and, in the long run, also facilitates a more even distribution of the income in developing countries, through it development effects (Tsai 1995; Chen 2017).

Furthermore, since the capital provided by FDI not only increases countries' productivity capital stock, but also changes in their capital-labour ratio, Lin (Lin,

2013) found that FDI inflows should also reduce income inequality in developing countries like China, by reducing returns on capital of labour.

Uneven income distribution may occur both between rural and urban areas and between inland and coastal regions.

In fact, Fan Yanhui and Duan Junshan (2003) showed how the differences in income distribution gap were obvious when analyzing data from rural-urban income inequality and, at the same time, that the impact of FDI on the Gini Coefficient in urban areas was also significantly greater than that in the rural areas. Later in 2016, Chen (2016) also found how FDI, through employment creation for rural unskilled labour, local economic development and knowledge spillovers, contributed to a reduction of income inequality, in particular urban-rural inhomogeneous income distribution.

It is important to note that literature focusing on income inequality and its relationship with FDI in China not only focused on urban-rural income distribution, but a considerable amount of studies was also conducted of uneven income distribution between the inland regions and coastal regions. The most important of which is the study conducted by Wan et al. (2007) finding that the effects of FDI contribute to a strong and positive share of regional inequality. Ouyang Lihua (2006) also revealed that the economy benefits brought by FDI were mostly directed to more developed eastern regions, rather than the internal ones, and to industry groups with high-level knowledge.

However, although the significant inhomogeneity in income distribution over the years, it is necessary to note that there was a strong increase in incomes, even if only in specific and limited areas, therefore it can still be accounted as an effect of FDI on economic growth.

4.2.3 Urbanization

Along with the ongoing economic growth, China also experienced a rapid increase of urbanization, i.e. the process of migration from rural to urban areas, resulting in a higher population concentration in urban areas. According to data

on the permanent population urbanization rate, the level of urbanization in China increased from 17.92 % in 1978 to 58.52 % by the end of 2017 (NBS 1978; NBS 2018).

One of the most common reason for urbanization in developing countries is a change in the national economy, due to the development of the economic structure, that led to a decline of the primary sector and a significant increase in the development and productivity of the secondary and tertiary sector.

Moreover, there are many other forces driving people to leave the primary sector to work in the secondary and tertiary sectors, migrating from rural to urban areas. According to the theories of Lewis, Fei and Ranis (1954; 1964), one of the factors that makes people leave the agricultural sector to work in the manufacturing sector, resulting in the consequent migration from rural areas to urban areas, is higher wages, also considering the already existing income difference between urban areas and rural areas.

Along with these theories, Todaro (1969) argued that <<even if there are a large number of unemployed people in the city, as long as the expected income in the city is higher than that in the countryside, rural people will flow to urban areas>>. In addition, together with the above theories, further attracting factors of the city life are also to be considered: the chance of a better education, medical services, more technological infrastructures (Wu and Chen, 2016).

However, how does FDI affect urbanization in developing countries? Although FDI theories do not directly address FDI on urbanization, it is necessary to consider that, especially in developing countries, it is expected that FDI will not only contribute to the economic growth and development, but it will also affect the urbanization process of developing countries in three ways:

1. by changing and facilitating the economic structure by contributing to the expansion of the secondary and tertiary sectors;
2. by absorbing surplus rural labour by creating employment in the secondary and tertiary sectors;
3. by offering higher wages and increasing income in urban areas.

It may also happen for some developing countries that FDI has no impact on urbanization: this situation occurs when the investment is mainly directed into the primary sector, like agriculture and natural resource-based industries.

In such cases, workers tend to remain in rural areas, having no impact on urbanization. In some extreme cases, if FDI has predominantly flowed into resource industries, attracting the urban population into rural areas, FDI may even have a negative impact on urbanization (Wu and Chen, 2016).

In China, by the end of 2017, almost 97% of FDI stock flew into the secondary and tertiary sectors (UNCTAD, 2017). FDI plays an important role in China's economic development and structural change, enhancing both push and pull forces for urbanization.

The share of the primary sector in GDP in China decreased from 27.9 % in 1978 to 7.19 % in 2018, while the share of the secondary and tertiary sectors increased from 72.1 % to 92.8%. However, despite the decline of the primary sector, there has been a strong increase in agricultural productivity after the reforms of 1979; in fact, the share of FDI directed to agriculture brought in new technologies, automatized production and efficient resource allocation. The progressive decline but, at the same time, increasing developing of this sector led to a huge surplus of rural workers, forced to move into urban areas looking for new employments.

Another reason for urbanization in China because of FDI inflows is the process of land acquisition (Li et al., 2016): it is a common practice in China, aimed at promoting economic growth and it consisted in the government acquiring rural land to be leased to urban business (especially, FDI firms). Data show that almost 2 million Chinese farmers lost their land each year: in fact, when a leasing agreement was reached, farmers received a compensation for the lost land and to be encouraged to start again in the cities (UNCTAD, various years).

Many studies in literature discussed the impact of FDI on urbanization in China. However, some of these studies only focused on either a limited number of cities (Chubarov and Brooker, 2013; Kang and Qi, 2013) or on a particular region (Feng, 2011).

All the studies (Wu and Chen, 2016; Chen and Wu, 2019; Shi and Hamnett, 2002) confirmed the positive effects of FDI on urbanization in the coastal regions but no

significant impact in the inland regions: this is due to the fact that inward FDI flew more in some regions rather than in others, also contributing to a more severe difference of urbanization rates between coastal and inland regions in China. In fact, the inland region not only attracted a smaller amount of FDI inflows, but the most of inward FDI was directed to resource-based and agriculture-related industries, which may retain surplus rural labour in the rural areas, thus having no impact on urbanization (UNCTAD, various years).

However, not only thanks to the inward FDI but also to the government's policies, the phenomenon of urbanization has been growing: in fact, accelerating the transfer of rural surplus labour to urban areas and encouraging the transfer of population from rural areas to cities are still one of the most important and long-term tasks in China. In order to increase the urban population, China launched in March 2014 a project called "New-type Urbanization Plan" (NUP), whose goals are to be accomplished by 2020 and it aims at increasing the urbanization rate from the current level of 53.7% to 60% (Cheshmehzangi, 2016).

Conclusion

The aim of this thesis was to assess whether there was any relationship between the convergence of Chinese accounting standards with IFRS and the economic growth in China. It is based on the models of the studies available in literature but, at the same time, aims at collecting and providing more updated data, at integrating the study with the analysis of more aspects (usually not taken into account in literature), such as the sectorial distribution of the FDI and at analyzing new developments in the Chinese economy not yet occurred in the period in which past studies were conducted.

In order to support this hypothesis, the level of inward FDI was evaluated since in the years after the convergence, due to the increase comparability and transparency of Chinese financial statements, foreign investments soon started to consistently increase, becoming one of the main factors driving economic growth. Obviously, there were also other factors that contributed to the Chinese economic development, such as a great deal of rural labour force transfers to non-agricultural industries, the speeding up of urbanization, the implementation of export-oriented open-up policies, the improvement of human capital, high savings and investment and continuously improved economic structures.

This thesis gave evidence of the plausibility of this hypothesis since, analyzing the level of inward FDI from the beginning of the process of convergence until 2017, the increase of this value is undeniably strong.

In fact, the increase of the level of FDI can influence areas such export promotion, especially through processing trade, but also by providing competitive assets for export-oriented production and by allowing China to gain access to new and larger markets; income distribution, through the impact on industrial structures and creation of employment, even if it tends to promote inhomogeneous income distribution in the country; and urbanization, by concentrating investments in the secondary and tertiary sector, making people move from rural areas to urban areas.

These areas have been strongly influenced by FDI and, since they are closely linked to economic development, it is possible to argue that the two factors are connected.

However, much is yet to be accomplished for IFRS to work perfectly in China in order to attract more FDI and keep promoting economic development; therefore, further developments in both accounting field and investing management are needed.

First of all, as literature suggests, more attention should be paid on implementation and institutional settings: in countries like China, where IFRS is hard to be implemented, the benefits of convergence tend to be weak, according to the theory that the effectiveness of high-quality accounting standards strongly depends on managers' reporting incentives. Since China has always been characterized by poor investor protection, weak rule of law and low audit quality, its institutional setting creates weak incentives for managers to produce high quality financial statements.

Another important implication is on the enforcement, which allows the ensure of an efficient market, resulting in a further attraction of investors, both domestically and internationally.

In addition, an even great responsibility is given to standard setters: it is important for standard setters to consider the potential economic consequences of IFRS, because the high or low costs for firms may affect the demand, acceptance and implementation. The problem is that standard setters are often under political pressure, exerted by government, society, investors or large multinational companies (MNCs are listed among the most influential source advocating for accounting convergence since an uniform accounting system helps firms to communicate information to investors), aimed at guaranteeing that the revision of accounting standards will create positive economic consequences.

In conclusion, the role played by policy makers is also extremely important. In fact, the objectives of IASB reveal that the policy makers place emphasis on the positive economic consequences of the convergence, including more efficient equity and capital markets as a result of enhanced financial reporting transparency and comparability. In particular, the ultimate objectives of the policy

makers include higher market liquidity, lower costs of capital and increased cross-border investment. From a policy perspective, IFRS alone is not enough to attract FDI inflows, therefore it is necessary for them to constantly improve country's location advantage, but also to improve domestic financial system, becoming more effective in channeling and transforming the advantages of FDI inflows in economic development.

Chinese government should also keep promoting policies including both fiscal and financial incentives to attract investments.

Anyway, there is no guarantee that this would further improve neither the convergence process nor the Chinese growth that, although still characterized by a growing economy, seems to be more stable.

Given the fact that literature offers controversial results, it is possible to affirm that literature still lacks an overall and reliable research assessing whether the convergence of Chinese accounting standards with IFRS had any effects on economic growth; moreover, considering the limited number of studies conducted, the topic needs further researches.

Acknowledgements

In China, they say: “千里之行，始於足下”, *a journey of thousand miles begins with a single step.* I would like to start from here.

First of all, I must thank Professor Michela Cordazzo, who helped me to achieve this goal: for her advice, her assurances and her constant guidance, but also her willingness to do all of this even when I was on the other side of the world.

I would like to extend my thanks to my family: mamma Daniela, papà Diego e Giulia. I wouldn’t be here if it wasn’t for you. Thank you for always believing I could be someone, thank you for letting me travel and experience the world, and for always reminding me that anyone can have roots, but not everyone is brave enough to have wings. You cannot forget about those who will love you at highs, but especially at your lows.

Throughout this path, my second family, “Casa2”, has also been fundamental for my achievements. Thank you for making every night special and everyday different, you were my home away from home.
A special mention goes to Federica for her special 24/7 support, and Sara that made everything easier, they both taught me that, as long as you are surrounded by the right people, you can have fun and feel good even if you live in Mestre.
In winter.

Thank you, Laura, for being such an incredible flatmate and friend. Thank you for everything we shared because it will always have a special place in my heart.

I would also like to thank everyone who stood by my side during this last year abroad, in Paris and Beijing. In particular, to Alessandra, Mary and Margherita: you were there when I was facing a hard time of my life, but you always reminded me how beautiful life can be when you eat 饺子 after clubbing.

Then, to my special one. Steven, thank you because you made me realize who I really am and who I want to become, and because you reminded me that, as long as I believe in myself, I can achieve anything. Thank you because you are always my biggest supporter and I owe you so much.

Last, but not least, I want to be thankful to that part of myself that always pushed me to strive towards my goals. I know I am still far away from becoming the strong and successful woman I would like to be, but I am trying to achieve the best version of myself day by day.

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