

# The Analysis of Foreign Investment in China-Based on the Research of Current Situation

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**Abstract** –The topic of this essay is “The Foreign Investment in China”. It includes main four parts. First, the paper analyzes the current situation of foreign Investment in China. Second, it raises the main reasons why foreign investment into China. Third, there are also some problems on foreign investment which influence China’s environment and economy. Finally, the paper analyzes the solving measures and how to coping these problems suitably. This article uses the interpretation of the inductive analysis and graphical analysis, in order to find methods about how to develop foreign investment in China more correctly and efficiently.

**Keywords** –Foreign Investment; legal environment; politics; strategies

## 1. Introduction

With the development of reforming and opening up for thirty years, China's foreign investment has made great achievements in many aspects. Foreign investment plays an important role in China's economic development. However, facing the new current international environment, China still has some problems in the process of the foreign capital utilization, which cannot be ignored.

Different types of countries and regions in the world provide a good model of use foreign capital and technology to realize the economic development for China to use foreign capital. With the background of the economy ties the increasing internationalization, any developing countries cannot get all of the resources for its needs in the conditions of completely closed to other countries in the economic development situation. Foreign investment enterprises are playing an increasingly important role in promoting the growth of national economy, promoting industrial technology progress, expanding exports and providing employment opportunities.

The purpose of this paper is to find out the problems about foreign investment in China and how to coping these problems correctly based on the analysis of current situations and reasons related to foreign investment in China.

## 2. Concepts related to Foreign Investment

### 2.1. Foreign investment

Yang (2000) raises that foreign investment within the concept contains "To use the foreign capital, including tangible goods, services and technology, which is used to develop their economy and improve their economic growth". Lin and Cai (2003) divides the foreign investment into four types:

The first is the foreign loans; the second is the introduction of foreign direct investment; the third is using other foreign investment, including compensation trade, international leasing; the forth is to accept foreign donations, including foreign governments, international organizations, other economic organizations and individuals to provide free aid

The illustration of this paper is foreign direct investment referred to foreign enterprises, economic organizations or individuals (including overseas Chinese, Hong Kong, Macao and Taiwan compatriots and Chinese registered enterprises overseas) in the Chinese territory of opening whole foreign owned enterprises. It also contains the approval relevant department projects of the government and the total investment, which is borrowed from foreign capital enterprises.

### 2.2. Foreign economy

Sang (2006) states that "foreign investment economy is pointed to foreign investors, which is short for foreign economy" This paper raises that foreign economy includes Hong Kong, Macao and Taiwan investors according to China's relevant foreign laws, rules and regulations. As a joint venture, cooperation or wholly owned form in China started businesses, it has produced the formation of non-public sectors of the economy. There are three main forms, namely foreign joint venture, Sino-foreign cooperative enterprise or a wholly foreign owned enterprise, which referred to as "foreign invested enterprise" collectively and also called the enterprise with foreign investment.

## 3. The analysis of the current situation of foreign Investment in China

### 3.1. The quantity of foreign investment in China

Chen (2005) states that the real significance of introducing large scale foreign capital is after 1979. To the end of 2006, more than 480 of the world's top 500 translation company have invested in China or set an organization, in various forms of R&D center. Cui (2008) calculates that foreign investment enterprise income tax was up to 153.48 billion yuan, accounting for 21.68% of the total amount of foreign and national tax, and has employed more than 2000 employees to 2007. Li (2002)

states by March 2010, China is engaged in international investment and management of all kinds of enterprises, which have developed to more than 600 thousand. In addition, investment in foreign has expanded to more than 180 countries and regions, and the total amount of foreign direct investment was up to 890.428 billion dollars.

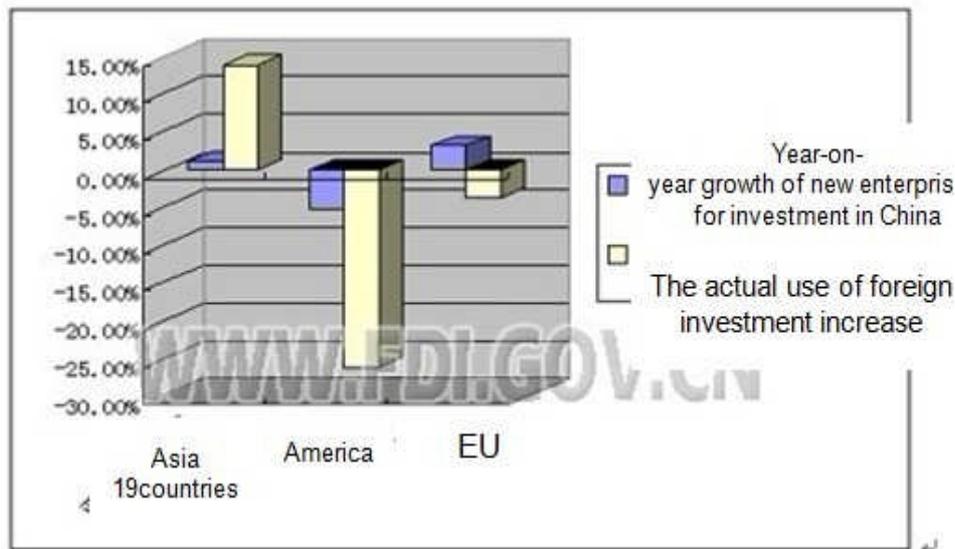


Figure1. 2011 China-invested enterprises and actual use of foreign capital

The figure1 shows the Asia 19 countries invest more capital in China. The most outstanding feature of the graph is the actual use of America decreased 25% of the whole capital. The Europe investment capital decreased 5%. In China, The foreign investment Europe and the United States has shrunk because of the new round of financial crisis in Europe.

### 3.2. Political and legal environment analysis

Luo(2009) states that the role of government: including government policies, clean and efficient civil service, and the attitude to foreign investment, efficiency, and social security. China's economic system is transferring from a planned economy to a market economic system, currently in the perfect stage of the socialist market economic system. During this period, government intervention in the economy is the guiding indirect control, control efforts are constantly enhanced. Not only China, but also the Southeast Asian economic development model is an important aspect of the role of government in promoting the development of the great economic, can be called a government-led economic development. Wang(2010)points that "even western market economy countries, since the economic crisis in the thirties, the power of the government is growing, and its economic system has become a mixed economic system". Therefore, the government's role is an important variable to affect foreign direct investment. China's central management system with high concentration is undoubtedly in this way. Clean and efficient civil service

is the main body of the exercise of governmental power, they play part in economic development planning, coordination and supervision. This role have a direct impact on foreign investment, the civil service of the foreign service, service quality, the development of foreign investment industrial policies for foreign capital management, will affect the access of foreign investors.

Zhang and Long (2011) argue that on behalf of the government dealing with foreign direct investment and the quality of personnel actions, also in foreign directly influence the local government's image and credibility, the credibility of the government affect foreign direct investment is one of the factors. Government efficiency impact on foreign investment: investment in the implementation and business process to handle the matters to be government efficiency. Procedures with conciseness and efficient reduce the foreign transaction fees. The government's preferential policies for foreign earnings are reflected from the tilt that in the same income, who enjoy preferential policies to increase real income and disposable wealth. Therefore, the preferential policies for foreign investors have a strong appeal.

Tax Receive benefits is one of the preferential policies, such as many parts of the introduction of income tax, value added tax and export tax rebates. In many preferential policies it gives itself a super-national treatment of foreign enterprises, and the soil around the introduction to transfer the preferential use of payments, etc., from foreign firms substantially increased the potential income, as Important weight in attracting foreign investment. Social security system mainly

reduces the risk of foreign property, foreign investment and stability. Local social security situation is an important reference factors for foreign investment. As a developing country, China's economic growth rate is rapid, which has formed a strong attraction to foreign investors. The author states the stability of the economic policy and the Chinese market rules gradually integrated with the international regulations, which are advancing to a stable direction, more in line with the desire of the foreign investors.

### 3.3. Economic analysis

The GDP growth rate represents the strength of the local economy and economic development level and wealth of residents, reflecting local market capacity and potential. Occupation of foreign direct investment in overseas markets is one of the main objectives, there is a market place and the market potential entry of foreign capital will be induced. Therefore, the economic strength is becoming the basis for attracting foreign investment, and those foreign investors tend to place strong economic strength is an obvious example in reality. On the other hand, foreign investment and local economic growth will form the strength of the interaction.

Some studies have shown that foreign investments give rise to substitution of efficient producers for inefficient ones especially through international companies. Empirical evidences suggest that in countries where there are no specific barriers against trading and

investment and the economic environment is favorable for private sector activities (both internal and external), international companies have positive effects on allocation of resources.

Hu (2010) finds that "there is a positive correlation between GDP and FDI, which is the annual GDP growth 1%, the corresponding growth in FDI inflows 1.24%". Economic growth is also reflected local economic vitality. Foreign investment prefers these places where have many economic activities, a corresponding reduction in investment risk. This will increase the expected return of foreign investment, increase investor confidence.

## 4. The reasons why Foreign enterprises and investors choose to invest in China

### 4.1 Human resources

Labor is an important factor of production. Abundant and cheap foreign labor is the most attractive aspect and the most advantageous investment environment factors. Educational level of workers determines the overall quality of the labor force. Standards of professional and technical personnel of enterprises and the proportion of technical capacity are also important. In recent years, the wage of Chinese workers is higher than before, but it is still the low level of world.

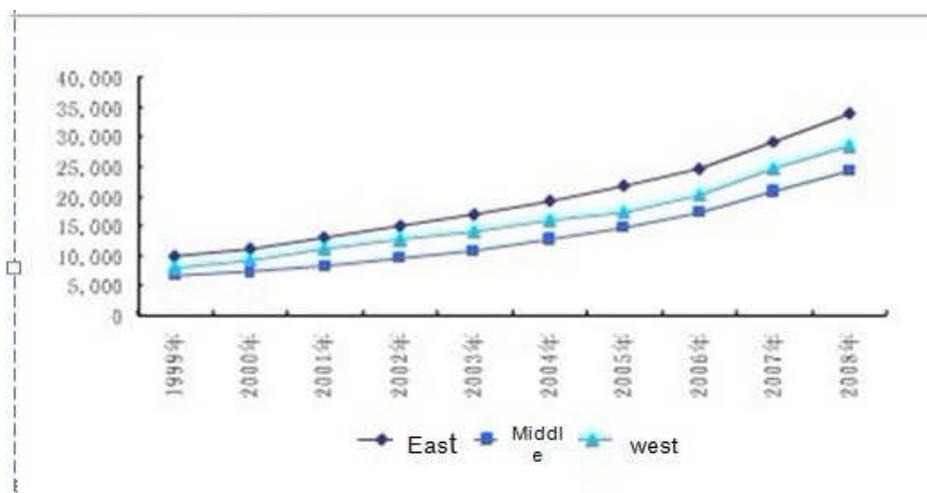


Figure 2. The average wage of the central and western regions

The chart above shows the average wage of the central and western regions from 1999 to 2008. The labor cost is rising, but the average wage is nearly 40000RMB in the whole year of 2008. It is far lower than western countries. In summary, the low labor costs is an important factor to appeal foreign investment. Investment in human resources for the environmental impact is manifold: the quantitative impact of the production scale of labor and production costs, also affect the choice of labor foreign-funded enterprises. Labor wages have a direct impact on production costs, due to wage rigidity, wages high, fast-growing, competitive products backward. Labor relations and the power of collective bargaining between employers and employees ultimately affect and determine

the cost of production. Meanwhile, the tense labor relations, production and threatened the stability of foreign labor relations will avoid bad places. The main function of trade unions is to protect the interests of labor, but the different objectives of trade unions have different effects on foreign investment.

### 4.2. Infrastructure

Infrastructure is essential which includes transport, communications, electricity, water and other public infrastructure. Foreign investment in infrastructure is needed to hard environment, foreign-invested enterprises established and normal operation of material support. To attract foreign investment into local production and

management, infrastructure is a prerequisite. If there is no basic water, electricity, communications, transportation security, not only foreign capital will not enter, but also local enterprises cannot survive. Ma(2003) found that "improving the investment environment, the first is to speed up infrastructure construction"(3). Years of efforts by local governments, China's major infrastructure supply and demand tension come to a certain degree of ease and its impact on the investment environment is gradually reduced. As China's regional and local differences in the degree of differences in basic facilities, a local infrastructure of the local investment environment will be different. Infrastructure around the differences in the degree of perfection, still affect the location choice of foreign direct investment and this is one important factor.

### **4.3 Integrate resources by mergers and acquisitions**

In recent years, multinational companies have always been interested in merger between developed and developing countries, which shows a keen interest in investing in China by mergers and acquisitions gradually. Shan(2011) argues that a lot big companies need to integrate resources all around the world. There are many small companies with a lot of workers in China, and the multinational companies need labor, which also lead to much capital of foreign investment flowing into China. With the growth of Chinese economy keeping rising in a high speed, the western enterprises realize that China's economic value and importance in the international economic system, which has led to the increase of investment in China in order to speed up the occupation of China the market and make up for the gap of other countries' investment in China. Compared with creation, the cross-border mergers and acquisitions has the advantages of less investment and quickly achievements. Merger and acquisition make the multinational companies enter the market of our country quickly.

## **5. Several problems of foreign investment in China**

### **5.1. Low quality and efficiency in the utilization of foreign capital**

Some localities, departments and enterprises pursue the quantity of foreign investment blindly, and even ignore the cost and the consequences in recent years. Li(2008)points that "There are still many places putting one-sided emphasis on quantity, regardless paying attention to the tendency of the actual effectiveness of using foreign capital in China"(102). Foreign direct investment projects leads to low-tech investment in small-scale. Some local governments do not attach importance to the practical effect of foreign capital, which will lead foreign capital to a mere formality. In addition, some local governments take the amount of foreign investment as a measure of the performance indicators. In the process of pursuit performance, the blind introduction of foreign capital and the keen on

economic development zone, hi-tech development zones and industrial parks, has led to some projects of low-level, negative impact, high pollution. Xia(2010) raises that "The introduction of foreign investment and the use of foreign direct investment on China's overall implementation of the strategy had a negative impact in many aspects". In our large-scale foreign capital, a considerable portion is still a relatively low level of technology, which is generally labor-intensive processing project, and the quality of project is low, that is to say, the quantity of large-scale capital projects and higher level of technology is relatively few.

### **5.2. The orientation of foreign investment is unreasonable**

The structure of foreign investment is not reasonable, which is the most important part in the foreign investment. Lu(2011) argues that "After the reforms, the state adjusted policies several times to guide and encourage foreign companies to invest needed industrial projects". These actions have made great achievements in some areas, but the current situation is that the foreign investment structure is still not rational. At present, China's urgent need is to develop industries such as energy extractive industry, which is just a small proportion of foreign investment. To the contrast, the foreign manufacturing absorbed significantly higher proportion and the number of processing industries accounted for a larger proportion. Such enterprises have used a lot of cheap land, labor, energy and raw materials stimulated by a variety of preferential policies. These actions in part exacerbated domestic energy and raw materials supply tension, and a considerable number of enterprises have polluted the environment very seriously.

The foreign direct investment in primary industry has low proportion of total investment, such as agriculture, forestry, animal husbandry and fishery industry. Wei(2002) found "The proportion of foreign investment in the tertiary industry, commercial food services and transportation is about 3 percent". Yan(2008) points that "a larger proportion of the real estate industry has been more than 11%", while the proportion of high-level scientific and technological research is very small, which is not reach the goal of attracting foreign advanced technology. Consider to the technology-intensive degree, foreign investment mainly put into labor-intensive industries, while the investment scale about capital-intensive and technology-intensive industries is relatively small. This is determined by the fundamental purpose of foreign investment in China. Thus, foreign investors tend to invest short-term, quick and low risk industries, while ignore those infrastructure sectors, which are long time, slow efficiency and high risk. Direct investment in China is mainly concentrated in the second industry. The investment is more positively in the manufacturing industry and energy development especially. Among them, the investment in the manufacturing of computer and electronic products, chemical, transportation equipment accounted for a relatively large.

The regional distribution of foreign direct investment is also not rational. In the past few years, Wang(2010)

raises that “foreign direct investment projects and funding are located in economically developed regions and eastern coastal areas”. The central and western regions where the economy is relatively backward has absorbed a very small proportion of foreign investment. Although there have been changes in recent years, foreign direct investment enterprises in the western region accounted for the local share of total output is still below the national average and the level of the eastern region. In addition, the quantity of large multinational investment projects is relatively less compared with other places. The regional distribution is not balanced. At present, the United States invested in China is mainly concentrated in the East District which is around Chang Jiang River and in the North District which is around the Bohai sea. Although the pace of investment in center-west region to be accelerated somewhat, but it is still in the secondary position.

## **6. The coping strategies about the problems of foreign investment in China**

### **6.1. Strengthen policy coordination and promote balanced development**

Foreign investment should be encouraged in advanced manufacturing industries and high-tech industries. China's current capital is relatively abundant with sufficient foreign exchange reserves, and international trade has balance every year, in addition, the gap of construction fund is small. In this case, the focus should turn to the high-tech foreign capital and advanced management, in order to encourage the foreign-funded enterprises in China to enhance the research and development capabilities. Zhu (2010) argues that upgrading the domestic industries and accelerating services liberalization to promote foreign investment flow are necessary in modern service industry (77). In addition, advanced agricultural industrialization develops production management techniques, focusing on the development of green agriculture, in order to optimize foreign investment. It is also important to improve the market economic system and investment environment, in order to develop a strategy about correcting foreign capital investment re-regulate behavior, improve the comprehensive investment environment for foreign investors, improve the quality and level of utilization of foreign capital.

### **6.2. To promote the China's industrial upgrading**

On the policy side, Shi (2011) points that it is necessary to support foreign investors entering the labor-intensive industries continuously and implement optimization and upgrading of industries management according to different regions and different industries(4). According to different levels of development situations, local government should encourage some of the existing labor-intensive enterprises in the eastern region with foreign investment moving to central and western regions. On the eastern to western re-investment of labor-intensive

areas of foreign-invested enterprises may consider re-granting preferential policies to foreign investment policy of certain industries and regions, and combine the tilt effectively. In addition, resource conservation and environmental protection should be in accordance with the requirements of the development new industry regulations and we should also access the requirements. It is suitable for China to build industrial structure on the basis of the growth mode conversion.

In the process of attracting foreign investment, government should also pay attention to balance China's regional economic structure, and achieve balanced development between regions. Xu, Zhou and Shan(2009) states that Chinese enterprises should use the foreign direct investment policy based on the advantages for the central and western regions and industry characteristics, in order to further develop and improve the central and western policy to attract foreign capital(3). Central and western regions should integrate their resources, labor advantages and market potential to encourage and guide foreign investment in resource development projects and related infrastructure actively. In addition, it is a good way for government to continue supporting foreign investment in high-quality and labor-intensive industries. Meanwhile, the middle and west regions have a complete range of industrial foundation, and it may be an appropriate method to introduce a number of capital and technology intensive projects. It is also a suitable reform to renovate the existing old foreign investment enterprises to a new industrial system.

### **6.3. To create a more attractive environment for foreign investment**

It is a very comprehensive work when using the foreign capital. On one hand, it is needed to create conditions to attract foreign investment actively; On the other hand, Taking other measures to absorb the introduction of foreign capital is also important. The ultimate goal is to use foreign investment to promote economic growth. Thus, in the process of utilizing foreign capital, Yang (2000) points that government needs to promote the coordination of other policies and foreign investment policy actively, and further improve the investment environment in order to grasp the utilities, transportation, communications, which based on the hard environment (134). Legal basis, the legislative process, and the operating mechanism are not yet fully transition to a market economy. There are a number of relevant laws and regulations which go against the principles of market economy and the market economy .There are also some problems about the terms of the implementation process, which cause the biggest obstacles to the enterprises with foreign investment that operated in the environment of market economy. Therefore, on the foundation of classification and the cleaning up of the existing foreign investment legal, it is important to reserve, mergers and cancel same items reasonable. It is also necessary to pay attention to the improvement of China's administrative environment.

#### 6.4. Pay attention to the environmental protection

Considering about environmental factors, the effects of foreign direct investment in the evaluation will be changed. A large number of foreign investors has shifted pollution-intensive industries to China. Liu and Li(2008) found that most enterprises have invested in China directly under the guise of dumping of hazardous waste; transfer of the negative impact of imperfect high-tech(3). As a result, China imports imperfect technology, which has affected China's natural environment. Government and local business must pay attention to the introduction of the negative impact of GM technology and monopoly of important economic resources typically. These behaviors have led to the deterioration of China's environment directly, which should be paid enough attention to it. It is also essential for government to attract foreign investment reasonably, make greater efforts to standardize and use the foreign investment rationally, which is playing a crucial role in the economic development.

#### 7. Conclusion

This paper shows China's utilization of foreign investment and raises government and enterprises should consider about the current problems in the current problems in the process of how to implement the scientific concept of development comprehensively, how to improve the quality and level of foreign investment, and how to promote comprehensive, coordinated and sustainable development of society. It has become the urgent problem to study and solve.

Based on the analysis above, the author proposes some solutions about how to handle problems brought by foreign investment in China, but the problem of the imbalance of foreign investment in the industrial structure cannot be solved in a short time. It is necessary to do more further explores in future [6-10].

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