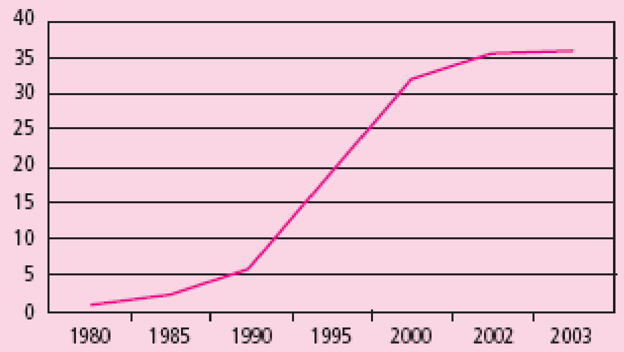
FDI Bonanza in China

Case taken from The International Business Environment, second edition (Palgrave, 2006), by Janet Morrison

China has become the new workshop of the world, its factories churning out consumer goods for both domestic consumption and export. Its own growing middle class is a huge market in itself, but more important are growing export markets, in which Chinese production costs undercut virtually all rival locations. Inflows of FDI reached a record $52.7bn. in 2002, followed by $53.5bn. in 2003. This has been a key factor in China's success and low-cost labour has been the chief attraction for foreign investors. The opening of the economy began in 1979, when China's Communist Party rulers introduced economic liberalization policies which were to gradually reduce state ownership and control. These reforms paved the way for outside investors to enter China through joint ventures with local companies. Foreign ownership restrictions have been further relaxed in recent years, and, combined with WTO membership in 2002, China's attraction for foreign investors has continued to rise. As the figure shows, inward FDI stock has rapidly risen from virtually nil in 1980 to 35.6 per cent of GDP in 2003. Labour costs have risen in other Southeast Asian economies, including Taiwan and South Korea, and these economies have consequently lost out to China as a manufacturing location, where the cost of unskilled labour undercuts all but Indonesia, Vietnam and Cambodia.



Inward FDI in China as a percentage of GDP

Source of data: United Nations, *World Investment Report 2004* (Geneva: UN), Annex table B.6.

FDI has concentrated in the southern coastal area of the Pearl River delta, which has seen booming industrialization, made possible by a seemingly endless supplies of workers. In this area, approximately the size of Belgium, 30 million people work in manufacturing, producing a vast range of products from shoes to computers. The area is home to 800 shoe manufacturers. One of the largest, the Taiwanese company Pou Chen, employs a total of 110,000 workers, 80,000 in one factory, producing 100 million pairs of shoes a year for brands including Nike, Adidas, Timberland and Reebok. It is estimated that 80 per cent of the stock of FDI in China is held by overseas Chinese investors, mainly from Hong Kong, Taiwan and Singapore (Story, 2003). These investors have seized the opportunities presented by liberalization, and their Chinese cultural heritage gives them an advantage over other foreign investors.

Dr Martens, the British shoe manufacturer, concluded in 2003 that it could not compete unless it, too, shifted production to China. Dr Martens was paying workers $490 per week in its factory in the UK, where assembly of whole shoes was carried out by small groups of workers. By contrast, mass production techniques are used in the massive Pou Chen factories, where workers earn about $96 (£59; a89) a month for a 69-hour week.

High-tech industries are also flourishing. Flextronics, a Singapore-based electronics manufacturer, is a contract producer for Microsoft, Motorola, Dell and Sony Ericsson. The output of its factory near Zhuhai rose 500 per cent from 2001 to 2002. Ricoh, the Japanese electronics company, makes most of its photocopiers in the Shenzhen special economic zone, which claims to make 70 per cent of the world's photocopiers. While it used to make all its newer models in Japan, Ricoh now uses the Chinese factory to manufacture models only months after they begin production in Japan.

Whether FDI flows will continue to rise is a question which concerns both Chinese policymakers and foreign investors. Labour costs are inevitably rising. More highly skilled work in technology-based industries lures workers away from the likes of the shoe factories, which find it hard to retain workers. A solution adopted by Pou Chen is to build factories further inland, where labour is in abundant supply. One manufacturer explains: 'If we run out of people, we just go deeper into China' (Roberts and Kynge, 2003). It is estimated that there is a pool of some 200 million rural inhabitants who are underemployed: while they are a source of labour for manufacturing expansion, they are also a potential source of social unrest, should economic growth falter. Jobs provided by the continued manufacturing boom would bring economic development to these poorer areas. On the other hand, China's economic liberalization has not been paralleled by political liberalization. The long-term economic prosperity of its people will require its political and social institutions to adapt to the rapidly changing environment.

Sources: Kynge, J. 'An industrial powerhouse emerges by the waterfront', Financial Times, 23 January 2003; Roberts, D. and Kynge, J. 'How cheap labour, foreign investment and rapid industrialization are creating a new workshop of the world', Financial Times, 4 February 2003; Story, J. (2003) China: the Race to Market (Harlow: FT Prentice Hall); United Nations (2004) World Investment Report 2004 (Geneva: UN).

Case questions

What are the factors in China's FDI boom?

How likely is it to continue?

@Briefing on the national business environment in China can be found on the World Bank's website at http://www.worldbank.org/en/country/china

@The Office of the US Trade Representative, at http://www.ustr.gov , also provides briefing documents on national investment climate