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The Impact of FDI on Chinese Industries and Our Coping Strategies

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Abstract. Foreign direct investment has played an important role in promoting China's economic development, however, the negative impact of foreign direct investment on Chinese industries can not be ignored. With the influx of foreign direct investment, the controlling rate of foreign investment over Chinese enterprises has greatly increased, which constitutes a barrier effect on independent development of national industries and technological innovation. From perspective of the stock ownership control rate of foreign investment, an enterprise is relatively controlled if the stock ownership controlling rate exceeds 20%, it is absolutely controlled if the stock ownership control rate exceeds 50%.The controlling rate of FDI over Chinese enterprises of equipment manufacturing and high-tech industry is higher than overall industrial controlling rate. As a result, Chinese industry may lose independent innovation and self-development capacity. The Countermeasures to maintain Chinese industrial security are the government should create a suitable survival and development environment for the strategic industries.

Keywords: foreign direct investment, controlling rate, strategic industry, mergers and acquisitions

1. Introduction

Utilization of foreign investment is an important part of the reform and opening up policy of China. From the beginning of reform and opening up to today, China's utilization of foreign investment is divided into four stages. 1979-1982 is the initial stage, 1983-1991 is the growth stage, 1992-2001 is the improving stage, it is the steady development stage since 2002. From 1979 to 1991, China's foreign direct investment remained stable changes, the maximum value is only reached $ 4.366 billion. From 1992 to 2001, China's actual utilization of foreign direct investment increased from $ 11.008 billion to $ 46.878 billion. Since 2002, China's actual utilization of foreign direct investment has experienced a decade of rapid growth.

Table 1: 2006-2012 China's utilization of FDI situation

Year	Number of items	utilization of FDI /$ one billion
2006	41485	69.468
2007	37871	74.768
2008	27514	92.395
2009	23435	90.033
2010	27406	105.735
2011	27712	116.011
2012	24925	111.716

Source: http://www.fdi.gov.cn/pub/FDI/default.htm

Foreign direct investment has played an important role in promoting China's economic development, however, the negative impact of foreign direct investment on Chinese industries can not be ignored. With the influx of foreign direct investment, the controlling rate of foreign investment over Chinese enterprises has greatly increased, which constitutes a barrier effect on independent development of national industries and technological innovation. In accordance with the prevailing international standards, the general external trade dependency index of a country's economy should not exceed 20% -25%, the dependency index on FDI should not exceed 5%, the warning line of the market share of foreign industrial enterprises is 30% in the international community.[1] From perspective of the stock ownership control rate of foreign investment, an enterprise is relatively controlled if the stock ownership controlling rate exceeds 20%, it is absolutely controlled if the stock ownership control rate exceeds 50%.[2]

The controlling rate of foreign investment over Chinese enterprises can be evaluated by following index, see Table 2 and Table 3.

2. The Negative Impact of High Controlling Rate of FDI over Chinese Industry

The controlling rate of FDI over Chinese enterprises of equipment manufacturing and high-tech industry is higher than overall industrial controlling rate. The adverse effects of the control of foreign investment over Chinese strategic industry is that china can not obtain core technology and key technology when our leading enterprises are controlled, technology research and develop activities still carried on in home country. As a result, Chinese industry may lose independent innovation and self-development capacity. Specifically speaking, the adverse effects include the following aspects.

Table 2: 2000 ~ 2009 controlling rate of foreign investment over Chinese enterprises of equipment manufacturing (Unit: %).

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Market		43	44.3	44.9	49.5	51.5	52.9	52.3	51.4	47.8	44
Stock Ownership		37.2	38.2	38.5	41.2	44.1	46.1	46.7	46.2	44.1	41.5
Technology	Invention Patents	23	18.1	25.9	27.7	24.9	30.1	33.4	41.4	30	-
	Research and Development Expenses	29.5	26.4	27.4	30.6	34.6	36.8	37.1	38.2	32.9	-
	The Output Value of New Products	43.9	46.3	46.1	47.5	51.5	51.4	52.8	53.6	50.6	-
Total Assets		32.2	33.1	34	37.3	40	43.1	43.7	44.4	41.5	39.9
Fixed Assets Net Value		33.9	37.3	38.3	40.7	43.6	47.3	49	50.4	48.3	43.8

Source: China Statistical Yearbook (2001 ~ 2010) and China Science and Technology Statistical Yearbook (2001 ~ 2010)

Table 3: 2000 ~ 2009 controlling rate of foreign investment over Chinese high-tech industry (Unit: %)

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Market		59.9	61.4	61.9	67.3	74	73.1	72.4	73	70.4	65.7
Technology	Invention Patents	30.2	23.7	23.8	38.7	38.8	28.7	42.6	48.3	36.5	28.9
	Research and Development Expenses	28.8	28.7	32.6	34.1	41.6	42.1	44.2	44.5	41.1	36.9

	The Output Value of New Products	57.2	64	63.5	57.8	68.4	66.5	69.1	70	69.5	56.9
Total Assets		38.1	44.7	36.1	53.7	62.4	64.0	65.2	68.9	67.6	61.5

Source: China High-tech Industry Statistical Yearbook (2001 ~ 2010)

2.1. Technological Progress and Structural Optimization

The high controlling rate of FDI over Chinese strategic industry will prevent technological progress and structural optimization of China’s national industries, which makes it possible that national industries be long-term controlled by transnational corporations in important products and key technologies. The strong technological controlling sense will make transnational corporations to take all means to prevent the outflow of the core technology. The reality shows that foreign multinationals transferred to us are mostly so-called “appropriate technology”, but these technologies are often in the backward and even outdated technologies, the real high-tech or upstream technology is rarely transferred to us. On the other hand, due to over-reliance on foreign parent-shelf technology, domestic enterprises lack motivation of self-development, which makes them failed to play a big role in promoting their technological progress.

2.2. Industrial policy security and military security

If China decides to develop a(some) strategic industry(s) based on the judgment of internatingal and domestic political and economic situation, yet China does not grasp the core technology and the technology can not be bought from abroad, Chinese industrial policy will lapse. This will lead to security problems of the industrial policy. If dual-use technology appears problems mentioned above, it will affect the modernization of china’s military equipment and will endanger China’s military security.

2.3. Virtuous interaction of local economy

According to the Competitive Advantage of Nations, the related and supporting industries are one of the main factors that affect a country's competitive advantage. The value of the related and supporting industries lies not only they can provide inputs to the providing industries by lowest price, more importantly, the proximity in the geographical scope with the leading industries will make they can frequently and rapidly transfer product information and exchange innovative ideas between each other, which will greatly promote the technological upgrading of enterprises and create a virtuous interaction of local economy. If FDI controls the related and supporting industries belonging to the leading industries, it will sever the relationship between them, which will affect the formation of a virtuous interaction of local economy.

2.4. The development of the industry

Some strategic industries (such as high-tech industry) are belonged to the so-called mainstream industries that can meet the needs of the world today, which directly affects the ideal economic development of a country. If one (or some) of the industries are controlled by FDI, the independent innovation capacity of Chinese enterprises will be limited, so an industry may lose the development opportunities, or the enterprise does not have enough users in the market even when it comes into an industry. Obviously, these factors will affect the development of Chinese industries.

2.5. Energy security

Energy industry is one of the strategic industries, it is also the lifeblood of economic development, yet, the energy shortage has increasingly become a worldwide problem. Therefore, the independent innovation capacity in the field of energy often determines whether or not a State could solve the energy problem. For example, South Africa’s oil resources are scarce, but the country launched a series of independent innovation measures in the coal to oil technology field, then it found a good solution to solve the oil supplying security issues. China is also an energy shorted country, so it is necessary to attach importance to the independent innovation capacity in the energy field, and then we should prevent FDI from controlling our energy industry.

3. Our Coping Strategies to maintain Chinese industrial security

Generally speaking, the Countermeasures to maintain Chinese industrial security are the government should create a suitable survival and development environment for the strategic industries. Chinese enterprises should make full use of the environment and enhance competitiveness, which is the most fundamental measure to prevent FDI from controlling Chinese industry.

3.1. Formulating the Laws Relating to Foreign Investment

Foreign mergers and acquisitions system in China is not sound, legislation lags far behind foreign mergers and acquisitions practice, and the laws on industrial security review are almost empty. The rank of current national security censorship laws is low, the legislative authority of them is unknown, the contents of them lack of retionality, stability and clarity, so foreign investors could not reasonably forsee its investment risk, which is not conductive to foreign investors to make investment decision and may ultimately affect our atractiveness to foreign investors. Therefore, I believe, we should learn from the experience of developed countries, combined with China’s specific natioal conditions, to build China’s industrial security review system.

3.2. Market access system

Those industries opened to foreign investment should be opened as quickly as possible to the private sectors, those industries not yet opened to foreign investment should be opened firstly to the private sectors before opening to foreign investment. Market access for private sectors is conducive to play our own advantages, this will help improve competition degree of the opened industries and improve the efficiency of domestic enterprises, then we can prevent domestic industries from being controlled by foreign investment.

3.3. Financial environment

Financing difficulties have greatly influenced the development of the private sectors and it is an important reason for foreign enterprises to achieve mergers and acquisitions over the private sectors with great advantage. In order to maintain industrial security, the private sectors should be given equal treatment with state-owned enterprises. As of the end of 2006, the registered private sector employees in China reached 63.955 million, the private economy accounted for the proportion of gross domestic product (GDP) reached 49.7% and has become half of China's economy; in some areas, the private economy accounted for the proportion of local economy reached 70% to 80%, the main force of the local economy and has become the main force of the local economy. So important an economic power need to obtain the financial resources that match their contribution, which is an inherent requirement of coordinate development.

3.4. Foreign mergers and acquisitions led by the local government

Attracting foreign investment is an important symbol of the political achievements of local government officials. Although this can promote to attract foreign investment, the foreign investment hunger of the local governments will make them attach low importance to the issues of the control of FDI over Chinese industries, which is disadvantageous to the maintenance of Chinese industrial security. Therefore, the evaluation of the political achievements of local government officials must be decoupled from the number of attracting foreign investment.

3.5. Monitoring of foreign mergers and acquisitions

Targeted acquisitions of domestic large-scale backbone enterprises by transnational corporations and those behaviors of obtaining control over domestic enterprises and monopolizing the market must be concerned about and limited. Government can achieve the monitoring of foreign mergers and acquisitions of domestic enterprises by legal, administrative or other means, such as by developing and improving laws and regulations of foreign mergers and acquisitions, defining industry-oriented of foreign mergers and acquisitions, establishing and improving industrial security warning mechanism and so on.

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