Why is foreign investment in china concentrated in the coastal areas essay sample...

It has been widely recognized that the policy in foreign trade and investment in the coastal areas of China is an important factor that contributes to unbalanced economic growth among China’s various regions. Then the obvious question becomes: “ Why is it that such foreign investment is not evenly spread across the areas nationwide, and is instead concentrated in the coastal regions? ” The concentration of foreign investment in the coastal areas is often attributed to the central government’s regional policies that will first benefit some regions, particularly its preferential treatment in these areas.

The following analysis is worth considering. The comparative advantages are playing an important role in attracting foreign investment. The theory of location explains the incentives of multinationals to invest in foreign countries. It claims that the location of production is determined by economic resources, and also by policies of the host countries. Moreover, the main considerations within multinational investment decisions are the comparative advantages of the host areas in terms of production factors, preferential policies and accessibility to the market.

Compared with the central and western areas, China’s coastal region possesses such comparative advantages, which would make the multinationals take returns as much and soon as possible. Certainly, China’s abundant resource of cheap labor is one main attraction to foreign investors. There is a popular illusion that this advantage is more prominent in the central and western areas, which is largely due to the fact that laborers in those areas earn much less money than their counterparts in the coastal areas. This supposition, however, has very little factual basis because labor costs do not refer to wage rates alone.

Labor costs are determined by both the wage rate and labor productivity. Lower wage rates do not only mean lower labor costs if labor productivity is low as well. Similarly, a higher wage rate does not only imply higher labor costs if labor productivity is also high. The general efficiency of the labor force is higher in the coastal areas than it is in the central and western areas. Labor productivities in the coastal areas in three industries were consistently higher than that in the central and western regions during all the periods.

The three industries refer Primary Industry (agricultural and mineral), Secondary Industry (manufacturing), and Tertiary Industry (service sector), Higher productivity strongly correlates with a higher educational level. The number of college students per thousand in the coastal areas was higher than those in the central areas, and also the number of coastal college students in comparison with the western areas was also higher. Accordingly, coastal areas attract foreign investment because higher education has made labor more efficient and productive. Infrastructure is also essential for foreign investors to do business successfully.

Infrastructure facilities, including transportation, communication, electricity, and water supply are more advanced in the coastal areas than that in the central and western areas. In addition, many foreign-invested industries need upstream or downstream industries to provide components or to absorb their products. Therefore, the developed industries in the coastal areas have an advantage to attracting foreign investment. Nevertheless, the value added of secondary industries in the three areas demonstrates a contrast in terms of industrial capacities.

The value added of secondary industries in the coastal areas was higher than that in the central areas, and higher than that in the western areas in the same period. The Coastal Areas are Geographically Convenient for Imports and Exports. Most of the productions made by foreign-invested firms are for export, and most of China's international trade must pass through its seaports. Therefore, the coastal areas are geographically convenient for export. The government's main purpose of attracting foreign investment is to absorb advanced technology and management skills, and to reduce the pressures from its large and redundant labor force.

Like most developing countries, China has been very reluctant to allow foreign investors access to its domestic markets. Since it first permitted foreign direct investment in 1979, the government has worked out a series of state laws and regulations that confirm the export requirements for foreign-invested firms. Since 1986, the State Council has provided favorable tax treatments to those foreign-invested firms that introduce high technology and export their products. In 1995, a guide for foreign investment issued by the Chinese government encouraged only foreign investment that abided by the above requirements.

Furthermore, all foreign-invested firms are required to balance their foreign currency accounts with their own export income. On the other hand, the import of input materials is indispensable for most export producers because

China lacks sufficient mineral and agricultural materials. Due to the above two requirements, the coastal area is naturally a better production location than the central and western areas. Domestic transportation is both costly and unreliable; this further reduces the comparative costs of the coastal areas.

Since construction of new expressways began only in the 1990s, the bulk of land transportation still relies on the antiquated railway system, which is owned by inefficient state companies. The uncertainties of the train schedules, the high damage rates, and the unreasonable charges are more than enough to discourage potential customers from choosing production sites other than the coast. Besides, the coastal areas house the ancestral birthplaces of most overseas Chinese, and such familial and social networks serve to lower operational costs.

Investment by overseas Chinese not only accounts for the lion’s share of total foreign investment in China, but also has a persuadable effect in inducing other investors to follow. According to transaction theory, social-cultural distance is another important factor that affects foreign investment. Social-cultural differences between a potential host country and a potential investor’s home country create enormous information needs, thus raising information costs. Operating in an unfamiliar location also increases business uncertainty and unpredictability.

The problem of high information costs and uncertainties is more pervasive in a country that lacks a sound legal system. China certainly falls into this realm. Foreign investment laws are too simple and too vague to be well implemented in practice. The administrative system is arbitrary, inefficient, and sometimes corrupt. Consequently, the first group of foreign investors was mainly overseas Chinese because their common cultural background enabled them to read between the lines in ambiguous official documents. Relatives in their ancestral villages or towns were also indispensable in helping them to establish and maintain networks.

These advantages lower operational costs for the overseas Chinese, and create a base for generous profits, while many potential non-overseas Chinese investors remained hesitant to invest in China. The fact that most overseas Chinese originally came from the coastal areas, especially from the two provinces of Guangdong and Fujian, has contributed to the location concentration of investment along the coast. After investment by overseas Chinese grew increasingly in the coastal areas, the persuadable effect led many other investors to follow.

The herd effect is actually quite rational, and it can be justified by information externalities of two dimensions. One is an information externality to potential foreign investors, whereby successful pioneering investment reduces uncertainties and encourages others to follow suit. In the case of China, the information externalities also extend to administrative institutions and enterprises in the coastal areas that supervise foreign investment, or to those who are partners of potential joint ventures.

These officials’ and potential partners’ past experience with overseas Chinese investors renders them familiar with international conventions and more comfortable with international investors. Thus for foreign investors, following the herd effect lowers operational costs and greatly reduces uncertainties. The Role of Favorable Government Policies toward the Coastal Areas is also play an important part. There is no doubt that the policy of opening up to the outside world has greatly promoted economic growth since 1978.

The move to embrace foreign investment has been an indispensable part of this policy. As in other aspects of reform, the Chinese government has implemented the opening-up policy gradually. It first opened the two provinces of Guangdong and Fujian, then the fourteen coastal cities, and afterwards other areas. The coincidence of the spatial distribution of foreign investment and the regional bias of the central government policies has been advanced as the strongest support for the policy preference argument.

In 1979, the central government granted the two provinces of Guangdong and Fujian certain autonomies to attract foreign investment and to open four special economic zones. Since then, these two provinces have taken the lead in absorbing foreign investment and have enjoyed the highest GDP growth. In 1984, most of these preferential policies were extended to fourteen coastal cities and their affiliated economic development zones, contributing to the faster growth of the coastal areas. Nevertheless, there are also some counterexamples to this argument.

In 1991, the central government further expanded the preferential policies to Heilongjiang, Jilin, Hubei, Hunan, Anhui, Shaanxi, and Sichuan, and in 1992 to Henan, Gansu, Yunnan, Guizhou, Jiangxi, Shanxi, Xinjiang, and Inner Mongolia. The economic development zones, high-tech industry parks, and special border economic zones approved by the central government in these central and western provinces accounted for 42 per cent of the total preferential policy areas nationwide. However, the share of foreign investment in these provinces did not thereafter experience significant increases as that in costal areas.

Another counterexample is the case of Shanghai. Pudong Economic Development Zone, which was approved in April 1990, and it subsequently enjoyed the same preferential treatments as Guangdong and Fujian, but Shanghai’s share of foreign investment, as a percentage of the national total, did not increase thereafter. Six years prior to and six years following the establishment of the Pudong Economic Development Zone, Shanghai’s average share of foreign investment in the national total was 10. 41 per cent and 7. 8 per cent respectively.

If we take into account the speculative investment in real estate in Shanghai in 1992 and 1993, which was higher than the average national level, the effective share of foreign investment was even lower than 7. 8 per cent. These examples contradict the generally accepted view on coastal versus regional income disparities. They demonstrate that the central government’s preferential regional policy with regard to foreign investment is not a fundamental reason for the unbalanced spatial distribution of foreign investment, nor is it a fundamental cause for the unbalanced regional growth.

However, the central government’s policy does play a role in promoting foreign investment in the coastal areas. Most importantly, it loosens repressive constraints, allowing the inherent comparative advantages in the coastal area to be realized. Changes in the preferential policies of the central government on foreign investment are usually understood as signals of change in the direction of economic policy, as well as changes in the direction of regional policy. The opening of more areas is seen as a continuation and development of the “ open-door policy.

It is argued that thereafter more foreign investment will flow, not only to the newly opened areas but also to the rest of the country. In contrast, a revocation of some of the preferential treatments in specific areas is regarded as a step backward from the status quo, which will retard foreign investment not only in those specific areas but nationwide as well. The concentration of foreign investment in the coastal areas is mainly due to the inherent comparative advantages, that is, the coast holds for attracting profit-oriented investors.

These advantages were obscured by repressive policies before China opened itself to the outside world. The “ open-door policy” implemented since 1978 has lifted these repressive constraints and allowed investors to realize the advantages. On the other hand, the policy preference toward coastal areas in the 1980s was the product of a political compromise, and it did not play an important role in affecting the inherently unbalanced distribution of foreign investment.

As a product of the comparative advantages of the coastal regions, this unbalanced distribution stems from the consideration of the whole nation’s development. Now we see that the policy that first benefits the costal regions is successful. China has attracted more and more investment from overseas, which has taken the first place in attracting foreign investment instead of America up to now. Accordingly, China now is carrying out the policy of developing the western areas.

All the preferential policies that have been implemented in coastal areas will be carried out in the western areas. Therefore, the policy of opening to the outside world is the first step of the whole stragetegic objective of China. This successful experience must push forward the policy of developing the western areas, and help to fulfill the goal of better-off society that rose during the 16th congress of CPC.