French direct investment in China: A survey report*

Qi Jianhong & Zhou Jieqiong, French direct investment in China: A survey report. East Asia Economic Research Group† Discussion Paper No. 6, January 2006, School of Economics, The University of Queensland. Queensland.

Abstract

This paper attempts to explain the economic effects of French direct investment in China on the French economy, based on our survey results using the relative data and case study. The paper begins with a brief description of the scale, location, industries, firms and forms of French direct investment in China, and then explains the economic effects of French FDI in China on both nations, such as the employment and income, import and export, balance of payments, industry hollowing, technological improvement, and others. Finally, the paper provides a case study about the success of Qingdao Hairun Water Supply Corp. Ltd, one of EJV of Sino French Water Development Company Ltd.

Keywords: FDI; Employment; Technological Improvement

Qi Jianhong
School of Economics
Shandong University
Jinan, Shandong
China
Fax: +86-531-88571371
chqi0829@sina.com

Zhou Jieqiong
School of Economics
Shandong University
Jinan, Shandong
China
Fax: +86-531-88571371
caneet82@126.com

* This paper was originally prepared for International Conference in France, 2005.
† The East Asia Economic Research Group was established in July 2005, providing a focal point for East Asia-related research of an economic nature, primarily conducted by academic staff of the School of Economics at Shandong University and The University of Queensland, their research collaborators and other interested contributors.

1. INTRODUCTION

In October, 2004, Kearney, a famous strategic management consulting company, ranked China the most popular FDI destination for a that third time, indicating that China still lead USA and other nations in the confidence of global investors.

We note that France, as an established industrialized nation, has been playing an important role in the global FDI, but lacked of great interests in investing in China. From 2001 to 2003, only 0.5 percent of French direct investment had flowed into China (Banque de France, 2005). By the end of 2003, only 1.23 percent of FDI into China had come from France (MofCom of China, 2005). In recent years, French direct investment into China has been increasing rapidly, but still does not catch up with the average growth speed of FDI inflow into China. This kind of phenomenon has not only prevented France from benefiting most from FDI, but also blocked China to raise the quality of FDI.

We first, in Section 2, will describe the scale, location, industries, firms and forms of French direct investment in China, using a comprehensive panel data over the recent years from MofCom of China and comparing them with other EU nations such as Britain and Germany. In Section 3, we explain the economic effects of French direct investment in China on both nations, such as the employment and income, import and export, balance of payments, industry hollowing, technological improvement, among others. Section 4 draws some conclusions and puts forward policy suggestions. Appendix offers a case study about the success of Qingdao Hairun Water Supply Corp. Ltd, one of EJV of Sino French Water Development Company Ltd., which comes out of investigation and suggests that there exist great potentials for French enterprises to enter China if they adopt the appropriate strategies and keep good relationships with the host nation.

2. BASIC FACTS

(1) Scale of French direct investment in China

Table 1 indicates that considering the FDI stock, the accumulative amount of French projects in China had been 2,591, with the contractual amount of $9.14 billion and actual amount of $ 6.9 billion by the end of 2004, ranking the 10th in the countries investing in China. This scale of French direct investment not only fell behind USA and Japan, but also lagged behind UK and Germany. If only the actual amount is considered, it amounted to 1/2 that of UK and 2/3 that of Germany.

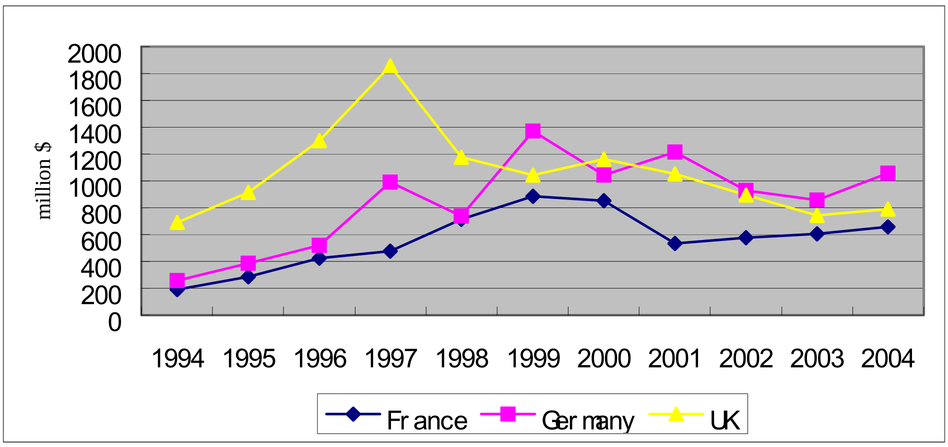
Table 1: FDI Stock in China by Five Countries at the End of 2004

Countries	Projects	Contractual Amount (billion $)	Actual Amount (billion $)
France	2,591	9.14	6.8
United Kingdom	4,344	22.126	12.2
Germany	4,112	17.995	9.909
USA	45,265	98.608	48.029
Japan	31,855	66.649	46.846

Source: MofCom of China, 2005.

Figure 1 illustrates that French direct investment has increased rapidly since 1997 when we consider the FDI inflow. The average annual growth rate has been 7.78 percent from 2001 to 2004, which has exceeded that of UK and Germany at the same period, but still can not compare with the average annual growth rate of 10 percent of FDI into China during the same period (National Bureau of Statistics of China, 2005).

Figure 1: FDI Inflows into China by France, UK and Germany

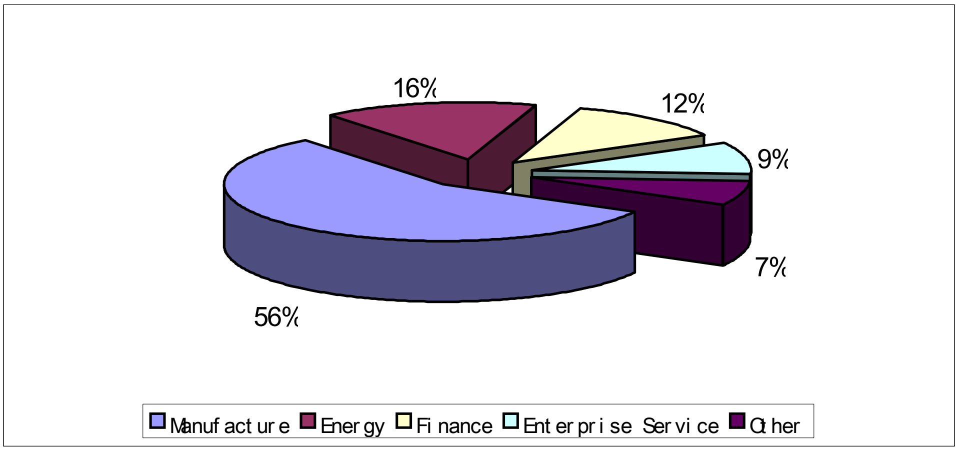


Source: National Bureau of Statistics of China, 2005.

(2) Industry distribution

Figure 2 indicates that French direct investment has focused mainly on manufacturing industries such as chemical, automobile, machinery, food, and so on, which accounted for 56 percent of total stock, with that in energy, finance and enterprise service accounting for 16 percent, 12 percent and 9 percent respectively. That is to say, French direct investment in the second industry accounts for more than 70 percent of its total, which was consistent with not only that of Germany (80 percent in 2002), but also the general case of FDI in China (75 percent in 2004). National Development and Reform Commission of China (2003) also found that the direct investment of EU including France in China chose the second industry as the investing priority and was intended to occupy the market, of which 59 percent was targeted at Chinese market, 19 percent at EU market, 15 percent at Asia-Pacific market and 17 percent at North America market.

Figure 2: Industries of French direct investment in China



Source: Banque de France, 2005

(3) Major French Firms in China

At present, French direct investment into China is undertaken mainly by more than 20 large-size French enterprises groups, such as Electricite De France, Suez, Alcatel Telecom, Michelin, Total Oil, Rhodia, Aventis, Lafarge, Saint-Gobain, Thomson, Scheider Electric, Alstom, Carrefour, Veolia Environment, Groupe Danone, Loreal, Psa Peugeot Citroen, BNP, Paribas, Crédit Lyonnais, Air France etc. Since 1990s', these enterprise groups began to gain in succession. In some industries, the market shares taken by them have been considerably large. For example, Groupe Danone sold 28 billion liter of water in China, and its market share amounted to 40 percent in 2003. Psa Peugeot Citroen has been the second largest enterprise in the automobile market with a sales income of 1.21 billion dollars and occupied the market share of 9 percent (CCPIT, 2005).

(4) Location of French direct investment in China

French enterprises paid more attention to the conglomeration effects of FDI when choosing the location. Therefore, they usually choose the most developed Eastern Regions such as Shanghai and Guangzhou and benefit from the radiation of this district. The former National Economy and Trade Commission (2001) observed that 75.95 percent of contractual amount of French direct investment had flowed into Eastern District, only 24.05 percent into Middle and Western Regions.

A fresh trend has been observed that some western cities such as Chongqing have become the new targets of French direct investment in recent years. According to Chongqing Foreign Economy and Trade Commission, 24 French enterprises with contractual amount of $35.59 million had settled there by the end of Oct. 2003.

(5) Forms of French direct investment in China

At the beginning stage, most of French enterprises availed themselves of the forms of Equity Joint Venture (EJV) or Contractual Joint Venture (CJV) in entering into China. For example, Sino French Water Development Company Ltd. established EJV in 18 large cities, supplying water and dealing with polluted water. With the accumulation of FDI experiences, these French enterprises adopted the more flexible forms including M&A. For example, Michelin consolidated its four EJV in China in 2002, and became a Wholly Owned Subsidiaries (WOS) in Aug, 2003. Loreal acquired Little Nurse and YUE-SAI (China) successfully. After Groupe Danone acquired Wahaha and Robust, two famous Chinese enterprises, it also bought the shares of Bright, another famous Chinese enterprise, and became the third stockholder at the end of 2004.

The reasons why only a limited number of French enterprises have entered into China are complex, mainly including the following aspects.

Firstly, before 1994 when FDI into China pyramided, France was sluggish in FDI in China due to the political divergence between two governments. That is to say, it was very late that French enterprises entered into China, which makes a sharp contrast with UK and Germany who regarded China as preferred choice of their international strategy early in 1980s' and 1990s'. Since 1994, the investment cooperation between French and China has still been restrained by multiple factors. (1) Most of investment projects between the two countries belong to public investments. French government succeeded in a few large-scale projects, but the beneficiaries of these projects were confined to a few French large-size enterprises. Moreover, the continuity and spillover effects of this kind of investment were very weak so that it failed to help to attract followers for other investment. (2) French enterprises still stuck to the inadequate understanding of China so that they were afraid of the inefficiency of Chinese government and the discontinuity of China's foreign policy. As a result, they hesitated in making more investment in China. (3) French government has established the perfect supporting system for overseas investment, but no special support for FDI into China. On the contrary, both Germany and Italy governments call upon the large-size enterprises positively to adopt their marketing channels and information, and boost the medium and small-size enterprises to exploit Chinese market well. In France, only few large-size enterprises did so and only few banks were willing to offer the long-term loans for the medium- and small-size enterprises to invest beyond the EU market.

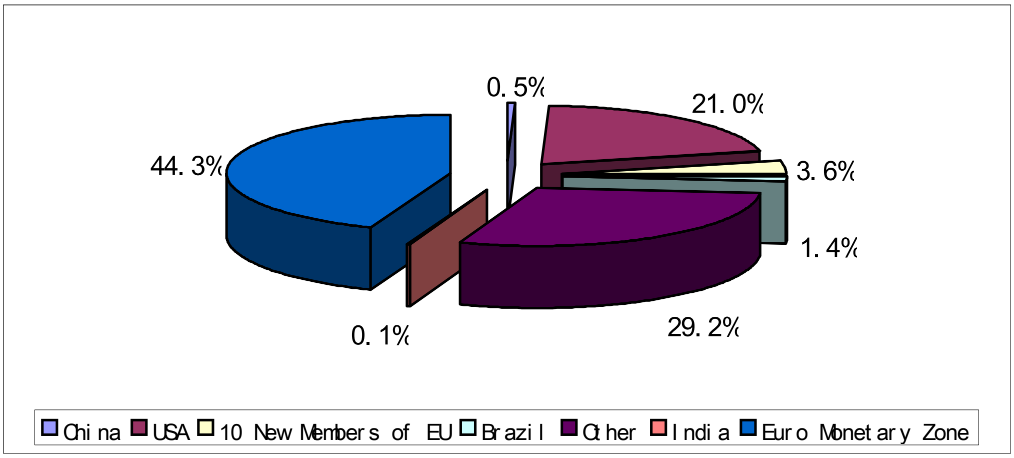
Secondly, France has concentrated its direct investment in Europe and North America for a long time, the two regions combined accounting for more than 3/4 of its total FDI. Table 2 shows the sharp contrast among French, UK and Germany direct investments in East Asia excluding Japan. In 1990s', only 2.5 percent of total French direct investment flowed into East Asia, against 8 percent and 5 percent for UK and Germany respectively. The main reason is that France is not interested in making FDI in the Emerging Markets including China. Figure 3 indicates that the proportion of total French direct investments flowing into new members of EU, India and China was 7 percent from 1983 to 2003, but that of USA, Germany and UK registered 20 percent, 14 percent and 9 percent respectively over the same period.

Table 2: Proportion of Three Countries' FDI in East Asia Excluding Japan

Countries	1989	1994	1995	1996	1997	1998	1999
UK	6%	8.3%	8.5%	9.6%	8.1%	5.1%	5.4%
Germany	3.9%	4.6%	4.7%	5.4%	4.9%	5.1%	5.6%
France	2%	2.5%	2.3%	3%	2.7%	2.9%	2.5%

Source: "East Asia and Europe: recent trends in foreign direct investment", *GPN Working Paper 4*, February 2003.

Figure 3: Geographical Distribution of French Direct Investment in China



Source: Banque de France, "Offshoring", *Banque de France Bulletin Digest*, No.133, January 2005, pp.21-35.

Thirdly, French enterprises have been attaching greater importance to the cluster effects when choosing the location of investment. Disdier and Mayer (2003) discovered that the probability of French enterprises investing in one country would rise by 4.5 percent to 4.9 percent if other French enterprises in the same industry in this country rose by 10 percent. Due to the limited quantity of French enterprises in China at present, relatively few French enterprises intend to enter here. At the same time, geographic distance and cultural differences between two countries are also the important factors affecting French enterprises' decision. Consequently, the majority of them do not favor China as the preferred investment destination.

3. COST-BENEFIT (CBA) ANALYSIS

Above all, we can note that, on one hand, as a developed country with high taxation, high welfare and slow growth, French economic development nowadays is restricted by lots of factors.

- French industries have the limited competitive advantages in hi-tech due to the lack of R&D.
- Its export commodities with medium added value failed in the fierce competition with the emerging nations, which could be justified by the fact that French trade deficit reached a record high of 11 billion Euros in the first half year of 2005.
- The slow growth of resident consumption and rising productive costs led to the contraction of enterprise investment in France.
- The high unemployment rate of 10 percent has become the bottle-neck of French economy. Therefore, French enterprises should expand FDI due to the domestic factor endowments and market conditions.

On the other hand, China has some advantages which can satisfy the need of French investors.

- Cost advantages. Blanco etal (2005) showed that the productive costs could be reduced by 85-90 percent if French transferred its capital into China, but only by 65-75 percent into North Africa and Middle-and-East Europe.
- Efficiency advantage. Some French enterprises having settled in China found that the productive efficiency of Chinese workers with low wages is not lower than that of Europe.
- Market potential. For example, it was reported that Scheider Electric still could not meet the market demand in China, even if it had established 11 factories. Groupe Danone has regarded Chinese market as the second largest in the world. Based on these advantages, French direct investment, when coupled with appropriate strategies in China, will guarantee great benefit for individual enterprises and inevitably boost the French economic development.

It should not be denied that French economy will suffer some loss in this course. The question remains whether the benefits are greater than the costs.

(1) Economic benefits

- Technological improvement and industrial upgrade

On one hand, the benefits gained from the direct investment in traditional industries in China can be used to develop the emerging industries such as hi-tech, which will help to perfect the industrial structure in France. On the other hand, French enterprises must increase R&D to keep a leading position in the fierce competition in the Chinese market, which will eventually foster technological improvement in France. Jiang (2004) observed that almost all the multinational enterprises in China had adopted the most advanced technology which their parent companies were using, and half of which was ushered less than 2 years ago in the home country. The same is true of the computer industry of USA, which has been developing rapidly mostly due to the migration towards other countries in the form of FDI.

- Ex-import and BOP

Fontagne and Pajot (1997) observed that French trade surplus would rise by 35 cents if it increased FDI by $1, even rise by 40 percents if considering the relevant effects. The observation will be proved true if French direct investment flows into China. In the short run, French enterprises must export large amount of machinery, special materials and inputs to fulfill the localization in China. In the long run, the importance of French ex-import in China will become greater, because most of Chinese trade partners are its major investing countries such as USA and Japan. From another point of view, this is also the best way for French enterprises to cast off the price competition with the developing countries in the traditional industries and enhance the competitive advantages of its export commodities.

- Employment and income

It was estimated that French direct investment in China can bring 25 jobs for France if it can create 100 jobs for China. Blanco etal (2005) found that French direct investment in emerging nations can not only bring more jobs, but also better the employment structure. In the above example about the FDI of USA computer industry, jobs with high income level such as computer engineers and Internet system analysts expanded rapidly. According to the European Bureau of Statistics (2005), French workers, although with higher productivity than Britain, Germany, USA and Japan, had to accept lower level income. Obviously, the perfection of employment structure will increase these workers' income significantly. Otherwise, unemployment would exacerbate due to the bankruptcy of traditional industries in the fierce competition.

(2) Economic costs

In the course of French direct investment in China, France has to face some economic costs, mainly manifested by the proliferation of friction unemployment and deterioration of balance of payments. That is, reducing the staff trimmers due to French direct investment will render some unskilled labors out of work for whom it is very difficult to find new jobs; French direct investment will lead to the effect of export substitution, i.e., the export from traditional industries will decline and the import of them will increase correspondingly; it needs much longer time to cultivate the emerging industries so that it is impossible to increase the export of hi-tech in the short run.

However, it should be clear that most of these costs exist only in the short run. Moreover, French government is good at regulating the macro economy with reasonable policies so that it can reduce the FDI costs to the lowest.

4. CONCLUSIONS

It is well known that French direct investment is beneficial to the quality improvement of FDI and the sustainable economic development of China.

On one hand, Chinese government is endeavoring to improve the quality of FDI, which France is certainly able to assist. (1) The rate of French actual investment was as high as 74.4 percent at the end of 2004, but that of average was only 60.58 percent at the same period (MofCom of China, 2004). (2) The scale of technology transfer to China by France is only nest to that of Germany among the members of EU. (3)

French passion to invest in China's Western Regions is helpful to lesson the disequilibrium of economic development facing China.

On the other hand, energy supply and environment protection have become the two obstacles to China's economic growth. In contrast, French enterprises have got significant advantages in such fields. For example, France has got the most advanced technology in the construction of high-speed road; such famous enterprises as Suez and Veolia Environment have got know-how in the field of water supply and environment protection; French enterprises has ever participated in the construction of Chinese power plants including Daya Bay nuclear plant and Ling'ao nuclear station; Areva, with the title of "Queen of nuclear power" has the ambition to build nine new EJV in China.

Therefore, Chinese government should take some positive measures for French direct investment in China. To begin with, Chinese government should establish a special agency to offer consulting service, regarding issues like helping French enterprises understand Chinese market potential and investment climate. Chinese government should also adopt supportive policies regarding providing the information, finance support, and other assistance for French small-and-medium enterprises to enter Chinese market. In addition, Chinese government should make further efforts to enforce the protection of intelligent property rights, considering the fact that many French enterprises that have entered or will enter China take the form of technological cooperation.

APPENDIX

Case Study----Sino French Water Development Company in Qingdao[*]

Qingdao Hairun Water Supply Corp. Ltd, established by Sino French Water Development Company and Qingdao Hairun Water Supply Corp. Ltd., is the first Sino-foreign joint enterprise engaging in public utility in Qingdao. Put into operation formally in August, 2002, this co-partnership company poured into the total assets of 22.5 billion Yuan and held by each side with 50 percent shares.

So far Qingdao Hairun Water Supply Corp. Ltd has made the very considerable benefit with the annual return rate of 8 percent or so each year. With this speed, the company can be expected to cover the cost of investment in 10 years. Such successful operation of this company is due to both the rational strategies in itself and the effective relationship with the local government.

The analyses in detail follow below:

- The company has been adopting the advanced techniques and its products sharing good quality. With the advanced techniques and equipment from France and German Siemens, the company can supply water of high quality. The turbid degree of water is not higher than 0.5 ntu, which is much lower than the Chinese current water supply standard (below 3 ntu) and nearly reaches European Union's standard. The local government and consumers show their approval on the quality of the water.
- The employment of the original workers was arranged rationally. After the co-operation the company did not reduced the staff at will to cause a large amount of unemployment. On the opposite, all the 319 workers have found their suitable new positions on the different levels according to their abilities. Even the unaccomplished workers can earn their lives as dustmen or something else.
- Qingdao Hairun Water Supply Corp. Ltd has been insisting on the idea of long-term investment. The additional investment of the company was 9 million Yuan in 2003. With the renovated equipment and technological transformation, water

[*] All the data was obtained from two field surveys in Qingdao Hairun Water Supply Corp. Ltd in March 2003 and November 2003.

purification of every 1000 cubic meters reduces both the usage of electricity about 30 degrees and the usage of chlorine by 1/3. In fact, these additional investments were not carried on the regulation in joint-venture's contract, and as a result the company received the high appreciation of the local government and people. The brand of the Sino-French Water Company has been strengthened.

- The localization of the management. The administrators of the company have established good relationship with the local responsible department of the government; their personality glamour has played an important role in the process of managing workers.

As a result, the local government has also made some positive measures in favor of the Sino-French Water Company. Considering the high cost of the original water in Qingdao (especially in some specific seasons), which may increase the cost of the company, the local government gave up the routine method which prescribed a fixed price of 2.5-3 Yuan per square water all the year, but charge this company nearly 0.6 Yuan per square water only to make up for the cost of water. This method has avoided the loss risk caused by the season factors on the Sino-French Water Company and made it undertaken by the local government voluntarily.

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