

Overview of Outward FDI Flows of China

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Abstract

China is integrated rapidly with the world economy by increasing its foreign investment linkage with other countries. In 2005 China was the 4th largest investor among emerging markets, up from 14th in 2004 with 72.4% of all economies in the world receiving Chinese FDI. Through outward FDI into any sectors, industries or regions, there should be intra-industry productivity spillovers from foreign firms to domestic firms within the same industry, mainly through reduction of production costs, technology transfer and international R& D spillovers. Diffusion channels of technology know-hows and managerial practices induced by higher FDI penetration abroad make the purpose of the increased transparency and access of core technology practical. This article addresses this question through the lens of economics as to three collaborated sets of FDI determinants, the features of FDI outflows as the overall FDI scale, the target sectors, the geographic distribution and the concrete ways of outward FDI of China. The author concludes that there should be a caveat to the non-guided outward FDI but strategically tailored to suit the requirements of multiplying the investment efficiency and climbing up the value ladder of global economy.

Keywords: Outward FDI, Driving forces, FDI spillovers

1. Introduction

China is integrated rapidly with the world economy by increasing its foreign investment linkage with other countries. China's direct investment both inward and outward FDI provides important net long-term economic benefits for both home and host countries. In the past two decades, outward FDI from China increased by nearly 300% (Note 1). According to the special report of TNCs and Canada-China FDI, the development of China's outward FDI can be classified into two stages: (1)1982-2000, spontaneous stage, (2)2000-current, government-oriented stage. Starting from virtually no OFDI in 1979, the initial outward FDI flows from China are few and mainly for establishing offices and agencies in other countries. In 1990s the FDI flows grew increasingly volatile. In 2005 China was the 4th largest investor among emerging markets, up from 14th in 2004 with 72.4% of all economies in the world receiving Chinese FDI. The annual growth rate was 19.7%, which was much higher than that of GDP. Based on the results of the work of the OECD investment committee, China's OFDI flow and stock stands as the 4th and 6th largest respectively among developing countries. The Chinese outward FDI has risen to 56.53 billion in 2009. The first section of the study encompasses an introduction of three collaborated sets of FDI determinants--economic conditions, the regulatory framework and investment promotion. Section two outlines the features of FDI outflows as the overall FDI scale, the target sectors, the geographic distribution and the concrete ways of outward FDI of China as exemplified by the affirmative data. Section Three summarizes the findings and sketches some reflections about concrete actions to further the spread of FDI outflows in a properly arranged business-led agenda.

2. Literature Review

The turn of the new century seemed to spark the rapid buildup of Foreign Direct Investment in China during which China ranked the eighth in FDI inflows and leaped to the fourth of FDI recipient in 2006, then the fifth in 2007, and in 2009 the second just following the United States. The grown importance of China onto the world stage has spawned a proliferation of research papers written on the various aspects of China's inward FDI. As compared to this, the literature researches on China's outward FDI remains rather sparse. The varying impact of country-, industry-, and firm-specific considerations on the location characteristics of countries has been extensively analyzed

by the international economists as Dunning and Gray in as early as 1982. The scholars and researcher in this area aim to examine the determinants of Chinese direct investment abroad, or attempt to reformulate existing conventional theories or newly emerging perspectives to explain Chinese MNCs or China outward FDI. These literatures sum up the causes of the continuing spate of cross-border M& As since 2001 to a combination of market motivation, diversification, foreign technology or other resources, by adopting theoretical peeling, case study, or methodological confirmative models.

In 2007, Diego Quer of University of Alicante, Spain in his papers Chinese Outward FDI: driving Factors, theoretical background and strategic implications mainly concludes that resource-seeking, market-seeking and asset-seeking are motivating factors of Chinese FDI outflows, and the role of government is the key facilitator while limited experience in M& As, poor innovation process and vulnerability are the chief restrictions. Dr. Paz Estrella Tolentino of the University of London uses multiple time-series data from 1982-2006 to examine the relationship between several home country-specific macroeconomic factors and the level of outward FDI of China. Through adopting a Vector Autoregressive model, this empirical research proves that characteristics associated with income per capita, openness of the economy, interest rate, human capital, technological capacity, exchange rate and its volatility do not Granger cause the level of OFDI of China. Similarly, Tolentino, Paz Estrella touches the same question that positive determinants of the outward FDI of China are host economies' GDP, sharing of the same border, cultural proximity. He concludes that landlocked countries had a disadvantage in both flows and stocks of China FDI. The Results of the Work of the OECD Investment Committee of March 2008 demonstrates the fact that China's official OFDI statistics may underestimate the actual volume of outward flows as those reported by OECD countries are on average 40% higher. The report points out that China's OFDI is dominated by state-owned enterprises and has been flowing into developing countries at a higher rate than to industrialized economies. In 2010, Shujie Yao from University of Nottingham in his research papers China's Outward FDI and Resource-seeking Strategy reports his case-study findings that a national power-building globalization strategy and the extended far-reaching protection from the State are two important theoretical propositions of China's FDI outflows.

A long list of Chinese scholars have addressed the issue of China's outward FDI in the global arena and their analysis mainly confines on different aspects as the scale and structure of OFDI of China, the constraints, facilitators or the policy-making drivers of OFDI, or a combination with direct weaknesses and challenges and indirect strengths and opportunities on the basis of SWOT analysis. Other scholars screen the issue through the lanes of the FDI outflows of Chinese small-and-medium enterprises from the similar perspectives. Empirical research on the impact of outward FDI on home country economic growth is comparatively scarce.

3. The Driving Forces of FDI Outflows

As China is rapidly integrating with the global economy, its outward FDI has increased by nearly 300% in the past two decades. Numerous stories have witnessed Chinese acquisition efforts to be as a source of FDI, say, the eye-catching Lenovo's acquisition of IBM PC announced in December 2004, the TCL's acquisition of France's Thomson Electronics in 2004, Haier's building plants in the US since the late 1990s, Nanjing Automotive's success in acquiring UK's MG Rover Group in 2005. The energy crunch in 2006 exemplified China's source-seeking effort in the outward FDI to invest in oil companies in the world, in particular in Russia, Central Asia, and Africa.

China's spectacular re-emergence as a world power is now universally recognized, and the situation is exemplified in FDI, especially the dramatic rise of outward FDI. Several forces collaborate and the best discussed in terms of the three sets of FDI determinants: economic conditions, the regulatory framework and investment promotion (Note 2). As this is the exact statement for the two-way investment flows, further perception of these for the outflows of investment from China is self-convincing.

3.1 Economic conditions

China's economic growth has surpassed the three significant developing countries Brazil, Russia and India since the beginning of its economic reforms and opening-up three decades ago. The growth of GDP averaged about 10 percent per year in the last several years, except at about 9% in 2008. China has the largest agri-food sector in the world and is among the top 5 importers and top 5 exporters. As a dynamic, rapidly growing nation, China has surpassed Germany becoming the world's third largest economy after the U.S. and Japan in 2007. In terms of the purchasing power parity basis, the Chinese is the second largest one in the world after that of the U.S. in 2008. Meanwhile, China's priority is maintaining its economic growth targeted at 8 percent. In November 2008, China approved a 4 trillion (US\$586 billion) government spending package for 2009-2010 to challenge the economic slowdown and boost domestic demands. In 2009, China is the third largest exporter of goods and services after U.S. and Germany. In the second quarter of 2010, China has eclipsed Japan in terms of trade volume and ranked the second in its GDP figures only after U.S.

3.2 Regulatory Framework

The policy framework in China is geared to maximize the convenience of domestic firms and the value of the most

important renewable resources. The Chinese government has sanctioned many laws and regulations to further spur the outward investment. The more concrete ones are the Legislation of SME Development at the beginning of 2003, which stipulates explicitly the small-and-medium enterprises are the core targets of domestic financing in overseas investment and operation. In 2005, as requested by the commitments in the Protocol of China into WTO, China further opened up its financial market to foreign entities. This entices more severe competition yet gives more opportunities for domestic firms to gain financial supports. The year 2008 has experienced two important commercial regulations both aiming to facilitate the domestic firms to pool up funds for business conducts. All the aforesaid are the harbingers of huge expansion of Chinese firms, and based on this strong backbone investment overseas is definitely practical.

From global perspective, related international organs are highly contributory to espouse a new multinational economic order, such as APEC, WTO as in its TRIMS agreement, OECD Multinational Agreement on Investment. UNCTAD, established in 1964 to promote the development-friendly trade integration of the first and third world, may become China's allies on the issue of monitoring and verifying corporate compliance with codes of conduct in the world markets. Furthermore, Foreign Investment Protection and Promotion Agreements (FIPAs) provide a framework for bilateral investments and permit greater predictability with regards to investments through advance negotiations or bilateral talks under the skeleton of such organs. Though FIPA is a Canadian model from the very beginning and the signed parties may undoubtedly gain from its mutually binding clauses. Yet to update a new model or make it enforced in a revised way may be conducive to the overseas operation of Chinese firms.

3.3 Investment Promotion

Trade costs and restrictions into the global markets had a positive impact on outward FDI of China. The technical barriers of trade in the developed countries seem to stir up the worldwide requirements for quality, specifications, sanitation and quarantine range, which bans Chinese exports to a certain degree. On the other hand, along with the advancement of world economy, the global industrial labor division was formed with East Asia the supplier of parts and components and China the processing and manufacturing base, while European countries and United States researchers and practitioners of core technologies. This shall definitely lead to a trade surplus of China to Europe and United States, moreover, the exacerbated trade frictions and dramatically degraded exporting environment. All factors combine together to scale down the exports opportunities of Chinese makes. When trade costs are high, firms might choose FDI as a substitute for exports and may strategically locate a fragment of its production activity in the source country or practice outsourcing its externality-rich economic activities to its overseas partners or the third party. Consequently, outward FDI was used as export platforms and namely a quest for efficiency through global cost reduction.

Many Asian Multinational corporations possess sophisticated and distinctive advantages which they have created and nurtured for many years. Besides proprietary expertise and technology, their advantages cover a wide range as comparatively low labor cost, technology expertise in the oil& mining industry etc. These competencies allow them to operate in overseas environments and compete with foreign firms.

4 Current FDI Outflows of China

4.1 the Scale of FDI Outflows

Table 1 shows the symmetry panorama of China foreign direct investment from the perspectives of both FDI flows and FDI stocks with both soaring up at a steady rate for the chosen time span 2002-2009. The FDI stocks increased steadily since 2002 and the average FDI flows is 22.9 billion in this 8-year sample. Yet there is still a huge gap as compared with that of the developed countries, e.g. in 2006 China ranked 13th in the world with its FDI flows valued US\$ 21.17 billion, while it is more than US\$100 billion for Holland, the United Kingdom, France etc. In as much as this, the average FDI volume of all the participating firms of China is low, as in 2006, it was US\$123, meanwhile it is US\$66.5 million for the developed countries and US\$4.5 million for the developing countries. All these figures hint that the outward FDI of China is in its initial stage.

4.2 Target Sectors of FDI Outflows of China

The Chinese FDI outflows cover wide ranges as the primary industry, the secondary industry and the tertiary industry as well, with the crux missions of forestry, mining and fishing, and the processing& assembling etc.

Table 2 shows explicitly that mining and manufacturing sectors are traditionally target industries for China's outward FDI as self-alleged in 2003 and 2004. Yet by the year 2005 licensing and business services held the largest proportion of outward FDI stocks from China and became top contributor, which had a biggest and growing share of 38.85 in 2008 and 36.21 in 2009. The mining sector dropped to a weak flicker and the wholesale& retail remained stale. This well announced that the FDI outflow of China is moving up the global value ladder and the Chinese firms are trying to sink into fertile hi-tech industries.

4.3 Geographic Distribution of FDI Outflows of China

Traditionally, outward FDI of China is mainly invested in Asia, which accounted for 71%, particularly in Hongkong, Macao and Korea. In 2005, the majority of China FDI concentrated in tax heavens like Hongkong, Cayman Islands, the British Virgin Island. These were among the top 20 destinations for FDI in the world. Latin America also accounted for a significant amount of Chinese FDI in 2005 at 20%, followed by Europe at 3%, Africa 3% and North America 2% (Note 3).

Table 3 shows the outward FDI flows of China are becoming more and more global. Asia is still the main target area of Chinese FDI outflows with the average proportion of 63.16% during the time span 2003-2009. This phenomenon can be well supported by the geographic proximity, closer cultural similarity and low relative operational costs etc. Latin America took the secondary key position with 30.67% except in 2005 and 2006 as it overtook Asia and ascended to number one with a respective 52.7% and 48.03%. The FDI outflows in the Europe, Africa, North America and Oceania accounted for an average of 14% in these years.

As shown by the Business Journal Review 2009 of the China Ministry of Commerce, the geographic sources of China's outward FDI have become more diversified from 2003 to 2009. Hongkong, Macao, Korea, Singapore and Indonesia are still the dominant foreign recipients with Hong Kong occupying a biggest share of 80%. The two tax heavens the Cayman Islands and the British Virgin Islands are the crux of Latin America, while in Africa, South Africa, the Federal Republic of Nigeria, Algeria and Zambia are the core recipients (Note 4).

4.4 Concrete Ways of Outward FDI

From 2006 to 2009, the non-financial outward FDI took the dominant position in the FDI outflows of China and it goes as 6 times as that of the financial outward FDI. Three sources of FDI injections are green field investment, merger& acquisition and re-investment of retained earning. In developed economies, M& As have been the dominant drivers of FDI inflows as during 1987 to 2007, on average, M& As accounted for more than 70% of the developed countries' FDI inflows. The green field investment in the concrete form of joint ventures is overwhelmingly prevailing in the FDI outflows of China, with the majority of the foreign affiliates established by the mainland Chinese.

5 Conclusions

As China is rapidly mingled with the global economy, the outward FDI in the concrete form of multinational corporations of diverse kinds are making contributions to the economy advancement of China to a great extent. Yet the FDI outflows should be strategically tailored to suit the domestic requirements of economic development. The Chinese government should refresh the definition of FDI donators as no more than a cosmetic exercise but well designed to strengthen its world power substantially.

5.1 Enhance Policy Stewardship

China should launch a major policy shift and cling to its hard-line position, that is, one of the keystones of outward FDI is that the foreign FDI access must boil down on the welfare enhancement of the country as a whole. This appeal echoes positively in the post-financial crisis age. Still, the implicit and explicit policies and measures should be figured out to under-whelm the characterized green field FDI but to orientate more mergers& acquisitions so as to strengthen the economic power of China in the world stage. The practice of screening the industries, sectors and regions of FDI penetration may combine together to optimize the consolidated returns.

5.2 Strengthen the Technology Spillovers

Through outward FDI into any sectors, industries or regions, there should be intra-industry productivity spillovers from foreign firms to domestic firms within the same industry, mainly through reduction of production costs, technology transfer, business model copying innovation, and international R& D spillovers. Diffusion channels of technology know-hows and managerial practices induced by higher FDI penetration abroad make the purpose of the increased transparency and access of core technology practical. Such being the case, the Chinese government is forced to authorize a wide range of government-funded or organized consortia in research& development and commercialization of advanced technologies, thus make the FDI outflows more fruitful. On the other hand, making outward FDI from China more acceptable to other countries especially developing nations could multiply the investment efficiency.

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Notes

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Table 1. The Outward FDI Flows of China from year 2002 to 2009

Measurement Unit: US\$ Billion (1 billion=1,000,000,000)

Year	FDI Flows	FDI Stocks
2002	2.76	29.9
2003	2.85	33.2
2004	5.5	44.8
2005	12.26	57.2
2006	21.17	90.6
2007	26.51	117.91
2008	55.91	183.97
2009	56.53	245.75

Data Source: the Ministry of Commerce, China (Data of year 2002-2005 are non-financial related, 2006-2009 covers outward FDI of all sectors)

Table 2. the Percentage of FDI Outflows in Diversified Sectors from Year 2003 to 2009

Measurement Unit: %

Sectors	2003	2004	2005	2006	2007	2008	2009
Mining	48	32.7	13.7	4.03	15.3	10.42	23.6
Manufacturing	21	13.7	18.6	4.3	8	3.15	3.96
Wholesale& Retail	13	14.5	18.4	5	24.9	11.65	10.86
Leasing& Commercial Service	10	13.6	40.3	21.4	21.15	38.85	36.21
Logistics& transportation	3	15.07	4.7	6.5	15.3	4.75	3.66

Data Source: www.mofcom.gov.cn

Table 3. Target Regions of FDI Outflows of China from Year 2003 to 2009

Measurement Unit: US\$ 10,000

economy	2003	2004	2005	2006	2007	2008	2009
Asia	150503	301399	448417	766325	1659315	4354750	4041000
Europe	14503	15721	39549	59771	154043	87579	335000
Africa	7841	31743	39168	51986	157431	549055	144000
Latin	103815	176272	646616	846874	490241	367725	733000
America	5775	12649	32084	25805	112571	36421	152000
North	3388	12015	20283	12636	77008	198560	248000
America							
Oceania							

Data Source: Statistic Reports of FDI Outflows of China 2009