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DYNAMIC INCREASE IN CHINA'S OUTWARD FOREIGN DIRECT INVESTMENT IN THE YEARS 2007-2009 AND ITS INVESTMENT POSITION IN THE LIGHT OF DUNNING'S THEORY

Abstract: Observation of the stage of development of People's Republic of China through Investment Development Path created by J.H. Dunning pointed out that between 2007 and 2009 PRC has moved rapidly from the second phase (value of FDI inflow is much larger than capital outflow) to the third stage, when the expansion of outward investments and slowing growth of inward FDI can be seen. That phase of economic development is characteristic, among other things, of new industrialized economies. Furthermore, keeping the present pace of growth, in 2011, the value of the Chinese foreign investments outflow can surpass the FDI inflow to China. As a result, China's economy would be classified, based on the above-mentioned theory, as pertaining to the fourth stage, which is characteristic of developed countries.

Key words: China, FDI outflow, Investment Development Path.

1. Introduction

Since the beginning of the economy transformation process (1978), the international role of China has dramatically changed. Foreign capital, which flew into Chinese economy mostly through Foreign Direct Investment (FDI), has played a very important role in that process.¹

Since the early 1980s, Beijing has paid initial attention to setting up the economic position of People's Republic of China (PRC) by internationalization of local companies, but in the late 1990s, the government took an official decision to assist in this type of economic activity. As a result, the stock value of China's outward foreign investment reached the level of 184 billion US dollars between 1978 and 2008, but the amount of outflow capital only in the years 2007-2008 amounted to 82.4 billion

¹ Between 1978 and 2008 the stock value of used FDI by China reached the level of 852.6 billion US dollars.

US dollars.² Estimated data concerning 2009 shows that the next increase of China's FDI was estimated at by more or less 30% (in the same time the value of foreign direct investment in the world economy has fallen by about 39%, from 1.7 trillion to 1 trillion US dollars).³

The main aim of this paper is to analyze the statistical data and factors concerning an increase of outward FDI as well as to define, on the basis of the Investment Development Path hypothesis created by J.H. Dunning, the investment position and the level of economy development of China. This study focuses on China's economy rapidly moving, between 2007 and 2009, from the second to the third stage of development measured by the net outward FDI (that level is characteristic of the so-called new industrialized economies – Hong Kong, Taiwan, South Korea and Singapore).

2. Description of China's outward foreign direct investment

Looking at the data presented on Figure 1, in 2001 and next since 2003 we can see an increase in the value of FDI outflow. It is based, among other sources, on published by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in a 1999 guideline on the subject of internationalization activity of Chinese companies. Furthermore, in 2000 the government of PRC recognized FDI as the one of the important elements of the "go out policy". As a result, MOFTEC and the Ministry of Foreign Affairs have lifted many restrictions concerning the capital export, extended rights for local governments to approve investment projects and took a decision to include diplomatic posts in promotion of national companies abroad.⁴

The analysis of official data published by National Bureau of Statistics of China allows for an interesting observation. Following these facts it can be pointed out that between 1978 and 2008 the stock value of China's outward FDI into business services (leasing, finance agency, transport, distribution channels) reached the level of 91.3 billion US dollars (that is about 50% of the whole capital outflow).⁵ Surprisingly, the statistics do not confirm the opinion expressed by many economists that getting an access to the natural resources is the main aim of Chinese activity abroad. The difference in views can be caused by the fact that 80% of outward FDI are undertaken by subsidiaries located in Hong Kong and in tax havens (Kayman Islands and Virgin

² *China Statistical Yearbook 2009*, National Bureau of Statistics of China, Beijing 2009. But the comparative analysis of data presented by the PRC and Organization of Economic Cooperation and Development (OECD) shows that the value of China's outward FDI presented by Beijing could be lower even by 40% in relation to statistics prepared by OECD.

³ The value of China's outward FDI in 2009 is estimated to be more or less 60-70 billion US dollars.

⁴ Among other things, in 2006 State Administration of Foreign Exchange (SAFE) passed to local branches rights for approval FDI up to 20 million US dollars.

⁵ *China Statistical Yearbook 2009*.

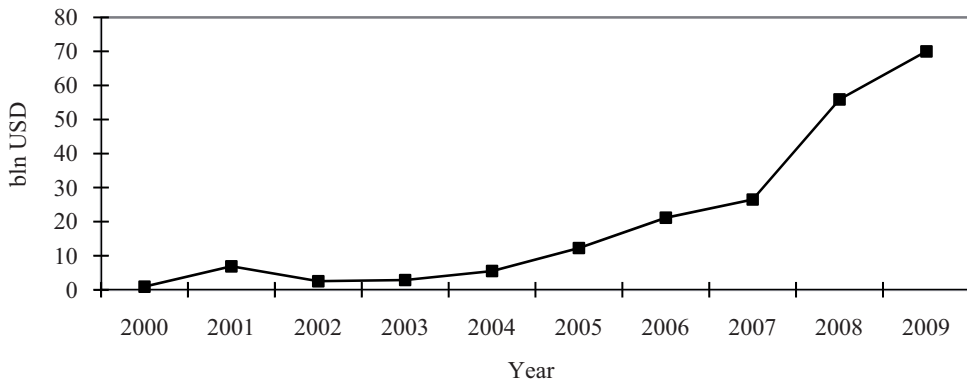


Figure 1. Values of China's outward FDI between 2000 and 2009*

*Between 1982 and 1989 the average annual FDI outflows was about 453 million US dollars, but between 1990 and 1999 the value reached the level of more or less 2.3 billion US dollars.

Source: own study based on data from *China Statistical Yearbook 2009*, UNCTAD statistics as well as estimated data concerning 2009.

Islands) which are the platform for mainland's corporation activity in different parts of the world.⁶ They are classified in China's statistics as investments directed into business services (comprehensive data on final sectors of the outward capital are not available yet). On the other hand, an increase in activity of China's companies on the international market influences the growing demand for transport, consulting and insurance services.⁷ It leads also to the development of supply channels, research and development centres (R&D) and agencies of local financial institutions, which provide special services for wealthy "Chinese overseas".⁸

Looking at the geographic distribution of direct total investments from China, we can see that 131.1 billion US dollars have flown to Asian countries, with over 50% to Hong Kong.⁹ Chinese companies have also invested 32.2 billion US dollars in Latin America and 7.8 billion US dollars in Africa (as much as 7.1 billion US dollars flown to Africa in 2007 and 2008).¹⁰ Moreover, only 5.1 billion US dollars have been directed into Europe and 3.66 billion US dollars into North America.¹¹

⁶ *China's Outward Direct Investment*, OECD, 2008, p. 8.

⁷ K. Davies, *While Global FDI Falls, China's Outward FDI Doubles*, Columbia University, New York 2009, p. 2.

⁸ For example, Huawei Technologies and ZTE have created R&D centres in Sweden, Haier corporation formed these types of institutions in Germany and USA.

⁹ *China's Outward...*, p. 9.

¹⁰ It is a result of China-Africa summit in Beijing 2006 and implementation by PRC of the first strategy concerning activity in Africa.

¹¹ *China Statistical Yearbook 2009*.

It is worthy of noticing that Chinese sources of capital can be classified into three groups of organizations, i.e., State Administration of Foreign Exchange (SAFE),¹² which have ready cash at the level of over 2.4 trillion US dollars; investment funds supported by the SAFE (China Investment Corporation, China Development Bank, China Export-Import Bank); state-owned enterprises which can use, at the preferential conditions, financial resources accumulated by the above mentioned financial institutions.¹³

3. China's FDI in the evaluation of the Investment Development Path (IDP)

In the economy literature there are a number of theories concerning flows of capital between different economies. The hypothesis which has developed the Eclectic Theory of International Production (has tried to join conclusions taken from the oligopolistic, location and internalization theories) is the Investment Development Path created by J.H. Dunning. The hypothesis divides the development of the country into five phases which correspond to its investment position (net outward FDI and GDP *per capita*) – Figure 2. This theory also takes into consideration the dynamic

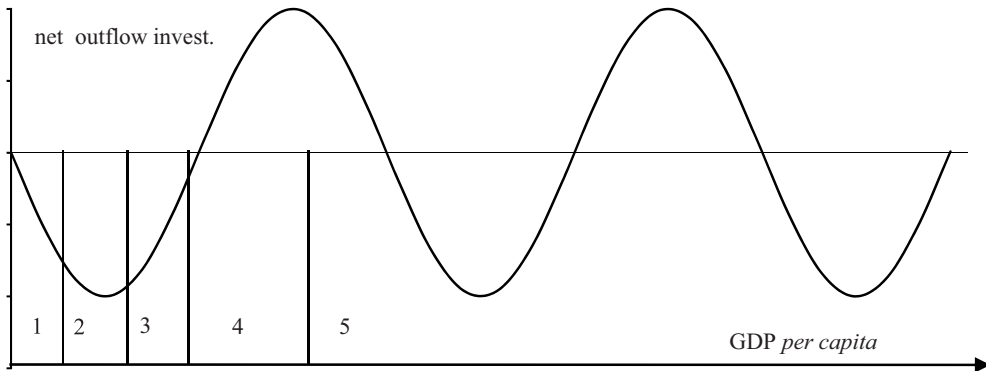


Figure 2. The pattern of the Investment Development Path

Source: J.H. Dunning, R. Narula, *Foreign Direct Investment and Governments*, Routledge, London and New York 1997, p. 2.

¹² At present the State Administration of Foreign Exchange can invest up to 5% of possessed financial resources in commercial assets. Estimated data indicates that SAFE has invested by 2008, among other things, about 16 billion US dollars in the securities issued by British financial institutions.

¹³ D. Scissors, *Drowning in Cash, Chinese Foreign Investment: Who, What and Why*, The heritage Foundation, 2009, <http://www.heritage.org/research/commentary/2009/06/drowning-in-cash-chinese-foreign-investment-who-what-and-why-part-1-of-3>.

character of internationalization processes of companies' activity.¹⁴ Moreover, each stage is described by advantages included in the Eclectic Theory of International Production (Table 1).

Table 1. Investment Development Path through Eclectic Theory

Stages	Characteristic	
	FDI outflow	FDI inflow
Stage 1 (very little OLI advantages)	Very little	Low value; character of investment "resource seeking"; outdated technologies
Stage 2 (net importer of FDI)	Growth of value; investment related with export and import of goods and the acquirement of strategic assets – comparatively low value	Dynamic rise mostly import substituting manufacturing investment (tariff and non-tariff barriers); character of investment "resource seeking" and "export oriented"; the growth of inflow in human capital
Stage 3 (net importer of FDI)	Dynamic growth, "export oriented" and "market seeking" into countries in the stages 1 and 2; "asset seeking" and partly "market seeking" into countries in the stages 3 and 4 of development	Based on knowledge and the latest technology; the character close to the investment inflow into countries in the stage 4; gradual decrease in the rate of growth of inward investment
Stage 4 (net exporter of FDI)	"Asset seeking" and "market seeking" into countries in stage 4 of development; growth of intra-industry trade and production; continuing to grow off-shore location for operation	"Asset seeking" and "market seeking" into countries in stage 4 of development; some investment can originate from countries at lower stages of development
Stage 5	No single country has absolute hegemony of created assets; cross-border transactions within international enterprises; cross-border flow of capital and trans-border cooperative agreements; position of investment balanced	

Source: own study based on J.H. Dunning, R. Narula, *op. cit.*, pp. 2-22; B. Park, K. Lee, Comparative analysis of foreign direct investment in China, *Journal of the Asia Pacific Economy* 2003, Vol. 8, No. 1, p. 60.

Based on the analysis of presented chart (Figure 2), key factors that impacted FDI outflows and inflows as well as conclusions reached by D. Freeman, it can be pointed out that there is a relationship between China's net direct foreign position and stage of economic development. According to the observation, the most important influence on geographic direction of the capital has factors, which are listed in Table 1. There is a penetration of local market, getting new technology, acquisition

¹⁴ M. Kola, M. Kuzel, *Polish Direct Investment in the Evaluation of the Investment Development Path*, Uniwersytet Mikołaja Kopernika, Toruń 2006.

of new brands and the possibility to reduce costs.¹⁵ Having considered the above-mentioned elements, we can conclude that China is at the third stage of the path postulated by the Investment Development Path theory. That correlation is presented on Figure 3.

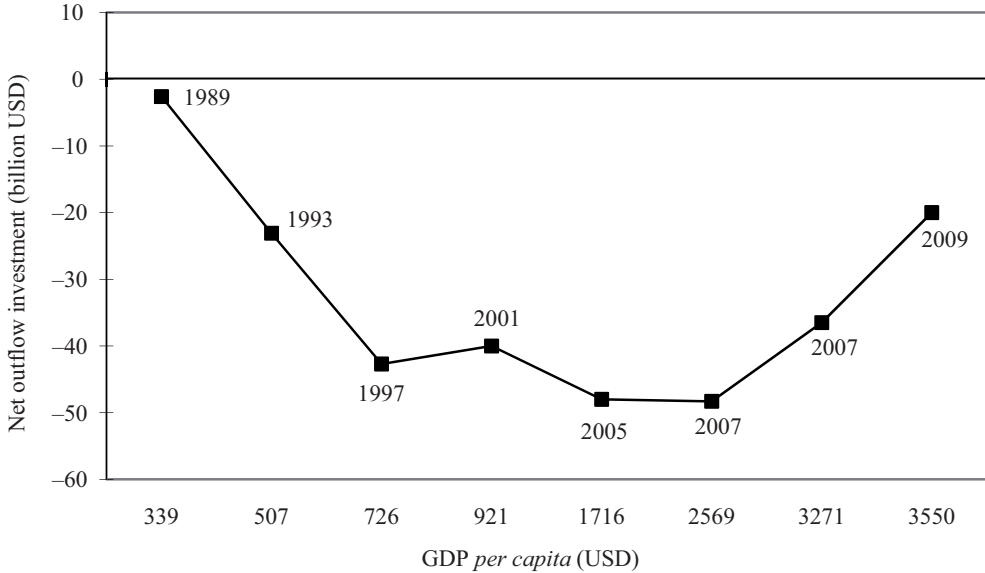


Figure 3. Investment position of PRC between 1989 and 2009

Source: own study based on data from *World Investment Report 2004*, United Nations, New York and Geneva 2004, International Monetary Fund and *China Statistical Yearbook 2009*.

4. Conclusions

Observation of the stage of development of People's Republic of China through Investment Development Path created by J.H. Dunning pointed out that between 2007 and 2009 PRC has moved rapidly from second phase (value of FDI inflow is much larger than capital outflow) to the third stage, when the expansion of outward investments and slowing growth of inward FDI can be seen (that phase of economic development is characteristic, among other things, of new industrialized economies). Furthermore, keeping the present pace of growth, in the two or three years period value of the Chinese foreign investments outflow can surpass the FDI inflow to China. As a result, China's economy would be classified, based on the above-mentioned theory, as pertaining to the fourth stage, which is characteristic of developed countries.

¹⁵ D. Freeman, *Roundtable Discussion of the EU-China Group on Outward Investment by Chinese Companies*, The Institute of International and European Affairs, 2010.

In the author's opinion the main factors which could influence in the near future China's FDI increase to developing countries as well as to the developed economies are the following.

1. The situation of uncertainty in the global economy can cause next fall of market values of international companies, which will create the possibility to acquire shares at lower prices. Furthermore, the perspective of strengthened RMB exchange rate could decrease the cost of China's outward investments.

2. The surplus on the current account as well as capital account expended China's foreign exchange reserves to the level of over 2.4 trillion US dollars. In order to reduce pressure on increase the RMB exchange rate, to reach the higher profit on foreign exchange reserves and to obtain the influence over management in international corporation by Chinese managers, Beijing will probably be increasing the purchase of commercial assets. The growth will be also used to execute strategic aims of the Chinese government, for example investment in energy deposits.¹⁶

3. The growing number of enterprises possessing financial resources and know-how will enable Chinese companies to enter into international market and to compete with factories based in developed countries. Also strong competition on the local market is the incentive for Chinese companies to expand their activity abroad.

Taking under consideration the above-mentioned factors and other economic indicators, it can be concluded that the importance of PRC's economy in the world will be growing. One of the leading factors of Beijing's impact on the international market will be the export of capital, mainly in the form of FDI.

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¹⁶ Research made by the International Monetary Fund indicated that in 2007 wasted revenue (opportunity cost) from keeping by the Chinese financial authority US bonds was estimated as more or less 66.4 billion US dollars.

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**WZROST WARTOŚCI
CHIŃSKICH INWESTYCJI ZAGRANICZNYCH
W LATACH 2007-2009 A POZYCJA INWESTYCYJNA CHRL
W ŚWIETLE TEORII ŚCIEŻKI INWESTYCYJNO-ROZWOJOWEJ
J.H. DUNNINGA**

Streszczenie: Próba określenia stadium rozwoju gospodarki ChRL na gruncie teorii ścieżki inwestycyjno-rozwojowej wskazuje, że Chiny w okresie 2007-2009 przemieściły się z drugiego stadium rozwoju (dynamika wzrostu inwestycji napływających jest wyższa niż kapitału wypływającego) do fazy trzeciej, w której tempo wzrostu środków wypływających jest większe niż ZIB napływających. Ten etap rozwoju gospodarczego charakteryzuje m.in. kraje nowo uprzemysłowione. Ponadto przy utrzymaniu obecnej dynamiki wzrostu, już w 2011 r. wartość chińskich inwestycji zagranicznych może przekroczyć wielkość ZIB napływających do gospodarki ChRL. W rezultacie gospodarka Państwa Środka może zostać zaklasyfikowana (w świetle powyższej hipotezy) do czwartego etapu rozwoju odpowiadającego krajom rozwiniętym.