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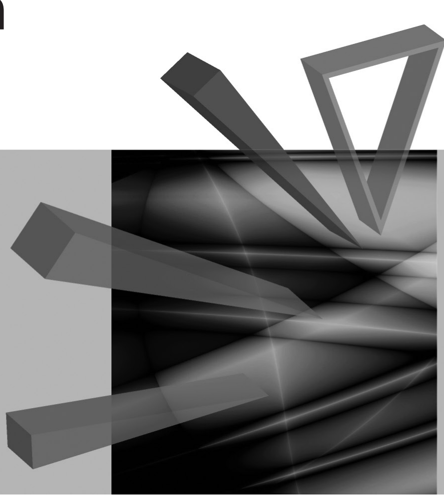

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Contents

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THE GOVERNMENT PERSPECTIVE ON CHINESE OUTWARD FOREIGN DIRECT INVESTMENT

Abstract: Outward foreign direct investment (OFDI) from China has grown significantly in recent years, becoming a common phenomenon in today's business world. The basic purpose of the article is to present Chinese outward FDI from a governmental point of view. On the basis of the policy towards OFDI, the article explains why and how the government stimulates outward investments undertaken by Chinese enterprises. This study describes the governmental institutions that have an influence on Chinese overseas investment as well as presents changes of the policy towards outward foreign direct investment and their impact on international activity of Chinese corporations.

Keywords: Foreign Direct Investment, China, policy on FDI, regulatory institutions, political institutions.

1. Introduction

The emergence of China as a strong player in the international economic system is now widely recognized and well known in business, political and academic circles. Most of the attention on China's economic success has been paid to its high and sustained economic growth over the last three decades, with foreign direct investment (FDI) as the most significant factor of the Chinese economy development. Since the economic reforms initiated in the late 70s China has been very successful in attracting foreign capital, becoming thus one of the largest recipients of foreign direct investment in the world. According to the UNCTAD World Investment Report 2011, China[1] is one of the most attractive FDI destination countries in the world and third among developing countries after Hong Kong and Brazil. Its total FDI inward stocks between 1980 and 2010 amount to 578.8 billion USD, what represents 9.7% and 3% of developing-country and global inward FDI stocks respectively.[2]

The high levels of FDI undertaken by foreign investors in China have overshadowed the international activity of Chinese enterprises. China is no longer

[1] Excluding Hong Kong SAR and Macao SAR.
[2] Data from: UNCTAD Statistical database, www.unctadstat.unctad.org (retrieved 2.05.2013).

only a recipient of foreign capital but also an increasing source of outward FDI itself. Although Chinese outward investment is still relatively small, especially in comparison to developed countries, China's outward FDI is growing fast and Chinese multinationals are gaining importance as new sources of international capital. In 2010 the country was ranked fifth among all countries investing overseas, with its FDI outflows of 68 billion USD, what accounted for 5.18% of all outward foreign direct investment undertaken in 2010.[3]

The increase of Chinese FDI outflows has come from the rapid development of country's economy, the process of economic liberalization implemented by the government as well as the availability of international markets and strategic intent of Chinese enterprises to exploit their competitive advantages and expand their activities on a global scale. This growth is also driven by the government activity towards OFDI promotion, which has a significant influence on international expansion behaviour of Chinese multinational companies. Recently the governmental institutions encourage local enterprises to go global, looking at the same time for the interest of home economy development as well as for the growth and global expansion of individual Chinese enterprises.

The main purpose of this article is to present Chinese outward foreign direct investment from the governmental perspective. The article is organized as follows. Section 2 presents features and trends of China's outward FDI in general: its size, composition and structure as well as target locations. Section 3 delivers a short description of the governmental institutions that impact Chinese OFDI. In section 4 the centre issue is an evolution of government support for China's outward foreign direct investment and its consequences. The conclusions are included in section 5.

2. Descriptive overview of Chinese outward foreign direct investment

The outflow of foreign direct investment from China has risen substantially in recent years, especially after the implementation of the "go global" policy in the early 2000s, making at the same time China one of the most significant sources of capital in a great number of host economies. Chinese outward FDI amounted to over 68 billion USD in 2010, going up by 22% compared to the previous year. Although the FDI outflow has increased almost thirty times since 2000 and continues to grow rapidly, the total accumulated value represents only 1.4% of total world investments and, in relation to GDP, remains below the world average.[4]

The geographic allocation of China's outward foreign direct investments in 2010 was as follows: Asia – 65% of total FDI outflows (72% of outward FDI stock), Latin America – 15% (14%), Europe – 10% (5%), North America – 4% (2%), Africa – 3%

[3] *Ibidem*.

[4] Data from: *World Investment Report 2011*, UNCTAD, New York and Geneva 2011.

(4%), Australia and Oceania – 3% (3%). The data shows that Chinese overseas investment is greatly concentrated in the Asian region, while developed countries remain a much less important target location for Chinese investment. This is mainly due to geo-cultural affinity between China and other Asian countries as well as similarity of business conditions in the region. In 2010 Chinese outward FDI was undertaken mostly in the following countries: Hong Kong (56% of total investment made in the year 2010), British Virgin Islands (8.9%), Cayman Islands (5.1%), Luxembourg (4.7%), Australia (2.5%) and Sweden (2%). The distribution of overseas investment in 2010 is consistent with the accumulated value of Chinese OFDI. The largest receivers of Chinese capital (in terms of OFDI stock in 2010) are as follows: Hong Kong (62.8% of total investment stock), British Virgin Islands (7.3%), Cayman Islands (5.4%) and Australia (2.5%).[5]

The majority of China's outward foreign direct investment comes from primary and tertiary industries, which were the five largest investing industries in terms of Chinese FDI outflows in 2010, including leasing and business services (44% of total FDI outflows), banking services (12.5%), wholesale and retail trade (9.8%), mining industry (8.3%) and transport, storage and post (8.2%). They together accounted for almost 83% of total Chinese overseas investment undertaken that year. Secondary production like manufacturing of goods represented a relatively small share only. But the picture of Chinese OFDI changed a lot during last couple of years. The importance of mining industry, once the primary focus of Chinese investors, has its share diminishing by three quarters from near 33% in 2004 to 8.3% in 2010. Another decreasing destination sector is manufacturing industry which experienced a drop by a half from 13.7% in 2004 to 6.8% in 2010. In contrary, business service industry soared over three times from 13.6% to 44% in the same period. The sector composition of Chinese OFDI stock is similar to its flow. The five previously mentioned industries account for 82.7% of total stock in 2010.Their share in the accumulated value of China's outward investment is more stable than in the case of FDI outflows.[6]

Currently available data do not enable OFDI cross-classification together by country and industry, making it difficult to be more explicit about sector composition of Chinese outward investment in individual countries, regions and groups of countries.

The majority of current China's outward FDI is driven mostly by three motivating factors. Depending on the company and the field of its operations, Chinese enterprises expand their activities overseas to search for new output markets as well as to acquire natural resources (especially raw materials) and obtain strategic assets such as advanced technologies, know-how and organizational and managerial patterns.[7] The

[5] Data from: *2010 Statistical Bulletin of China's Outward Foreign Direct Investment*, www.mofcom.com.cn (retrieved 6.05.2013).

[6] *Ibidem*.

[7] For example, see: P.J.Buckley, L.J. Clegg, A.R. Cross, X. Liu, H. Voss, P. Zheng , The determinants of Chinese outward foreign investment, *Journal of International Business Studies* 2007, vol. 38, no. 4, pp. 499–518; Y.W. Cheung, X. Qian, *The Empirics of China's Outward Direct Investment*, Cesifo

investment motives have a significant impact on the form of outward FDI made by Chinese corporations. Generally, mergers and acquisitions are a foremost way of undertaking overseas investments. In developed countries M&As are used due to specific motivation for investing, i.e. obtaining strategic assets. Chinese enterprises invest also in developing countries, seeking mainly for natural resources which are desirable because of insufficient domestic resources. The lack of raw materials leads Chinese firms to invest in mining industry in countries that are rich in natural resources – mainly in Africa and Australia. The major form of these OFDI is also M&A, but greenfield investments are applied as well.

The aforementioned information shows that Chinese outward foreign direct investment remains relatively small, especially compared to the economy's size. China's OFDI is mainly focused on nearby developing countries, tax havens and countries that are rich in natural resources. Mergers and acquisitions remain a predominant form of making foreign investments. It indicates that many Chinese companies are still in the initial phase of the internationalization of their business activities.

3. Institutions affecting OFDI undertaken by Chinese enterprises

The institutional architecture of an economy, especially an emerging one, determines the ability and desire of domestic companies to make foreign investments. This is due to the fact that firms' activity is influenced to a great extent by the home institutional environment which is formed by government and its agents. Compared with major source countries for FDI, investing activity of Chinese enterprises is highly regulated. There are many regulatory and political institutions in China that have a real influence on making investments by domestic firms outside their country. The major bodies are: State Council, People's Bank of China (China's central bank), Ministry of Commerce, State Administration of Foreign Exchange, National Development and Reform Commission and State-owned Assets Supervision and Administration Commission. Taking into account the scope of state control over the China's economy the institutional environment has utterly profound and deep effects on the investment decisions of Chinese companies willing to expand their operations abroad.

State Council

The State Council, known also as the Central People's Government, is the chief administrative authority of China. As the highest executive organ in the country the State Council is responsible for carrying out major regulations and laws, developing

Working Paper no. 2621, 2009, pp. 1–39, www.ideas.repec.org (retrieved 5.05.2013); A. Boateng, W. Qian, Y. Tianle, Cross-border M&As by Chinese firms: An analysis of strategic motives and performance, *Thunderbird International Business Review* 2008, vol. 50, no. 4, pp. 259–270; L.K. Cheng, Z. Ma, *China's Outward Foreign Direct Investment*, Paper presented at the Indian Statistical Institute, 12 December 2008, http://www.isid.ac.in/~pu/seminar/12_12_2008_Paper.doc (retrieved 6.05.2013).

policies as well as for coordinating national economic development by dealing with such issues as internal politics, finance and economy. The State Council does not involve in concrete policy initiatives for outward foreign direct investment, but by making major policy decisions and establishing economic strategy it plays an important role in encouraging OFDI. However, foreign operations of Chinese companies are mainly affected by specific policy measures applied by subordinate organs of the State Council.[8]

People's Bank of China

The People's Bank of China (PBC) has functioned as the central bank of China since 1983, having the power to formulate and implement monetary policy and to regulate other financial institutions in the country. PBC is also responsible for supervising as well as managing national foreign exchange reserves. The combined authority over domestic financial policies (interest rates) and foreign exchange control (the foreign exchange reserve ratio and the value of the Chinese currency) has an influence on Chinese outward FDI. When PBC increases the value of RMB (Chinese yuan) it motivates more companies to invest abroad as RMB can be converted to more units of a foreign currency and thus the costs of making FDI become lower. Similarly, the intentionally diminution of the foreign exchange reserve ratio increases the availability of foreign exchange capital on the domestic market, what allows more firms to invest abroad.[9]

Ministry of Commerce

The Ministry of Commerce (MOFCOM) is an executive agency of the State Council of China. It is a major ministry that is responsible for promoting and managing Chinese outward FDI[10] at the central level. MOFCOM's principal responsibilities concerning Chinese OFDI include:[11]

– supervision of Chinese OFDI by development and implementation of specific policies and regulations, and ratification of large non-financial OFDI projects;
– bilateral and multilateral negotiations connected with treaties on trade and investment; Ministry of Commerce represents therefore China on the international scene in many economic organizations, especially at the World Trade Organization;

[8] http://english.gov.cn/2005-08/05/content_20763.htm (retrieved 8.05.2013).

[9] Y. Luo, Q. Xue, B. Han, How emerging market governments promote outward FDI: Experience from China, *Journal of World Business* 2010, vol. 45, p. 71.

[10] Besides managing OFDI, Ministry of Commerce is also responsible for formulating policy on foreign trade (import and export regulations), market competition, protection of consumer rights as well as negotiating bilateral and multilateral trade agreements.

[11] H. Wenbin, A. Wikes, *Analysis of China's Overseas Investment Policies*, Working Paper 79, Center for International Forestry Research (CIFOR), Bogor 2011, p. 3.

– ensuring the alignment of Chinese economic and trade regulations and laws with international agreements and treaties signed by the Chinese government;
– coordination of Chinese foreign aid policy as well as other relevant loan and funding schemes.

The aforementioned functions provide MOFCOM with a direct and indirect ability to control and affect the range and direction of outward foreign direct investment undertaken by Chinese enterprises.

State Administration of Foreign Exchange

The State Administration of Foreign Exchange (SAFE) is an administrative agency responsible mainly for development of rules and regulations regarding foreign exchange market activities as well as supervision of foreign exchange inflows and outflows. SAFE carries out its OFDI-related function in the following ways:[12]

– reporting balance of payment data and the external credit and debt to the State Council (national level) and the International Monetary Fund (international level);
– proposing policy suggestions for reforming the foreign exchange administration system;
– monitoring inflows and outflows of foreign exchange for investment under the capital account of the balance of payments;
– managing foreign exchange market of the state, including oversight of the settlement and sale of foreign exchange, and development of the foreign exchange market;
– managing China's foreign exchange assets such as foreign exchange reserves.

National Development and Reform Commission

The National Development and Reform Commission (NDRC) is one of the core ministry-level bodies involved in outward FDI management, next to MOFCOM and SAFE. NDRC is a principle government agency that sets overall economic and industrial policies and formulates and implements strategies of national economic development. Its major functions concerning OFDI include development of objectives, strategies and policies to balance and optimize Chinese outward investments.[13] NDRC is also responsible for directing Chinese OFDI to particular locations. Together with MOFCOM, it announces a list of countries and sectors that are encouraged by the Chinese government to invest in as well as a list of measures, including financial incentives which are used by the government to assist in China's OFDI. Moreover, NDRC is also involved in the approval process for Chinese

[12] http://www.safe.gov.cn/wps/portal/english/AboutSAFE/Major (retrieved 9.05.2013).
[13] http://en.ndrc.gov.cn/mfndrc/default.htm (retrieved 9.05.2013).

overseas investments. All OFDI projects in industrial sectors, especially in natural resources industries, involving large sum of foreign exchange require prior approval from NDRC.[14]

State-owned Assets Supervision and Administration Commission

State-owned Assets Supervision and Administration Commission (SASAC) is a government institution established to manage the national state-owned assets, particularly large state-owned enterprises that operate in non-financial sectors. All OFDI projects of the companies under the supervision of SASAC need to be approved by the Commission which evaluates every foreign investment in terms of its profitability. As state-owned companies account for the majority of all Chinese companies, SASAC plays an important role in shaping activity of domestic enterprises involved in overseas operations.[15]

4. Evolution of Chinese OFDI policy

The Chinese enterprises' operations in form of FDI are highly regulated, monitored, but also supported and promoted by the aforementioned government agencies. These formal institutions have a great influence on shaping the extent and pattern of outward investments undertaken by Chinese companies. From a governmental perspective, Chinese OFDI policy development can be divided into five major periods. During these five phases, a significant change in the government policy towards outward foreign direct investments can be observed. The evolution of policy on outward FDI is important for a good understanding of the changes in Chinese OFDI.

Phase one (1978–1984)

The first phase was a result of the reform era beginning initiated through the "Four Modernizations" scheme commenced by Deng Xiaoping in the late 70s. During this period when overseas investments were under strict supervision of the state, only selected state-owned enterprises were permitted to invest abroad, mainly in the form of foreign joint venture. It was due to the fact that the government was focused on attracting foreign capital, mainly in the form of inward FDI, setting at the same time very tight restrictions on capital outflows.[16] The State Council was the only body responsible for the review and approval of outward investments. Chinese companies were in effect unable to invest abroad without getting a proper permission. During that period of time the scale of OFDI projects was slight and the total investment was very limited.[17]

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[14] Y. Luo, Q. Xue, B. Han, *op. cit.*, p. 72.

[15] H. Wenbin, A. Wikes, *op. cit.*, p. 5.

[16] P.J. Buckley et al., *op. cit.*, p. 504.

[17] Y.P. Woo, K. Zhang, *China Goes Global: The Implications of Chinese Outward Direct Investment for Canada*, p. 3, available on www.economics.ca (retrieved 5.05.2013).

Phase two (1985–1991)

In the second half of the 80s the governmental approach towards outward FDI became more liberal. The Ministry of Foreign Trade and Economic Cooperation, the predecessor of MOFCOM, was assigned by the State Council as the authority accountable for reviewing and approving OFDI projects. The Ministry revised regulatory framework on overseas investment and implemented standardized procedures for applying for as well as approving outward investments. As a consequence, the approval process has changed from a case-by-case approach to more general one. Therefore, more Chinese companies, including non-state enterprises, were allowed to establish foreign subsidiaries and affiliates. The eased OFDI policies supported the increase of Chinese outward investment which, however, still remained at a low level. On the other hand, the government activities undertaken in this period have established the foundations of Chinese foreign investment management system, affecting thus the OFDI growth in the next period.[18]

Phase three (1992–1998)

At the beginning of 90s a number of economic reforms towards liberalization was launched in China. OFDI was officially incorporated into the plan for national economic development, and resulted in active involvement of local authorities in promoting internationalization of enterprises. The state-owned corporations were supported in their foreign operations mainly in order to acquire new markets and to obtain foreign strategic assets. The change in OFDI policy caused a notable increase in foreign investments made by domestic enterprises. However, in the face of the Asian financial crisis in 1997 as well as growing suspicion of state assets embezzlement the OFDI approval processes, especially for large-scale projects, was highly tightened. In a consequence, the government established strict rules for monitoring OFDI projects to ensure that outward investments were driven by truly business motives.[19]

Phase four (1999–2001)

In the late 90s the approach of the Chinese government towards OFDI was contradictory. On the one hand, the approval process for overseas investments was tightened. On the other hand, the government recognized the importance of foreign investment and noticed its potential to drive domestic economic development. Eventually, OFDI advantages won over its disadvantages. In 1999 the Chinese government introduced the "go global" strategy to encourage Chinese enterprises to engage in the internationalization process. As a result, the government issued many favourable policies with a view to improve the allocation of domestic companies'

[18] H. Wenbin, A. Wikes, *op. cit.*, pp. 7, 8.
[19] Y. Luo, Q. Xue, B. Han, *op. cit.*, p. 75.

resources and increase their international competitiveness. The government proposed a number of incentives including assistance through insurance, interest-free credits and other supporting services.[20]

Phase five (2002–present)

The objectives of the "go global" policy were reviewed and strengthened at the 16th National Congress of Chinese Communist Party in 2002. In a consequence, an updated set of policies was established for further stimulation of Chinese OFDI development. The major resolutions concerning outward investment were as follows: reduction of direct control over the economy, removing of bureaucratic barriers of FDI outflows, creating incentives for overseas projects, providing information and guidance on investment opportunities and reducing foreign investment risks. These reform measures supported a significant surge in outward FDI undertaken by Chinese companies in the recent years.[21]

5. Summary

Over the last three decades, a significant change in the governmental attitude towards the state support for Chinese OFDI can be observed. The government, not convinced about the necessity of going abroad, generally discouraged Chinese enterprises from making overseas investments until the beginning of 2000s, when the new policy "go global" was introduced to encourage companies to invest in foreign markets. Before the new strategy has been implemented, Chinese OFDI policy was driven mainly by priorities of the central authorities. A number of changes in the policy were made in the 80s and 90s, but many of those were just political or administrative in nature and had a very limited influence on international activity of Chinese companies. However, China's policy towards outward investment has gradually shifted from the focus on political goals to commercial interests. At the same time, the process of approving OFDI projects has been much simplified as the decision-making power was delegated from the central authorities to the local ones and more recently to the companies.

While there is no guarantee that Chinese OFDI policy will continue to be liberalized, the last decades witnessed a huge shift that has already happened in the government approach. In a consequence, many Chinese enterprises have begun to expand their economic operations on the international scale and the government support for outward investment contributes to the increase of Chinese companies' presence and significance in the global economic system.

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[20] Y.P. Woo, K. Zhang, *op. cit.*, p. 3.

[21] D. Bach, A.L. Newman, S. Weber, The international implications of China's fledging regulatory state: From product maker to rule maker, *New Political Economy* 2006, vol. 11, no. 4, pp. 499–518; H. Wenbin, A. Wikes, *op. cit.*, p. 10.

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POLITYKA RZĄDU CHIN WOBEC WYCHODZĄCYCH BEZPOŚREDNICH INWESTYCJI ZAGRANICZNYCH

Streszczenie: W ciągu ostatniej dekady zaobserwować można znaczny wzrost bezpośrednich inwestycji zagranicznych (BIZ) z Chin, które stały się powszechnym zjawiskiem we współczesnej gospodarce światowej. Podstawowym celem niniejszego artykułu jest przedstawienie chińskich BIZ z perspektywy uwarunkowań politycznych. W artykule podjęto próbę wyjaśnienia, dlaczego i w jaki sposób rząd stymuluje przepływ zagranicznych inwestycji dokonywanych przez chińskie przedsiębiorstwa. W opracowaniu zaprezentowane zostały instytucje rządowe, mające wpływ na chińskie BIZ, jak również zmiany polityki wobec bezpośrednich inwestycji zagranicznych i ich wpływ na działalność międzynarodową chińskich przedsiębiorstw.

Słowa kluczowe: bezpośrednie inwestycje zagraniczne, Chiny, polityka wobec BIZ, instytucje regulacyjne, instytucje polityczne.