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## The impact of Chinese outward investment: evidence from Cambodia and Vietnam

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# The Impact of Chinese Outward Investment: Evidence from Cambodia and Vietnam

*Julia Kubny  
Hinrich Voss*



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## Abstract

This paper provides an initial qualitative assessment of the impact of China's Outward Foreign Direct Investment on local workers and firms in Cambodia and Vietnam. Based on interviews with 60 Chinese investors plus further interviews with other foreign investors and domestically owned firms in the manufacturing industries of the two countries, the study assesses employment and income effects, training, spillovers, and linkage effects.

The analyses show that the positive effects of Chinese manufacturing investment have been limited, while negative effects have not been observed. Chinese firms have a strong positive impact on the domestic workforce, but little interaction with local firms, which reduces the potential gains from spillovers. This contrasts with UNCTAD's expectations, but is in line with findings on industrialised-country FDI and shows that the impact of any investment, whether or not Chinese, is constrained by existing host-country conditions. The findings suggest separate policy recommendations for the local economy in Cambodia and Vietnam to derive greater benefit from this investment.



# Contents

## Abbreviations

<b>1</b>	<b>Introduction</b>	<b>1</b>
<b>2</b>	<b>Trends in China's OFDI in Southeast Asia</b>	<b>2</b>
<b>3</b>	<b>Host-Country effects of FDI</b>	<b>5</b>
3.1	Direct effects	5
3.2	Indirect effects	5
<b>4</b>	<b>Methodology</b>	<b>7</b>
<b>5</b>	<b>Impact of China's FDI on Cambodia and Vietnam</b>	<b>9</b>
5.1	Direct effects on local workers	9
5.2	Indirect effects on local firms	10
<b>6</b>	<b>Discussion and conclusion</b>	<b>11</b>
	<b>Bibliography</b>	<b>15</b>
	<b>Annex</b>	<b>19</b>



## **Boxes and Tables**

Box 1:	Distribution of China's OFDI stocks, 2003-2008 (US\$m)	4
Table 1:	Chinese OFDI stocks in ASEAN and ASEAN+3 (US\$m)	3
Table 2:	Country selection criteria	8

## **Tables in the Annex**

Table A1:	Overview of mainland Chinese firms interviewed in Cambodia	21
Table A2:	Overview of mainland Chinese firms interviewed in Vietnam	23

## Abbreviations

ACFTA	ASEAN-China Free Trade Agreement
ASEAN	Association of Southeast Asian Nations
BVI	British Virgin Islands
CI	Cayman Islands
CIEM	Central Institute for Economic Management (Hanoi)
FDI	Foreign Direct Investment
HK	Hong Kong
IMF	International Monetary Fund
ISEAS	Institute of Southeast Asian Studies (Singapore)
LDC	Least Developed Country
MNE	Multinational Enterprise
MOFCOM	Ministry of Commerce of the People's Republic of China
NGO	Non-Governmental Organization
NIEs	Newly Industrialised Economies
OFDI	Outward Foreign Direct Investment
UNCTAD	United Nations Conference on Trade and Development



## 1 Introduction

The discourse on the impact of China's Outward Foreign Direct Investment (OFDI) has recently been dominated by resource-seeking investment in Africa, and this FDI has frequently been accused of having mainly negative and exploitative consequences for the host economies (e.g. Alden / Davies 2006; The Economist 2009; Frynas / Paulo 2007; Brookes 2007). These assessments are controversial for two reasons. First, China's OFDI has become very important for a number of less developed countries, not least because it remained stable during the global economic crisis with non-financial OFDI reaching US\$ 40bn and US\$ 43bn (MOFCOM 2010) in 2008 and 2009, respectively, whereas global FDI flows contracted by 39 per cent in the same period UNCTAD 2010b. In Cambodia, for example, China ranked as the largest investor in 2009, according to the Cambodia Investment Board, and its FDI is assumed to be similarly important in Laos and Myanmar (Frost 2005). Chinese investment can therefore give the host economy significant economic stimuli.

Second, despite the importance of Chinese OFDI for many less developed countries, rigorous empirical evidence from primary sources of the effects of Chinese OFDI on host-country development is very scarce. Conclusions are often drawn from anecdotal and selective descriptive examples (e.g. Frost / Pandita / Hewison 2002). The lack of empirical evidence is, however, not restricted to Chinese OFDI. In assessing host-country effects of FDI in developing countries, extant research has often failed to distinguish between source countries or, if source countries are taken into account, it has usually focused on industrialised source countries (Fortanier 2007; Banga 2006). Studies that investigate FDI effects with the help of empirical evidence on MNEs from developing economies are generally rare. Lall (1983) and UNCTAD (2006), however, theorise that developing countries' OFDI is likely to have greater employment-generating potential and indirect effects. This view is motivated by the argument that lower technology levels and institutional and cultural proximity make FDI from developing countries more suitable for developing host countries. We address this research gap by using primary data from Cambodia and Vietnam to carry out an initial assessment of the direct and indirect effects of Chinese outward investment on these economies. Given the increase in FDI flows between developing countries, it will be beneficial to have better empirical evidence to facilitate our understanding of the effects of this type of FDI on host countries. This will contribute to the theorising on the development effects of FDI from emerging economies as well as to policy-making.

What is equally important is that the current discourse on Chinese OFDI seems to neglect the fact that a large share of this OFDI remains in Southeast Asia (MOFCOM 2008). Despite the focus of China's OFDI on its 'home region' (Rugman / Li 2007), there is little understanding about the nature and distribution of that investment. As this has implications for the potential host-country effects, we address this research gap by considering China's investment in the region from 2003 to 2008 to provide a baseline and enable more detailed and perceptive cross-regional comparisons of Chinese OFDI. As Buckley et al. (2007) and Morck et al. (2008) have indicated, the latter point is significant because the characteristics of China's intraregional OFDI can be expected to differ from its OFDI in other parts of the world in terms of risk-taking and local involvement with Overseas Chinese.

The next section addresses this second gap and provides an overview of trends in Chinese OFDI in the member countries of the Association of Southeast Asian Nations (ASEAN). This is followed by a summary of existing literature on host-country effects of FDI. The fourth section explains the research methodology applied. The fifth section presents our findings on the development effects of Chinese OFDI in Cambodia and Vietnam. The last section concludes with some initial policy recommendations.

## **2 Trends in China's OFDI in Southeast Asia**

In the early 1990s, when outward investment from China started to expand following domestic policy liberalisations (Buckley et al. 2007; Luo / Xue / Han 2010), the major recipient countries (by value) were industrialised economies, such as Australia, the United States, and Canada. While only one third of China's total OFDI volume went to developing countries, they attracted almost two thirds of China's OFDI projects. These proportions indicate that FDI projects in developing countries were smaller in scale than those in developed countries. At that time, the ASEAN member states were receiving around five per cent of China's outward investment (UNCTAD 2010a). The developing countries' share rose over time, and by 2008 they accounted for 60 per cent of China's OFDI volume, indicating a more even spread of investment in terms of scale. ASEAN's share rose to 17 per cent by 2008 (see Table 1).

The ASEAN member states' large share of Chinese OFDI may have been due to the regional integration fostered by ASEAN and its policies. Wong and Chan (2003) reasoned that the ASEAN-China free trade agreement (FTA) would stimulate inflows of FDI from China to ASEAN and predicted that "[i]n the near future, China could well constitute the fourth wave of FDI for Southeast Asia, following the first three waves associated with the West, Japan, and the four Asian NIEs." However, a positive influence of the institutionalised ASEAN integration process on Chinese OFDI in ASEAN per se cannot so far be inferred from official data (Kubny / Mölders / Nunnenkamp 2008). This is because the integration agreements have not yet been fully implemented and investors view the prospects of the process with scepticism. Although the 'fourth wave' has not yet materialised, Chinese investment has triggered a change of mindset on regionalisation (Frost 2005). While China was once mainly seen as an economic threat, the opportunities it presents as an outward investor are increasingly acknowledged and appreciated by its neighbours, to the extent that ASEAN countries are now making ever greater efforts to attract Chinese investment (Chia / Sussangkarn 2006).

From the viewpoint of the ASEAN host countries, the ratio of FDI from China to total inward FDI is low for ASEAN as a whole (below one per cent in 2006). FDI in Singapore and other more advanced ASEAN member countries is dominated by investment from Japan and the USA, Singapore alone accounting for 50 per cent of all FDI inflows to ASEAN in 2006 – which explains the low share of Chinese FDI for ASEAN as a whole. For some countries in the region, however, Chinese inflows are substantial. According to unpublished data obtained from the Cambodia Investment Board, China was the largest investor in Cambodia in 2009. Chinese investment in the Lao PDR and Myanmar is similarly substantial, accounting for nine and 22 per cent, respectively, of total inward FDI (UNCTAD 2010a). China's share may be higher than official home and host-country data

reveal, as the example of Vietnam illustrates. As a large proportion of Vietnam's FDI inflows originate from Hong Kong and the British Virgin Islands, Frost (2005) suspects that further significant amounts of Chinese capital are being routed to Vietnam via these and other offshore financial centres. On the other hand, there are also reasons to assume that China's share is overestimated in some host countries. During field research in Cambodia and Vietnam we found that a number of companies identified and registered as mainland Chinese were in fact owned by a parent company in Hong Kong, Macao or Taiwan. In some cases, the parent companies had been established in mainland China and later moved to Hong Kong for such reasons as taxation, logistics and proximity to clients. In other cases, however, companies originated from Hong Kong or Taiwan and were incorrectly registered as mainland Chinese.

**Table 1: Chinese OFDI stocks in ASEAN and ASEAN+3 (US\$m)**

	2003	2004	2005	2006	2007	2008
<b>Total world</b>	<b>33,222.22</b>	<b>44,777.26</b>	<b>57,205.62</b>	<b>75,025.55</b>	<b>117,910.50</b>	<b>183,970.71</b>
<b>Total world excl. BVI, CI, HK<sup>i</sup></b>	<b>4,366.64</b>	<b>6,635.08</b>	<b>9,779.37</b>	<b>13,796.05</b>	<b>25,691.96</b>	<b>37,320.65</b>
Singapore	164.83	233.09	325.48	468.01	1,443.93	3,334.77
Indonesia	54.26	121.75	140.93	225.51	679.48	543.33
Vietnam	28.73	160.32	229.18	253.63	396.99	521.73
Myanmar	10.22	20.18	23.59	163.12	261.77	499.71
Thailand	150.77	181.88	219.18	232.67	378.62	437.16
Cambodia	59.49	89.89	76.84	103.66	168.11	390.66
Malaysia	100.66	123.24	186.83	196.96	274.63	361.20
Lao People's Democratic Republic	9.11	15.42	32.87	96.07	302.22	305.19
Philippines	8.75	9.80	19.35	21.85	43.04	86.73
Brunei Darussalam	0.13	0.13	1.90	1.90	4.38	6.51
<b>ASEAN</b>	<b>586.95</b>	<b>955.70</b>	<b>1,256.15</b>	<b>1,763.38</b>	<b>3,953.17</b>	<b>6,486.99</b>
ASEAN as % of total	1.77	2.13	2.20	2.35	3.35	3.53
ASEAN as % of total excl. BVI, CI, HK	13.44	14.40	12.84	12.78	15.39	17.38
Japan	89.31	139.49	150.70	223.98	558.27	509.69
Korea, Republic of	235.38	561.92	882.22	949.24	1,214.14	850.34
<b>ASEAN+3<sup>ii</sup></b>	<b>911.64</b>	<b>1,657.11</b>	<b>2,289.07</b>	<b>2,936.60</b>	<b>5,725.58</b>	<b>7,847.02</b>
ASEAN+3 as % of total	2.74	3.70	4.00	3.91	4.86	4.27
ASEAN+3 as % of total excl. BVI, CI, HK	20.88	24.97	23.41	21.29	22.29	21.03

Notes: (i) OFDI stocks in Hong Kong, the Cayman Islands and the British Virgin Islands are excluded here to ensure a more accurate picture of China's OFDI distribution (see the Box below for a discussion of data problems).

(ii) ASEAN +3 comprises ASEAN, China, Japan, and South Korea. China is excluded here.

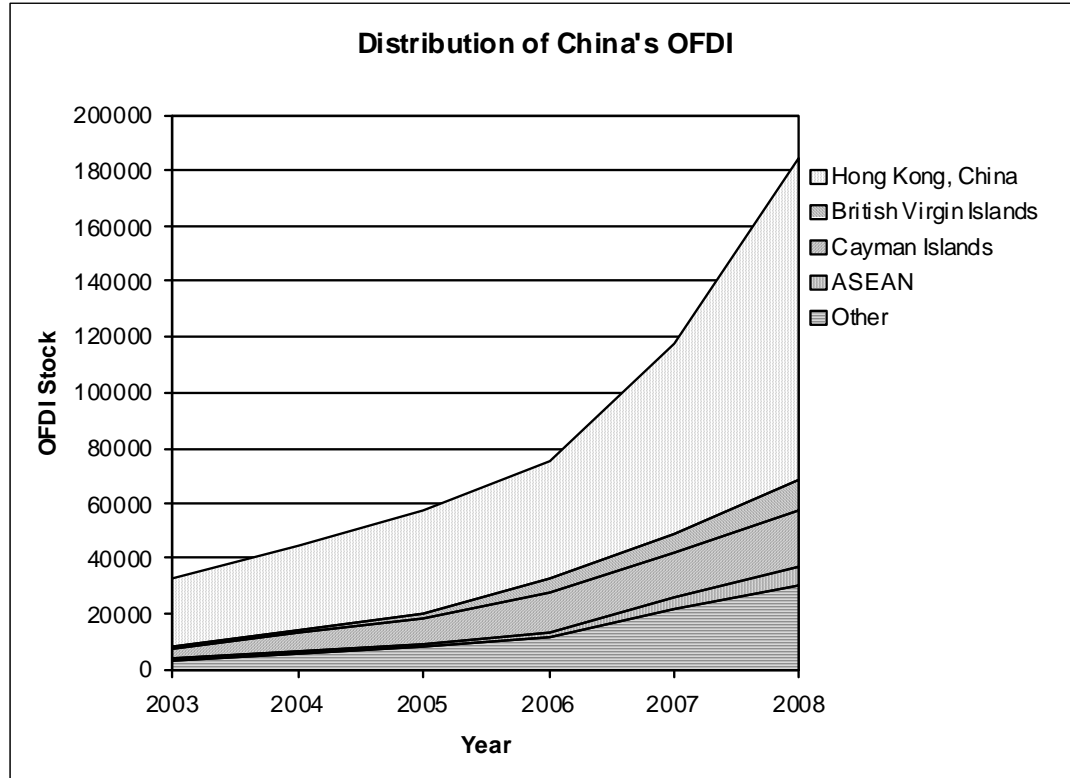
Source: UNCTAD (2010a)

Chinese OFDI is attracted to ASEAN by the attributes of its individual member states. Resource-rich countries such as Cambodia, Indonesia, and Laos have attracted Chinese investment in the primary sector (Pangestu 2004). Thailand benefits from an FTA with China, which has significantly increased FDI, especially to Northern Thailand (Frost 2005). Singapore's attraction for Chinese investors is its hub status in financial services, trade, shipping and logistics. As a consequence, Chinese OFDI in Singapore predominantly goes to the services sector (Chia / Sussangkarn 2006). Low-wage countries like Cambodia and Vietnam have received substantial Chinese OFDI in labour-intensive manufacturing. This investment is concentrated on the garment sector in Cambodia, but spread over a range of industries in the economically more advanced Vietnam. Other factors attracting Chinese OFDI to ASEAN member countries are historical ties, as in Thailand's case, and such favourable measures as the provision of infrastructure for investment.

**Box 1: Distribution of China's OFDI stocks, 2003-2008 (US\$m)**

Official data on Chinese OFDI suffer from various deficiencies. UNCTAD uses data from the Chinese Ministry of Commerce (MOFCOM), which are based on approvals up to the year 2002 and reflect real outflows (from the balance of payments) only since 2003. The change of measurement is accompanied by a sudden increase in total OFDI, indicating that it may have been previously underreported. The statistics used in this paper therefore begin with the year 2003.

On the other hand, Chinese OFDI may be inflated by round-tripping. Hong Kong and other offshore financial centres and tax havens together accounted for nearly 80 per cent of Chinese OFDI stocks by 2008 (Figure 1). A large share of this OFDI is likely to be channelled back to China to take advantage of classification as foreign investment. To sum up, as neither aggregated data nor the country or industry breakdowns given in the official statistics reflect the actual situation, official data must be treated with great caution.



Source: Own compilation based on UNCTAD (2010a)

### **3 Host-Country effects of FDI**

Understanding the spatial distribution of China's OFDI across ASEAN and its motivation is an important step in the assessment of the impact of Chinese investment on the host country. In a second step it is necessary to reflect on the theory and relevant empirical findings on FDI effects in host countries in order to be able to relate the conclusions to our empirical findings. FDI can have a variety of direct and indirect effects in host countries. We define direct effects as the immediate consequences of an MNE's activity in the host country, including training, employment and income effects. Indirect effects result from the interaction of an MNE or its employees with other enterprises or non-business entities in the host country and include spillovers and linkage effects.

#### **3.1 Direct effects**

Foreign firms directly affect a host economy by creating new jobs (employment effect) and so generating incomes for their employees (income effect). The income effect is augmented if foreign firms pay higher wages for comparable tasks than domestic firms (Aitken / Harrison / Lipsey 1996). The extent to which these effects occur depends largely on the type of FDI and on host-country characteristics, including the educational level of the labour force.

Effects on employment and income depend on the extent to which foreign firms use the local labour force. They are usually most pronounced in the case of efficiency-seeking greenfield investment in labour-intensive industries (Jenkins 2006). This type of FDI commonly exploits international differences in labour costs. Firms in such industries mainly employ low-skilled labour (e.g. in the garment industry) and provide less training than firms in skill-intensive industries such as consumer electronics (UNCTAD 1994; Vind 2008). In contrast, capital-intensive investment in, say, exploration for natural resources tends to create few jobs. In an analysis of the employment-generation effect of FDI in Vietnam, Jenkins 2006 finds limited effects and even conjectures that the indirect effect on employment may be negative. This he mainly attributes to the higher capital intensity of foreign firms cf. IMF 1999. Moreover, he detects a negative correlation between the degree of foreign ownership and employment in an industry and ascribes this to the few linkages created by foreign firms and the possibility of domestic competitors being crowded out.

#### **3.2 Indirect effects**

Spillover effects are indirect effects of inward FDI and are here defined as the unintended transmission of knowledge and skills from the FDI enterprise to domestic enterprises through demonstration effects and/or worker mobility. As external effects of the FDI enterprise's activity, they are not priced. It is generally assumed that foreign investors produce at a higher level of technology than local firms and are therefore able to stimulate such effects.

Spillover effects occur as a result of different types of indirect demonstration effects, imitation and competitive pressure (Glass / Saggi 1998; Wang / Blomström 1992; Blomström /



Kokko 1998; Görg / Greenaway 2003), the movement of workers from MNEs to local firms, which helps to disseminate advanced managerial practices, know-how, and technology (Fosfuri / Motta / Ronde 2001; Glass / Saggi 2002) and unintentional outcomes of linkage relationships with local buyers and suppliers (Fortanier 2007; Görg / Greenaway 2003; Hansen / Schaumburg-Müller 2006). Spillovers also depend on the difference in the level of technological intensity between MNEs and local firms (Kokko 1994) and on the degree of export-orientation of the FDI (Jenkins 2006). The larger the technology gap, the less likely are significant spillovers because of a lack of absorptive capacity (Kokko 1994). This has implications for the desired type of FDI. FDI featuring a *slightly* higher technology level than that found in domestic firms may be more desirable than high-technology FDI, which cannot establish relations with the domestic economy. Export-oriented FDI tends to generate more employment and facilitates access to the global economy via market access/export spillovers. On the other hand, it is often low-skill assembly activity which limits the upgrading of human resources (Giroud / Mirza 2006). Similarly, foreign firms that operate in isolation, with few linkages to domestic enterprises, are less likely to generate many spillovers to local firms.

Linkages are “formal and informal collaborative exchanges between legally independent firms, where material and immaterial resources are transferred, and/or practices shared and transmitted” (Hansen / Schaumburg-Müller 2006, 8). This may also extend to non-business entities, such as universities, research institutes, government institutions and private stakeholders (Mirza et al. 2004; UNCTAD 2001). Linkages, whether backward, forward or horizontal, act as facilitators of effects, but are not effects in or of themselves.

The creation of linkages depends on the foreign firm’s experience and embeddedness in the host economy (McAleese / McDonald 1978), the entry mode (Belderbos / Capannelli / Fukao 2001; UNCTAD 2000b), the level of technology acquaintance and market position of the domestic firm (Altenburg 2000; Belderbos / Capannelli / Fukao 2001) and the MNE’s motivation for investing. Industries with a production process that can easily be fine-sliced into multiple production stages have a higher potential for linkages than other industries (UNCTAD 2001). However this, too, depends on the level of development of supplying industries (Battat / Frank / Sheu 1996; UNCTAD 2000a; UNCTAD 2001) and their size, which has been found to have a positive correlation with backward linkages (Belderbos / Capannelli / Fukao 2001). The electronics and automobile industries vary in the depth of their linkages as a function of the availability of supplies. Where local suppliers have not been established or do not meet international standards, MNEs either integrate the respective production steps into their intra-firm value chain or use foreign suppliers. Evidence of relatively strong linkages in both industries was found in Southeast Asian economies (e.g. Giroud 2003), but weak linkages were identified in studies on the electronics industry in Mexico and the automobile sector in South Africa (Barnes / Kaplinsky 2000; UNCTAD 2001). In some instances, linkages are weak (e.g. Girma / Gong 2008) or the local sourcing ratio of foreign firms is below that of domestic firms (Görg / Ruane 1998; McAleese / McDonald 1978). In the garment and other such industries local sourcing is generally rare (Tavares / Young 2002).

As regards investment motivation, market-seeking FDI in developing countries facilitates more linkages than investment for other purposes (Belderbos / Capannelli / Fukao 2001; Reuber et al. 1973). One reason for this is that affiliates producing for the domestic market often have more freedom to choose suppliers than affiliates playing a part in their parent

company's international production system (UNCTAD 2001). Other factors are the size of the affiliate and the role assigned to it. In the Irish electronics industry, for example, small affiliates have stronger linkages than large ones (Görg / Ruane 1998), and affiliates with greater autonomy have stronger linkages in the electronics and garment industries in ASEAN (Giroud / Mirza 2006).

The occurrence of these direct and indirect effects and linkages has been extensively examined in the case of FDI flowing from industrialised to developing countries. For developing source countries, on the other hand, rigorous empirical assessment of development effects is still a rarity, and results are expected by some to contrast to the findings for industrialised source countries. UNCTAD 2006 assumes, for example, that FDI by emerging economies is more beneficial for host-country development, basing its assumption on theoretical considerations of a narrower 'technology gap', cultural and institutional proximity and the greater labour-intensity of this type of investment. But this conclusion lacks empirical evidence. In the light of soaring FDI inflows into developing economies from China, sound data on host-country effects are needed. We address this below.

## **4 Methodology**

The analyses in this paper are based on field research conducted in Cambodia, Vietnam and China between October 2008 and November 2009. Cambodia and Vietnam were chosen for case studies because of the relative importance of Chinese FDI to their economies and the difference in their levels of economic development (see Table 2). The first aspect enables us to assess the effects of Chinese investment when it accounts for a large proportion of external investment in the host economy. The latter aspect allows us to compare our findings, since the two countries are at different stages of economic development.

Analyses of the impact of Chinese investment are constrained by the lack of quality secondary data available. We therefore conducted interviews with 32 mainland Chinese companies, eight other foreign companies and one local firm in Cambodia and with 33 mainland Chinese companies, eight other foreign companies and four local firms in Vietnam (see Tables A1 and A2 in the Appendix). The interviews with firms were complemented by interviews with twelve stakeholders (business associations and labour unions) and 53 interviews with experts (representatives of government institutions and ministries, international donors, local research institutions, the media and NGOs) across both countries. Expert interviews were also held in China, Singapore and Thailand. The coordination and execution of the fieldwork were facilitated by the Central Institute for Economic Management (CIEM), Hanoi, Dr Hem Sochet, an independent consultant in Phnom Penh, and the Institute of Southeast Asian Studies (ISEAS) in Singapore.

<b>Table 2: Country selection criteria</b>							
<b>Criteria and source</b>	<b>Cambodia</b>	<b>Lao PDR</b>	<b>Myanmar</b>	<b>Vietnam</b>	<b>Indonesia</b>	<b>Philippines</b>	<b>Thailand</b>
LDC status (United Nations 2009)	yes	yes	yes	no	no	no	no
Income group (World Bank 2009)	Low income	Low income	Low income	Low income	Lower middle income	Lower middle income	Lower middle income
Chinese FDI stock in 2006 million US\$, (UNCTAD 2010a)	103.66	96.07	163.12	253.63	225.51	21.85	232.67
Chinese FDI's share of total inward FDI in 2006 (UNCTAD 2010a, mirror data)	3.51%	11.22%	3.26%	0.76%	1.18%	0.13%	0.34%
Institutional links and practicalities	+	-	-	++	+	-	+
Note: "Institutional links and practicalities" is a reference to the authors' access to institutions in the host countries to facilitate the field work.							

A questionnaire was developed to collect quantitative and qualitative data on direct and indirect effects, i.e. employment and income effects, training, spillovers and linkage effects. The data were collected from firms in the consumer electronics, garment and automotive industries. In Cambodia the vast majority of interview data stems from the garment industry, while the automotive industry (in particular motorcycle manufacture) is dominant in the Vietnam sample. The unequal distribution of interviews among the three sectors corresponds to their relative importance to the economy concerned. Besides the primary data collected, other available data were used to compare Chinese FDI with FDI from other source countries, including the World Bank Enterprise Surveys for Cambodia and Vietnam (World Bank 2008; World Bank 2010), data on member companies received from a business association in Cambodia, and available empirical studies on FDI effects in the same countries (Chandararot / Dannet 2009; Mirza et al. 2004).

The current study is limited by the small number of local firms which we were able to identify as suppliers or customers of Chinese firms and to which we were able to gain access. More data of this kind would have enabled us to improve our understanding of the various effects.

## **5 Impact of China's FDI on Cambodia and Vietnam**

In this section we report our findings on the direct effects of Chinese OFDI on workers and the indirect effects on local firms in the garment, automotive and consumer electronics industries in Cambodia and Vietnam.

### **5.1 Direct effects on local workers**

In Cambodia and Vietnam, Chinese manufacturing FDI is concentrated on low-skill, labour-intensive manufacturing and tends to be relatively small-scale. The Chinese parent companies are for the most part privately owned and have only one or two affiliates outside China. Some of the firms surveyed do not belong to a parent company, but have been established by a Chinese national in Cambodia/Vietnam. This is more common in Cambodia, where seven of the firms interviewed were established in this way, often by Chinese who had earlier worked for another Chinese garment factory in Cambodia. A variety of reasons for investing in Cambodia/Vietnam were given by the respondents, but in almost every case cheap labour played a major role. In Vietnam market-seeking was also one of the main motives.

In Cambodia the 27 manufacturing companies surveyed together employ 26,439 people, of whom 98 per cent are Cambodians. Chinese companies in Cambodia have an average of 979 employees. At 304 employees, average employment is lower in Vietnam. Here the 33 companies surveyed account for 10,020 jobs, 95 per cent of the employees being Vietnamese (see Tables A1 and A2 in the Appendix). The higher average and total employment figures in Cambodia are due to the sectoral distribution of investment. The majority of Chinese FDI in Cambodia has gone to the garment industry, where large, labour-intensive factories are typical. In contrast, the more capital-intensive motorcycle industry is more important in Vietnam. Moreover, the production facilities of one Chinese investor consist of a number of small factories, each specialising in particular components, which further reduces the number of employees per firm.

Given the efficiency-seeking nature of investment, it is no surprise that 100 per cent of shop-floor workers in Cambodia are local. Although this is generally the case in Vietnam, too, two larger Chinese companies employ a very small number of Chinese shop-floor workers. The situation is different at the more skill-intensive level within the firms. In Cambodia, less than 30 per cent of top- or middle-management posts are occupied by local employees, and the most senior management positions are usually filled by Chinese expatriates. Posts typically allocated to Cambodian employees are at a lower management level, examples being human resources manager, accounting manager, shipping manager, and head of administration. Supervisors, who monitor the performance of workers on the shop floor, are predominantly Chinese. This was found to be due to the perception that local candidates lacked skills and experience. Thus it is common practice in the garment industry also for companies from other (Asian) source countries to employ a large proportion of Chinese supervisors. Employing Chinese supervisors is, however, compromised by poor communication and cultural differences between the Chinese and Cambodian workforce, which occasionally leads to problems, including labour unrest and strikes.

In Vietnam, the ratio of local staff to expatriates in top and middle management and among engineers is almost reversed. Nearly 63 per cent of posts in this category are filled by Vietnamese. This major difference between Chinese firms in Cambodia and Vietnam can be largely attributed to differences in levels of education in these two countries. In Vietnam, Chinese companies incur less cost in training local staff for management posts. For many posts within management, it therefore pays to employ Vietnamese staff rather than costly Chinese expatriates.

Wage levels in Chinese companies are not significantly different in the two host countries (around US\$ 86 per month), but are considerably lower than in the Eastern provinces of China (around US\$ 300 in the corresponding parent companies), which was one of the main reasons the majority of respondent companies gave for investing. Wages paid by Chinese companies in Cambodia correspond to average wages paid in the Cambodian garment industry (US\$ 86.88) and exceed the official minimum wage of US\$ 50 and the “ideal” monthly minimum wage which, according to Chandarot and Dannet (2009), suffices to meet basic living costs (US\$ 71.99 or US\$ 74.85 depending on the scenario). The actual wage includes an obligatory living allowance, payment for overtime, which is common in the garment industry, and frequently a performance-based bonus (e.g. a piece rate). In Vietnam, on the other hand, 38 per cent of respondents stated that wages in their company were lower than wages paid by firms from other countries in the same industry and province, and seven per cent claimed their wages were lower than those paid by domestically owned firms. In contrast, 34 per cent (15 per cent) of respondents stated that their wages were higher than those paid in domestically owned (other foreign) companies. The majority of representatives of Chinese companies in Vietnam appear to see their average wage levels as lying somewhere between wage levels in Vietnamese-owned and other foreign-owned companies.

Training for local employees is mostly very basic in both countries. This is partly rooted in the types of production undertaken by the companies. By its nature the garment industry does not require high skills. Although the motorcycle industry is generally more skill-intensive, the stages of production located in Vietnam are mainly assembly activities and do not therefore require much training. Moreover, worker mobility was very high at around 50 per cent per year in the companies surveyed. The worldwide economic crisis in 2008-09 and subsequent dismissals probably gave this figure an upward bias, but labour turnover still tends to be high in the industries covered. Given a combination of low skill requirements, high worker mobility and a perfectly elastic labour supply curve, it is rational for a profit-maximising firm to keep expenditure on training low, and this is exactly what we find in Chinese companies in Cambodia and Vietnam.

## 5.2 Indirect effects on local firms

As outlined above, FDI may entail positive spillovers for local firms through worker mobility and demonstration effects. Linkages between foreign and local firms tend to increase (unintended) spillovers and intended linkage effects. The following explains the degree to which linkages have been forged between Chinese-owned and domestically-owned companies in Cambodia and Vietnam and the extent to which preconditions for the occurrence of spillover effects are met.

The average share of local sourcing (i.e. backward linkages) is, at six per cent, very low in Cambodia but, at 40 per cent, significantly higher in Vietnam. In both countries the type of input goods sourced locally are relatively low-technology products, such as plastic bags, cartons, hangers and thread for the garment industry and steel products for the motorcycle industry in Vietnam. Of the respondents in both countries, 70 per cent stated that the limited amount of local content is due to a lack of domestically owned suppliers. Moreover, in Cambodia the local companies that supply simple input goods to Chinese companies are mostly owned by Overseas Chinese, since entrepreneurship among the Khmer people is still very limited. In contrast, Vietnam does have local suppliers of various input goods, but they are often unable to produce competitively to the required specifications. In the garment industry, too, international buyers have a strong influence on the procurement of materials. As they negotiate with the Chinese parent company, which sends the materials to the Cambodian or Vietnamese affiliate, the latter has a very limited say in the sourcing of inputs.

As a consequence of the small proportion of local sourcing (Cambodia) and the low skill intensity of locally procured inputs (both countries), relations with local companies focus on market transactions, especially in Cambodia. They do not therefore involve any training or other kinds of support for local companies. Product specifications and quality requirements are passed on to suppliers in a number of cases in the Vietnamese motorcycle and consumer electronics industries. In three cases this also involves visits by Chinese managers or engineers and some technical support for the local company.

As Chinese OFDI in Cambodia is concentrated on the garments industry, it is by nature export-oriented and efficiency-seeking. The affiliates are dependent on their parent companies for the procurement of input goods and capital. This type of ‘insular’ investment has considerable employment and income effects, but limited potential for linkages and spillover effects. Accordingly, the findings cannot be attributed to specific characteristics of Chinese OFDI.

In Vietnam, Chinese OFDI is mostly oriented towards the local market, with the exception of a few export-oriented companies in the garment industry. Production activities are often vertically fragmented, with the final production stage being located in Vietnam to avoid high import tariffs and exploit labour-cost differentials in low-skill assembly activities. As expected, Chinese companies in Vietnam were found to be less dependent on their parent companies.

## **6 Discussion and conclusion**

The surge in China’s OFDI has attracted considerable attention. Most recent coverage has been directed at patterns of ‘neo-colonialism’ in Africa and the potentially adverse effects for the host economies. Rigorous assessments of the impact of Chinese investment are, however, few in number. We seek to address this shortcoming. We anchor our research in a well established body of theoretical and empirical literature on the effects of FDI on host economies. This research has mainly been theorised for investment by industrialised countries and in this case arrives at inconclusive empirical results. Building on that research, UNCTAD (2006) proposed that FDI from developing economies is likely to deliver more positive effects for developing host countries owing to narrower technology gaps and

greater institutional familiarity, which lead to investment that is more closely attuned to the local business environment.

For Chinese investment in the geographically very close nations of Cambodia and Vietnam, we find little evidence to support the notion that it contributes more to the host economies than investment from other countries. Chinese investment in Cambodia mainly targets the labour-intensive garment industry and employs, on average, large numbers of workers. But these average figures are no higher than for comparable foreign-invested firms in the region. Furthermore, the average wages paid by Chinese firms correspond to the average wages paid by other foreign firms in Cambodia, as the survey by Chandararot and Dannet (2009) shows. The picture of Chinese investment in Vietnam is more varied. Although the level of employment is significant, given that the investment goes to more capital-intensive industries, the effects on wages are inconclusive. It follows from these observations that Chinese investment has neutral to positive direct effects on employment and wages in these host economies.

The other direct effect, training, and the indirect effects considered in this study are very limited in the case of Chinese investment. Low-skilled assembly activities do not require specialised training or upgrading for local employees, and learning-on-the-job through the delegation of managerial responsibilities is virtually barred to Cambodian employees, since the majority of senior posts are held by Chinese expatriates. Even though more Vietnamese hold senior posts, there is again no evidence of any systematic training. Linkages to local firms barely exist. This is not, however, due to a specific self-centred business strategy, but to a lack of competitive and reliable suppliers. In such circumstances, Chinese firms rely more extensively on their parent company's business network. Indeed, the other option of helping to build a local supplier network, as such companies as Nestlé have done in China, is not represented in our sample. This may indicate a short-term investment orientation in which Chinese companies can rely on their own business networks and do not therefore require extensive local linkages.

It follows from this that the effects of China's manufacturing OFDI on the host economies are similar to the effects of investment by industrialised countries, and similarly inconclusive. This lends further support to the conclusions drawn from studies on the determinants and strategies of Chinese MNEs, which argue that, as they are very similar to those of industrialised-country MNEs, common theories apply. As regards FDI from other emerging economies, our findings suggest that effects, or preconditions for the existence of effects, should not be expected to be significantly different from those found and suggested for investment by industrialised countries. While we cannot detect any negative effects of Chinese investment, we also find limited positive effects. It becomes clear, however, that the impact of any investment, whether Chinese or not, is limited by the existing business environment. Sparse and poorly qualified supplier networks naturally limit the generation of linkages and spillovers as no recipients are present. Improvements in human capital may occur, but they will be limited by the absorptive capacity of employees.

These aspects have previously been discussed in the context of FDI from industrialised countries. What is new is that FDI from emerging economies, which is expected to be more suitable for precisely the kind of difficult business environment described above and therefore to have better development effects, does not bring about the anticipated effects automatically. Ironically, its failure to do so is largely due to the same factors as in the

case of “traditional” FDI. This is an indication of the weighty tasks left to the host countries: besides identifying the industries in which the national economy has comparative advantages and supporting local entrepreneurship in them, the improvement of skills and education is vital. As becomes clear from our research, Chinese firms do not perform this task, but assume activities that suit the environment they find in the host countries. As it is highly attractive to foreign investors, Vietnam can afford to be more selective as to the type of FDI it would like to receive, and it is increasingly able to foster closer ties with local companies in much the same way as China’s recent industrial policies illustrate. However, such policies will take hold only if local companies manage to upgrade and diversify considerably in order to qualify as local partners for foreign investors.

In contrast, Cambodia is much less attractive to foreign investment and particularly to FDI from industrialised countries. Although the Cambodian government has identified priority sectors in which it would like to see more foreign investment, it still welcomes most new investment projects as long as they are not inconsistent with its most basic environmental and other concerns. Although the general recommendation to improve skills and education also applies to Cambodia, it will be more difficult and take considerably more time to achieve significant improvements in education levels and the business environment. Local entrepreneurship is likely to remain relatively limited in the near future. Chinese investment, even if it goes to very basic and foot-loose industries, plays a very important role in providing capital, employment and income and in stimulating productivity and competition. One of the few characteristics that differentiate Chinese investors from “traditional FDI” by industrialised-country MNEs is that they invest on a considerable scale in countries like Cambodia, where Western investors are uncommon. Cambodia should continue to attract such FDI, while at the same time reducing costs associated with corruption and infrastructure bottlenecks (in particular the cost of energy) so that it may also become more attractive to industries that add more value and to other FDI source countries.





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## **Annex**



<b>Table A1: Overview of mainland Chinese firms interviewed in Cambodia</b>						
<b>Firm</b>	<b>Position of Interviewee(s)</b>	<b>Location</b>	<b>Ownership type</b>	<b>Industry</b>	<b>Size</b>	<b>Year</b>
F1	HR Supervisor	Phnom Penh	100% foreign-owned investment	Garments	Large	2004
F2	Owner and General Manager	Kandal	100% foreign-owned investment	Garments	Large	2005
F3	Shipping Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	2007
F4	Factory Manager; Shipping Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	1997
F5	Finance Manager; Secretary of General Manager	Phnom Penh	Sino-Cambodian Joint venture	Cigarettes	Large	1993
F6	General Manager	Kandal	100% foreign-owned investment	Garments	Large	2006
F7	Shipping Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	1996
F8	General Manager	Phnom Penh	Sino-Cambodian Joint venture	Paper	Medium	1996
F9	General Manager	Phnom Penh	Sino-Cambodian Joint venture	Garments	Large	2005
F10	Vice General Manager	Kandal	100% foreign-owned investment	Garments	Large	2005
F11	Owner	Phnom Penh	100% foreign-owned investment	Garments	Large	2007
F12	Managing Director	Phnom Penh	100% foreign-owned investment	Garments	Large	2005
F13	Owner	Kandal/ Phnom Penh	100% foreign-owned investment	Garments	Large	2002
F14	Administration Supervisor	Phnom Penh	100% foreign-owned investment	Garments	Large	2004
F15	Director	Phnom Penh	100% foreign-owned investment	Garments	Large	2002



<b>Table A1: Continued</b>						
<b>Firm</b>	<b>Position of Interviewee(s)</b>	<b>Location</b>	<b>Ownership type</b>	<b>Industry</b>	<b>Size</b>	<b>Year</b>
F16	Administration Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	2000
F17	General Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	2000
F18	General Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	2000
F19	Broker	Phnom Penh	100% foreign-owned investment	Motorcycles	Small	2004
F20	Broker	Kandal	100% foreign-owned investment	Picture frame	Medium	2007
F21	General Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	1994
F22	Vice General Director	Phnom Penh	100% foreign-owned investment	Garments	Large	1998
F23	Owner	Kandal/Phnom Penh	100% foreign-owned investment	Garments	Medium	2007
F24	Shipping Manager; Administrative Manager	Phnom Penh	100% foreign-owned investment	Garments	Large	2003
F25	General Manager	Preh Sihanouk	100% foreign-owned investment	Garments	Large	2005
F26	Owner and General Manager	Phnom Penh	100% foreign-owned investment	Garments	Medium	2006
F27	Owner	Kandal/Phnom Penh	100% foreign-owned investment	Garments	Large	2001
<p>Notes: “Year” refers to the year the company was established in the host country.  “Size” refers to the number of employees of the company: Small 10-49; Medium 50-249; Large <math>\geq 250</math>.</p> <p>Source: Own compilation</p>						

<b>Table A2: Overview of mainland Chinese firms interviewed in Vietnam</b>						
<b>Firm</b>	<b>Position of Interviewee(s)</b>	<b>Location</b>	<b>Ownership type</b>	<b>Industry</b>	<b>Size</b>	<b>Year</b>
F1	Assistant of General Director	Hanoi	100% foreign-owned investment	Motorcycles	Large	2001
F2	1: General Director; 2: Assistant of General Director	Hanoi	100% foreign-owned investment	Motorcycles	Medium	2006
F3	Administrative Officer	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Large	2000
F4	1: General Director; 2: Assistant of General Director	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Medium	2002
F5	Administrative Office	Hung Yen	100% foreign-owned investment	Motorcycles	Medium	2005
F6	Administrative Office	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Large	2002
F7	Administrative Office and Translator	Hung Yen	100% foreign-owned investment	Consumer electronics/airconditioning	Small	2003
F8	Head of Administration	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Medium	2002
F9	1: Head of HR; 2: Accountant	Hung Yen	100% foreign-owned investment	Motorcycles	Small	2005
F10	Head of Accounting Department	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Medium	2002
F11	1: Assistant of General Director; 2: Head of Workshop; 3: Translator and Assistant	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Small	2004
F12	Vice Director (also Senior Consultant of the company)	Hanoi	100% foreign-owned investment	Motorcycles	Small	2007

<b>Table A2: Continued</b>						
<b>Firm</b>	<b>Position of Interviewee(s)</b>	<b>Location</b>	<b>Ownership type</b>	<b>Industry</b>	<b>Size</b>	<b>Year</b>
F13	Vice General Director	Hai Phong	100% foreign-owned investment	Trucks	Medium	2007
F14	1: General Director; 2: Assistant	Hai Phong	100% foreign-owned investment	Electricity meters	Small	2004
F15	Vice General Director	Hanoi	Established as JV, then changed to 100% foreign-owned	Garments	Large	1994
F16	1: Director of Financial Department; 2: Translator	Dong Nai	100% foreign-owned investment	Textiles	Large	2006
F17	Head of Accounting Department	Dong Nai	100% foreign-owned investment	Automotives	Large	2007
F18	Head of Accounting Department	Dong Nai	100% foreign-owned investment	Consumer electronics	Large	1999
F19	Head of Accounting Department	Binh Duong	100% foreign-owned investment	Electrical products	Medium	2000
F20	1: General Director; 2: Assistant of the General Director	Binh Duong	100% foreign-owned investment	Textiles/trading company	Small	1995
F21	1: Manager; 2: Accountant	HCM City	100% foreign-owned investment	Textiles	Small	2008
F22	Chief Accountant	Hanoi	100% foreign-owned investment	Industrial machines	Small	2006
F23	Accountant	Hanoi	Sino-Vietnamese Joint venture	Grindstones	Medium	2001
F24	Head of Administration	Hanoi	100% foreign-owned investment	Animal feed	Medium	2000

<b>Table A2: Continued</b>						
<b>Firm</b>	<b>Position of Interviewee(s)</b>	<b>Location</b>	<b>Ownership type</b>	<b>Industry</b>	<b>Size</b>	<b>Year</b>
F25	Accountant	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Small	2003
F26	Accountant	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Small	2003
F27	Chief Accountant	Hung Yen	100% foreign-owned investment	Motorcycles	Small	2001
F28	Assistant and Translator	Hung Yen	100% foreign-owned investment	Motorcycles	Medium	2005
F29	Secretary of General Director	Hung Yen	Sino-Vietnamese Joint venture	Motorcycles	Medium	2007
F30	Accountant	Hai Duong	100% foreign-owned investment	Garments	Large	2003
F31	Accountant	Hai Duong	100% foreign-owned investment	Textiles	Medium	2008
F32	Accountant	Hai Duong	100% foreign-owned investment	Garments	Large	2003
F33	Director	Hai Phong	100% foreign-owned investment	Compact lights	Medium	2003
Notes: “Year” refers to the year the company was established in the host country. “Size” refers to the number of employees of the company: Small 10-49; Medium 50-249; Large $\geq 250$ . Source: Own compilation						



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