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Research Report

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Columbia FDI Perspectives, No. 5

Provided in Cooperation with:

Columbia Center on Sustainable Investment (CCSI) - A joint center of Columbia Law School and the Earth Institute, Columbia University

Suggested Citation: Davies, Ken (2009) : While global FDI fails, China's outward FDI doubles, Columbia FDI Perspectives, No. 5, Columbia University, Vale Columbia Center on Sustainable International Investment (VCCI), New York, NY

This Version is available at:

<https://hdl.handle.net/10419/253839>

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Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment

No. 5, May 26, 2009

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While global FDI falls, China's outward FDI doubles

by

Ken Davies *

In 2008 global FDI fell by around 20%, while outward FDI from China nearly doubled. This disparity is likely to continue in 2009 and 2010 as China invests even more overseas. What is driving this continuing surge in China's outward FDI?

China's FDI outflows took off in the 2000s as a result of the government's adoption and promotion of a "go global" policy aimed at establishing the country's national champions as international players. Having averaged only US\$453 million a year in 1982-1989 and US\$2.3 billion in 1990-1999, they rose to US\$5.5 billion in 2004, US\$12.3 billion in 2005, US\$17.6 billion in 2006 and US\$24.8 billion in 2007.¹ Preliminary figures for 2008 show a rise to US\$40.7 billion. **If financial FDI (not counted before 2006) is included, the 2008 total was US\$52.2 billion, nearly double the US\$26.5 billion in 2007.**

Anecdotal evidence suggests that China's outward FDI growth continued to accelerate in early 2009. China's direct investments in Australia alone reportedly rose from US\$1.4 billion in the first quarter of 2008 to US\$13 billion in the same period this year. If that trend continues, China's FDI in Australia alone in 2009 will equal its global OFDI in 2008. Chinalco's bid for 18% of Rio Tinto, if successful, would be part of this – at around US\$19 billion, this deal is larger than any previous overseas acquisition by a Chinese company. Other large deals in the energy sector are also in view.

*Five key drivers of China's OFDI explain this acceleration.*²

(1) One of the most reported motivations in the international media and in some academic writing is China's need to secure natural resources to fuel rapid growth, though this is actually not the most significant area of China's outward investment, which is service industry. Government backing, including official development assistance (ODA), has been crucial for this resource-seeking investment. (2) While most of China's exports are from foreign-owned enterprises, large domestic firms also export large volumes and need services like shipping and insurance. (3) China's major enterprises are also acquiring global brands (like Lenovo's acquisition of IBM's personal computer business or the SAIC and Nanjing purchase of MG Rover). (4) Large state-owned enterprises (SOEs) losing their monopoly position at home are diversifying

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¹ *OECD 2008 Investment Policy Review of China: Encouraging Responsible Business Conduct* and China's Ministry of Commerce website www.fdi.gov.cn

² Detailed in *ibid*.

internationally. And (5) some enterprises – despite China’s ample labour supply – seek to move their labour-intensive operations to cheaper overseas locations like Vietnam and Africa.

The relative strengths of these motivations are reflected in the sectoral and geographical distribution of China’s accumulated FDI.

The latest figures published by China’s Ministry of Commerce (MOFCOM) in February 2009 show outward FDI cumulated to end-2007 as US\$118 billion. The tertiary sector predominated, with over 70% of the total. Manufacturing remained modest at 8%, and construction even lower at 1.4%; so, with other items, the secondary sector contributed around 16% of outward FDI. The remaining 14% is accounted for by mining, quarrying and oil production (13 %) and agriculture, forestry and fisheries (1%).

While the sectoral composition tends to fluctuate with “lumpy” greenfield projects or M&A deals, the end-2007 figures give a fair representation. The predominance of services is the result of China’s export boom and the extension of China’s financial services overseas to utilize the wealth of the Chinese diaspora, learn advanced techniques and diversify earnings sources. Manufacturing OFDI is small, though it may grow faster as domestic production costs rise.

The vast majority of recorded OFDI from China is from large state-owned enterprises (SOEs) (84% of both stocks and flows by end-2005, according to MOFCOM figures³), but this appears to be gradually declining and is likely to be an over-estimate because private-sector OFDI is less likely to go through official procedures.

Media reports focus on China’s investments in Africa, but the continent that continues to absorb most of China’s capital exports is Asia, which accounted for 67% of cumulated Chinese outward FDI to end-2007, with Latin America receiving 21%, Europe 4%, Africa 4%, North America 3% and Oceania 2%. These figures are distorted by the use of tax havens, which obscures actual destinations. China’s investment in Latin America, for example, is mainly the 14% of China’s OFDI registered as going to the Cayman Islands and the 6% going to the British Virgin Islands. The bulk of China’s FDI in Asia goes to Hong Kong, China, which accounted for 58% of outward FDI stock up to end-2007.

Even if the actual figures are higher because of routing via tax havens, China’s FDI in the developed world, especially Europe and North America, is disproportionately small considering the high proportion of China’s trade with these regions. This probably results more from a lack of readiness to compete with global giants on their home territory than from protectionist pressures, though these have discouraged some large acquisitions.

An unknown proportion of investment in Hong Kong, China and the tax havens consists of “round-tripping” investment to take advantage of tax concessions in China, but this must now be falling since such incentives were abolished at the beginning of 2008 and Hong Kong is therefore unlikely to retain its dominant position. Genuinely outward FDI is therefore likely to be growing even faster than shown by official statistics.

The coastal provinces and municipalities, heavily engaged in international trade, are the main sources of China’s OFDI. Guangdong –the largest *recipient* of FDI – provided 20% of total outward FDI in 2008. The second largest source was Zhejiang, with 8% of outward FDI, Shandong following in third place with 8%. This distribution results from several factors: proximity to major seaports and thus overseas markets, strong links to a global diaspora originating from coastal areas, and positive spill-over and demonstration effects of inward FDI in or near the three major coastal economic centres of the Pearl River Delta, the Yangtze Delta and the Bohai Gulf.

How is the crisis affecting China’s outward FDI?

³ Ibid.

As an open economy, China can not escape the effects of the global financial crisis of 2008. The government is countering the downturn with a fiscal stimulus that will limit GDP deceleration, and credit has actually expanded. The OECD forecasts 6.3% GDP growth in 2009 and 8.5% in 2010.

China's resource needs will thus continue to increase, so it is seeking to secure reliable supplies by doing deals with producers. Such deals made in the first quarter of 2009 already reportedly exceed China's record FDI outflow in 2008.

With US\$1.9 trillion in foreign-exchange reserves, a current-account surplus forecast by the OECD to rise to 11.7% of GDP in 2009 and no credit crunch, China can afford large investments overseas. Chinese multinationals can snap up companies on the cheap to acquire market share and brands in the developed world. Unsurprisingly, China is campaigning vociferously against investment protectionism.

China's worries are not unfounded. While there are those who welcome Chinese investment, for example in African countries happy to receive accompanying unconditional aid, there are also widespread suspicions of China's intentions. The predominance of SOEs in China's OFDI has raised fears that such investment may not be governed by normal commercial considerations and may even be an arm of the country's foreign and defense policy.⁴

Other challenges for China's OFDI include raising the efficiency of natural resource exploitation by Chinese companies, coordinating internationally dispersed operations, abandoning the preference for vertical integration of industrial production, and handling the usual aftermath of cross-border M&A, including acquiring sufficient understanding of different management cultures to be able to assimilate and manage foreign companies.

China's OFDI accounts for not much more than 1% of the global total, far below the country's share of world trade. However, this total is rising fast and the country will eventually become a major source of global FDI. Potential recipient countries are beginning to recognize this as they start to offer inducements to attract Chinese MNEs.

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- No. 3. Anne van Aaken and Jürgen Kurtz, "The Global Financial Crisis: Will State Emergency Measures Trigger International Investment Disputes?" March 23, 2009.
- No. 4. Gert Bruche, "A New Geography of Innovation—China and India Rising," April 29, 2009.

⁴ Such concerns have also been voiced about the activities of China's sovereign wealth fund, the China Investment Corporation (CIC). CIC and its provincial equivalents have several hundred billion dollars to invest. Following initial investments of dubious profitability – much criticised within China – CIC has become cautious, but experience will embolden it.