

# Chinese Economy and International Exposure

## **Lecture 3 China's Foreign Direct Investment**

Prof. Dr. Ping Lv (吕萍)

School of Economics and Management

University of Chinese Academy of Sciences

Beijing, China



# Trade Theories and International Companies

- Trade theories explain exchange of goods and capital between **NATIONS**
- But say little about
  - Existence
  - Growth
  - Behaviour of



# Basic concepts (FDI vs. FPI)

- International investment happens primarily in two ways:
  - FDI (Foreign **direct** investment): the direct, hands-on management of foreign assets. For statistical purpose, the UN defines FDI as an equity stake of 10% or more in a foreign-based enterprise.
  - FPI (Foreign **portfolio** investment): holding securities, such as stocks and bonds, of companies in countries outside one's own but does not entail the active management of foreign assets. Foreign indirect investment.

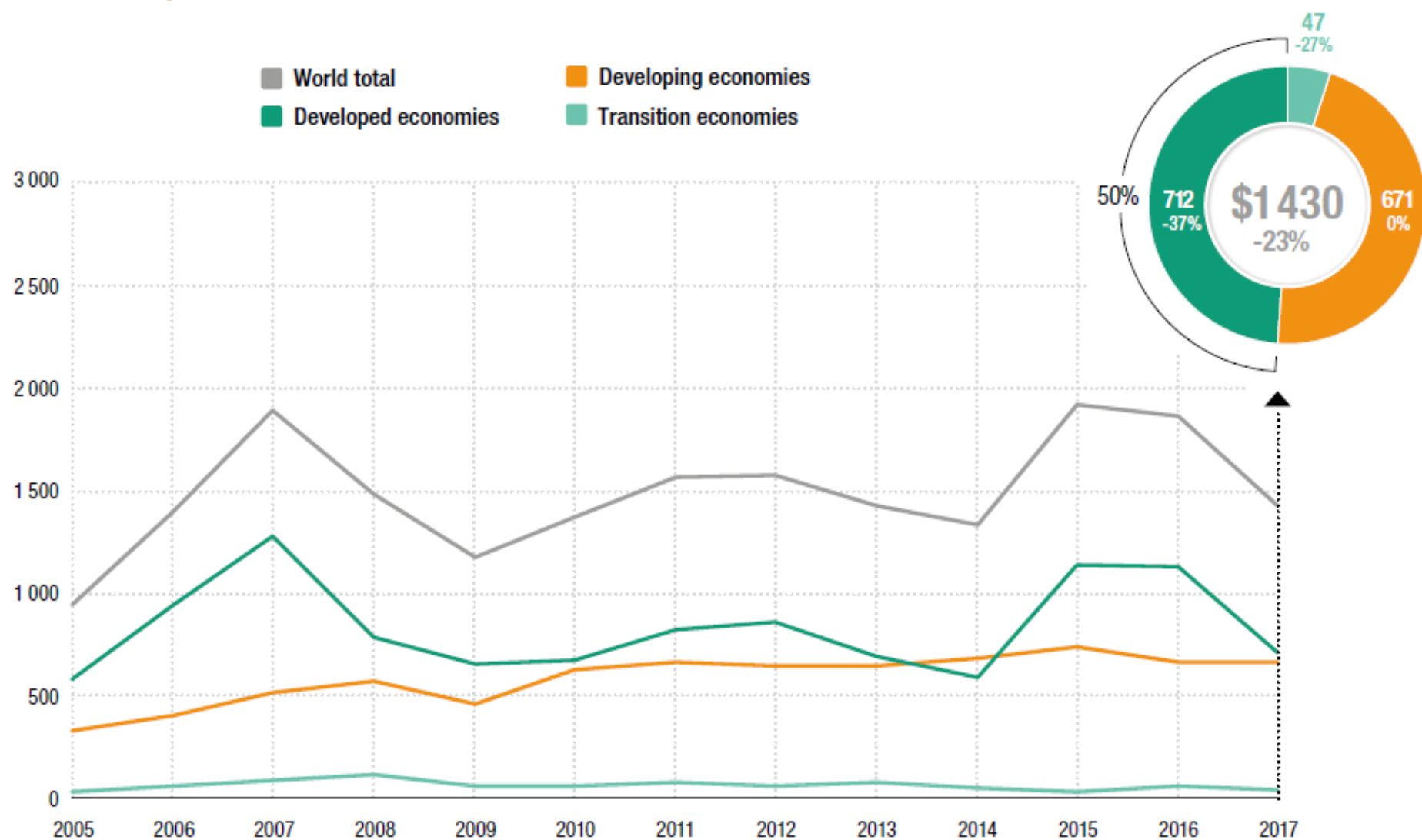
# Basic concepts (MNE vs. non-MNE)

- MNE: a firm that engages in FDI when doing business abroad
- Non-MNE firms can also do business abroad by exporting and importing, licensing and franchising, outsourcing, or engaging in FPI, but not FDI.
- What sets MNE apart from non-MNEs is FDI.

# Basic concepts (MNE vs. non-MNE)

- MNEs have existed for at least 2,000 years, with some of the earliest examples found in the Phoenician, Assyrian, and Roman times.
- In 1903 when Ford Motor company was founded, it almost immediately engaged in FDI by having a factory in Canada that produced its first output in 1904.
- MNEs have experienced significant growth since World War II. In 1970 there were approximately 7,000 MNEs worldwide.
- By 2010 over 82,000 MNEs managed approximately 810,000 foreign affiliates.

**Figure I.1. FDI inflows, global and by group of economies, 2005–2017** (Billions of dollars and per cent)



Source: UNCTAD, FDI/MNE database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Table I.2.

## Value and number of net cross-border M&As, by sector and selected industries, 2016–2017

	Value (billions of dollars)			Number		
	2016	2017	%	2016	2017	%
<b>Total</b>	<b>887</b>	<b>694</b>	<b>-22</b>	<b>6 607</b>	<b>6 967</b>	<b>5</b>
<b>Primary</b>	83	24	-70	206	550	167
<b>Manufacturing</b>	406	327	-19	1 745	1 690	-3
<b>Services</b>	398	343	-14	4 656	4 727	2
<i>Top 10 industries in value terms:</i>						
Chemicals and chemical products	130	137	5	345	322	-7
Business services	75	107	43	1 716	1 817	6
Food, beverages and tobacco	138	88	-36	200	227	14
Finance	97	59	-39	585	617	5
Electricity, gas and water	66	54	-18	209	171	-18
Machinery and equipment	32	52	63	195	183	-6
Information and communication	24	39	66	618	611	-1
Electrical and electronic equipment	75	26	-66	349	307	-12
Transportation and storage	46	23	-51	293	306	4
Mining, quarrying and petroleum	79	23	-71	138	466	238

Source: UNCTAD, cross-border M&A database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)).

Table I.3.

## Value and number of announced FDI greenfield projects, by sector and selected industries, 2016–2017

	Value (billions of dollars)			Number		
	2016	2017	%	2016	2017	%
<b>Total</b>	<b>833</b>	<b>720</b>	<b>-14</b>	<b>15 766</b>	<b>15 927</b>	<b>1</b>
<b>Primary</b>	54	21	-61	52	63	21
<b>Manufacturing</b>	295	338	14	7 703	7 678	0
<b>Services</b>	484	362	-25	8 011	8 186	2
<i>Top 10 industries in value terms:</i>						
Electricity, gas and water	129	95	-26	404	296	-27
Business services	96	80	-16	4 125	4 278	4
Motor vehicles and other transport equipment	56	62	12	1 077	1 103	2
Construction	126	62	-51	322	276	-14
Chemicals and chemical products	43	61	42	804	856	6
Electrical and electronic equipment	44	52	20	1 005	958	-5
Transport, storage and communications	56	41	-26	935	903	-3
Trade	27	32	21	902	1 001	11
Food, beverages and tobacco	24	29	17	596	664	11
Textiles, clothing and leather	28	28	1	1 558	1 476	-5

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets ([www.fDimarkets.com](http://www.fDimarkets.com)).



Figure I.3.

**FDI inflows, top 20 host economies, 2016 and 2017** (Billions of dollars)

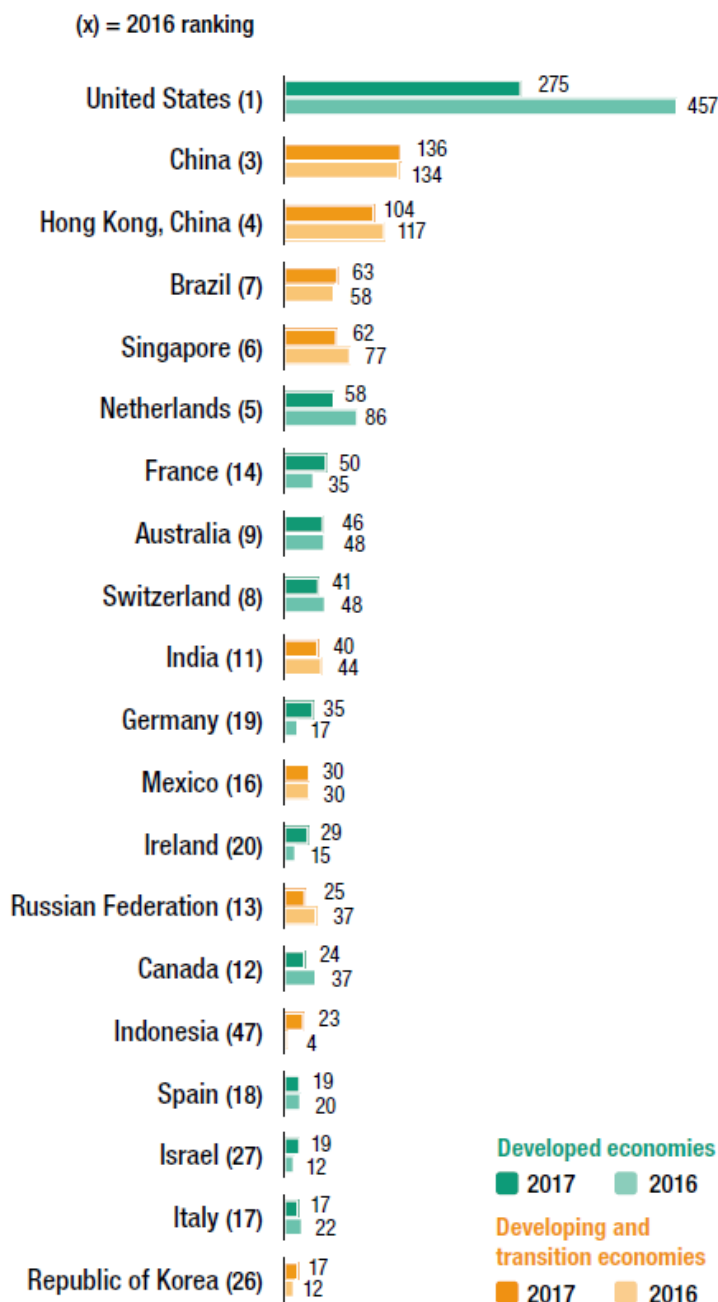
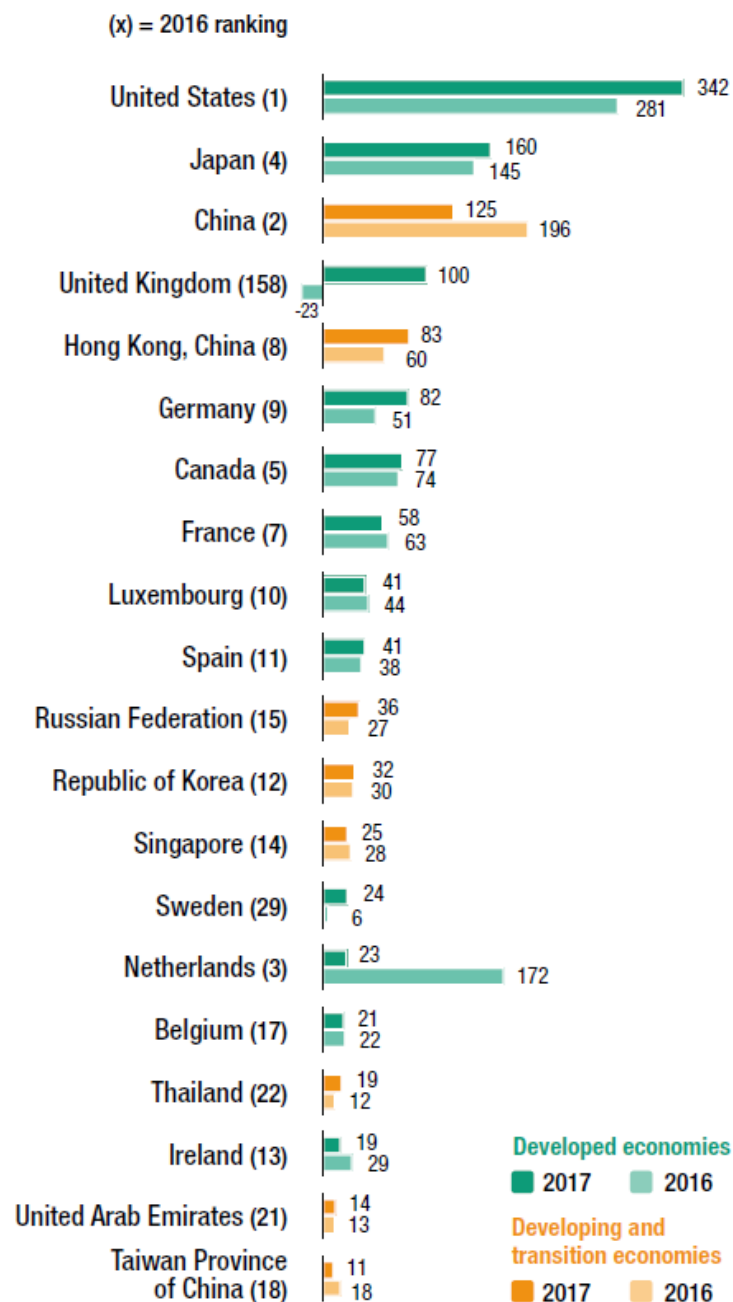


Figure I.6.

**FDI outflows, top 20 home economies, 2016 and 2017** (Billions of dollars)





# Why Abroad? And How?



# Why abroad?

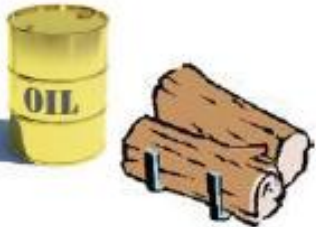
## Strategic goals of internationalization



50% annual sales growth in China  
'China – is a future core market for the Lego Group' Bali Padda, Lego's CEO

Market

1



Resource  
seeking

2



Innovation and  
strategic assets  
seeking

4



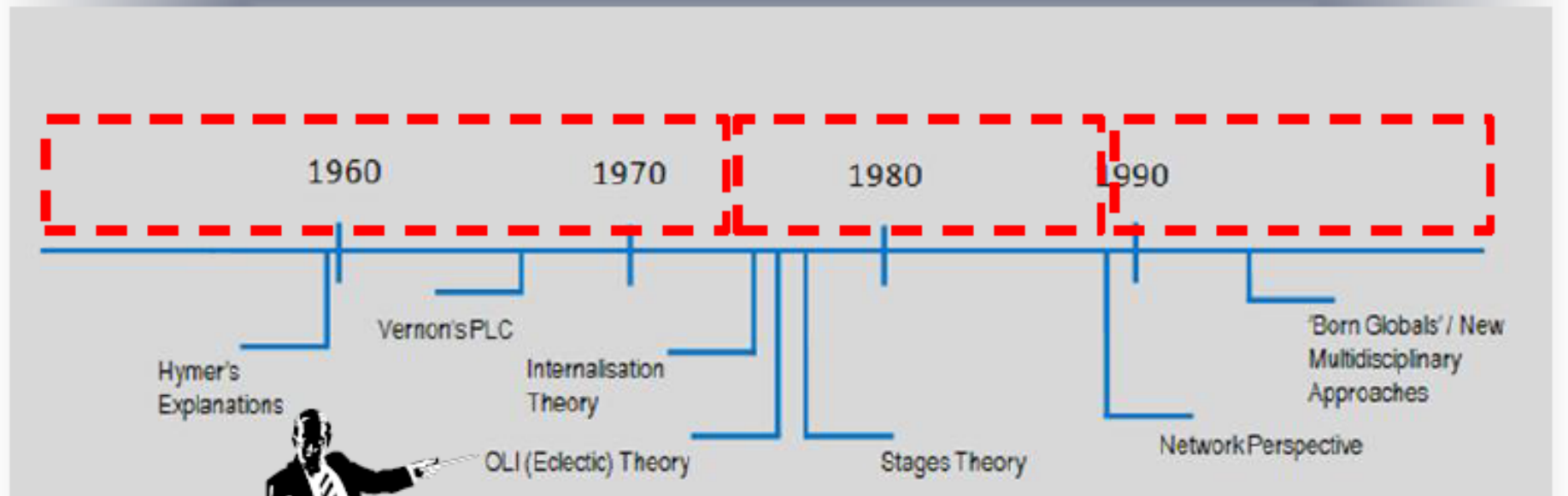
Efficiency  
seeking

3



# How abroad?

## Internationalization Theories







## The 1960s – mid 1970s

- Hymer's explanations
- First attempts to explain:
  - The territorial expansion of firms
  - Why firms wish to own and control their foreign activities
- Hymer: Behind the move are firms'
  - Desire to grow and strengthen their market positions
  - Desire to appropriate the maximum economic rent of their assets



# Shifting Contexts

- **Context of the 1960s**
  - Fragmented markets
  - Protectionism and high barriers to trade
  - ICT rudimentary stage
- **Changing Context of the 1970s**
  - Increasing global interdependence among the market economies of the world
  - More focus on the **enterprise** making foreign investment



## Mid 1970s – the late 1980s

- **Theory (paradigm) of *Internalisation* (e.g. Williamson, 1975)**
- Focus on multinational enterprises (MNEs)
- Distinguishing characteristics of MNEs:
  - headquartered in one country
  - owned value-adding activities in another country





## OLI (Eclectic) Paradigm (Dunning, 1977)

- Pulls together the various partial explanations
  - Attempts to encompass:
    - ‘why’
    - ‘where’
    - ‘how’
- To conduct **various** activities
- OLI:
    - **Ownership** (own a unique advantage to compete overseas)
    - **Location** (choose the optimal for exploiting and exploring assets related to ownership advantages)
    - **Internalization** (combine domestic advantages with those of foreign assets through ownership)



# Location advantages

- The sources of location advantages:
  - Natural geographical advantage: e.g. Vienna in CCE
  - Agglomeration: clustering of economic activities
    - Knowledge spillover, or the diffusion of knowledge from one firm to others among closely located firms that attempt to hire individuals from competitors.
    - Industry demand that creates a skilled labor force whose members may work for different firms without moving out of the region.
    - Industry demand that facilitates a pool of specialized suppliers and buyers also located in the region.
  - The effects of competitive rivalry and imitation, especially in oligopolistic industries

# Internalization advantages

- Why firms prefer FDI to licensing?
  - FDI reduces dissemination risks
  - FDI provides tight control over foreign operations
  - FDI facilitates the transfer of tacit knowledge through “learning by doing”
- From an institutional-based view, internalization is a response to the imperfect rules governing international transactions



# Stages theory of internationalisation

- Nordic internationalisation research
  - Obstacle to internationalisation: lack of knowledge about foreign markets
  - Such knowledge is developed through direct experience and learning-by-doing
  - Knowledge leads to increased commitments

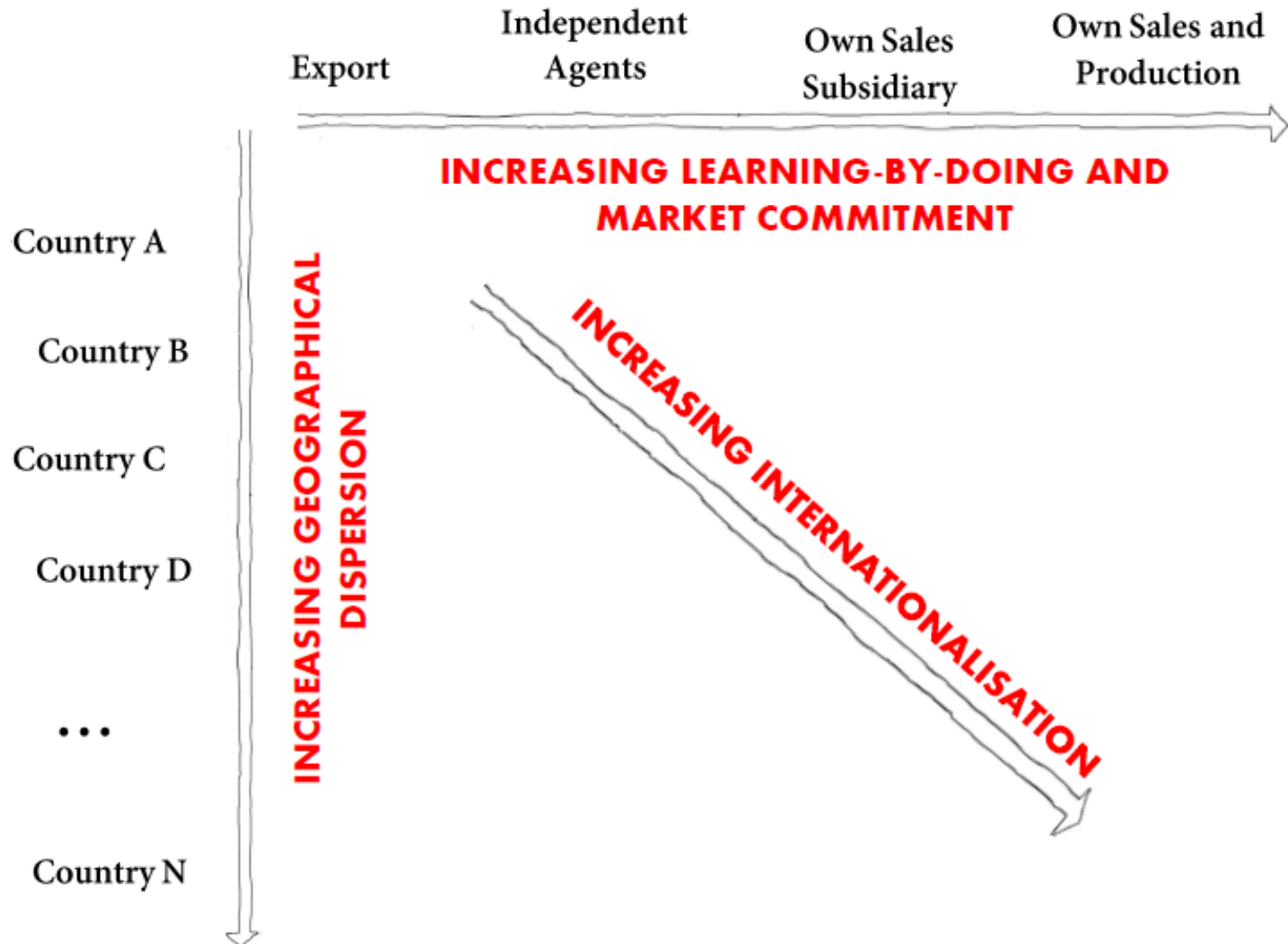


# Uppsala Stages Model (Markets)

- Firms follow this sequence:
  - First most familiar markets
  - Accumulate knowledge through learning-by-doing
  - Move on to less familiar territories



# Uppsala Stages Model (Commitment+Markets)





# Networks Perspective

- Globalisation erases countries borders
- Internationalisation of companies remains a process that is:
  - Governed by interplay between knowledge development and commitment
  - Commitment not in relation to countries, but to existing and potential business relationships (customers, suppliers, etc.)





'Young, entrepreneurial start-ups that initiate international business soon after their inception'


(Knight & Cavusgil, 2004)

**Learning process is still of crucial importance  
But is no longer conducted in stages through  
learning-by-doing**



**Rapid and early  
internationalisation**





International New Venture is a business organization that, from inception, seeks to derive significant competitive advantages from the use of resources and the sale of outputs in multiple countries' Oviatt & McDougall (1994)

## **MARKET CONDITIONS**

### **ENTREPRENEUR'S ROLE AND INTERNATIONAL ORIENTATION**

#### **SMALL SIZE AND LIMITED TANGIBLE RESOURCES**

#### **UNIQUE INTANGIBLE RESOURCES AND CAPABILITIES**

#### **DISTINCTIVE VIEW OF THE WORLD AS ONE MARKET PLACE**

#### **EXPORT MODE**

#### **NICHE PRODUCTS**

#### **RELIANCE ON PARTNERSHIPS AND NETWORKS**

#### **TECHNOLOGY AND KNOWLEDGE-INTENSITY**





# Realities of FDI

- Political views on FDI
- Effects of FDI on home and host countries

# Political views on FDI

- The **radical view on FDI** is hostile to FDI.
  - Treating FDI as an instrument of imperialism and a vehicle for exploiting domestic resources, industries, and people by foreign capitalists and firms.
  - Government embracing the radical view often nationalize MNE assets or ban/discourage inbound MNEs.
  - Between 1950s-1980s, this view was influential throughout Africa, Asia, Eastern Europe, and Latin America.

# Political views on FDI

- The **free market view** on FDI
  - Suggesting that FDI, unrestricted by government intervention, will enable countries to tap into their absolute or comparative advantages by specializing in the production of certain goods and services.
  - Leading to a win-win situation for both home and host countries.
  - Since 1980s, a series of countries such as China, Brazil, India, Hungary, Ireland, and Russia have adopted more FDI-friendly policies.
  - However, a totally free market view does not really exist in practice.

# Political views on FDI

- The **pragmatic nationalism view** on FDI
  - Considering both the pros and cons of FDI and approving FDI only when its benefits outweigh its costs.
  - The French government: “economic patriotism”
  - The Chinese government: JV vs. greenfield
  - The US government: “national security concerns”
- Overall, more countries in recent years have changed their policies to be more favorable to FDI, even countries like Cuba and North Korea.
- However, there is some creeping increase of restrictions in the form of policies discouraging inbound FDI in some countries.
  - E.g. France and Russia have recently issued decrees reinforcing control for FDI in the interest of public security or national defense.

# Effects of FDI on home and host countries

## Effects of FDI

Recipients vs. sources	<b>Cell 1</b> <b>Capital inflow;</b> <b>Technology;</b> <b>Management;</b> <b>Job creation</b>	<b>Cell 2</b> <b>Loss of sovereignty;</b> <b>Adverse effects on</b> <b>Competition;</b> <b>Capital outflow</b>	Host countries
	Cell 3 Earnings; Exports; Learning from abroad	Cell 4 Capital outflow; Job loss	Home countries
	Benefits	Costs	

# Benefits of FDI to host countries

- Capital inflow can help improve a host country's balance of payments
- Technology spillovers; demonstration effect
- Advanced management know-how
- Creating jobs directly and indirectly
  - FDI creates a total of 80 million jobs, representing around 4% of the global workforce.
  - In Ireland, more than 50% of manufacturing employees work for MNEs;
  - In the UK, the largest private sector employer Tata has over 50, 000 employees working for a variety of businesses such as Jaguar, Land Rover, Tata steal, Tata tea, and Tata consultancy Services.
  - Indirect benefits include jobs created when local suppliers increase hiring and when MNE employees spend money locally, which also results in more jobs.

# Costs of FDI to host countries

- The loss of some (but not all) economic sovereignty associated with FDI;
- MNEs may drive some domestic firms out of business
  - Cola wars
- Repatriating earnings to headquarters in home countries.

# Benefits and costs of FDI to home countries

- Benefits:
  - Repatriating earnings from profits from FDI;
  - Increased exports of components and services to host countries;
  - Learning via FDI from operations abroad
- Costs:
  - Capital outflow;
  - Job loss



# Realities of China's FDI

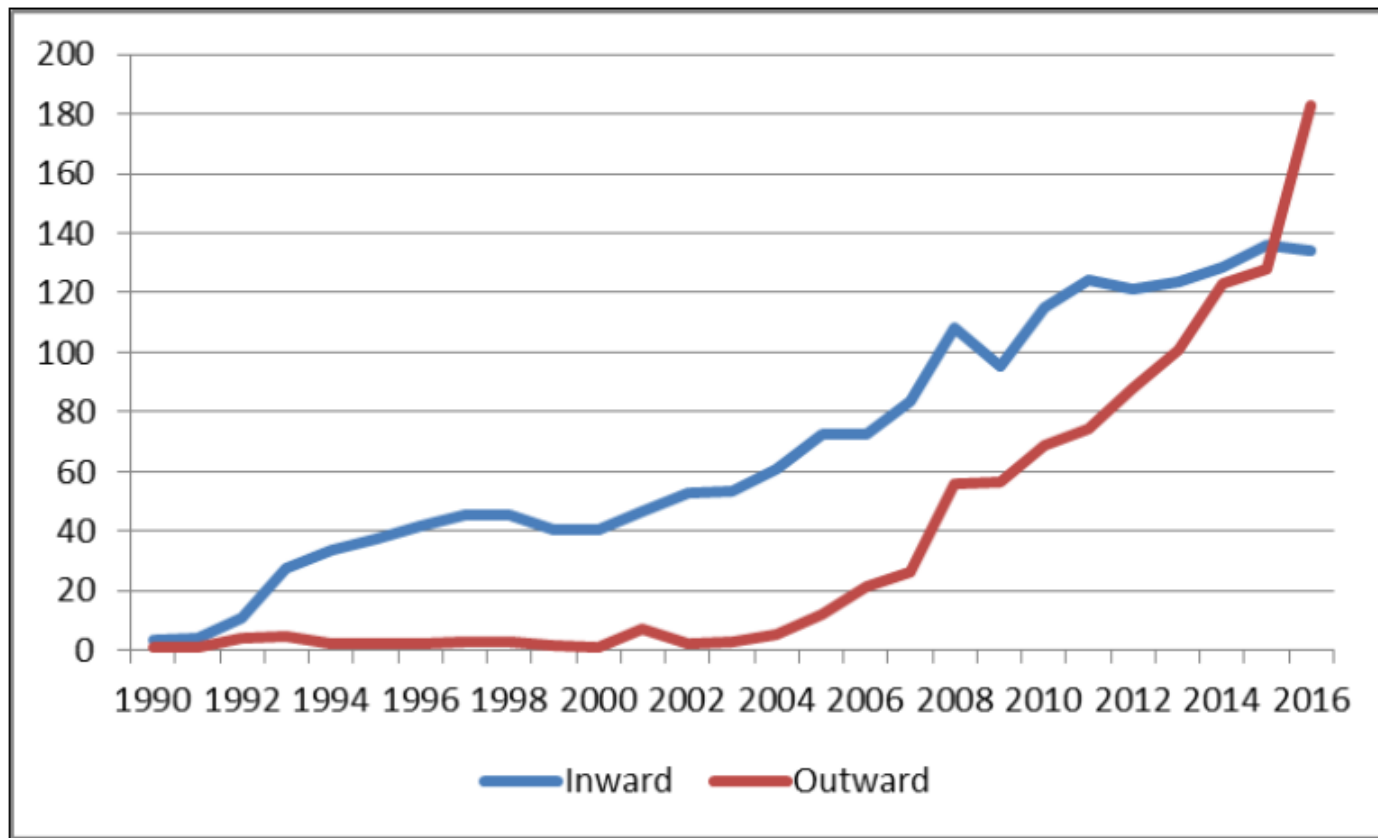
- China's inward FDI
- China's outward FDI
- China's Belt and Road Initiative

# Overview: inward and outward

- China's FDI inflows in 2016 were \$134 billion, making it the world's third-largest recipient of FDI (after the United States and the United Kingdom).
- China's FDI outflows in 2016 were \$183 billion, making it the world's second-largest source of FDI outflows (after the United States).
- China's FDI outflows exceeded inflows for the first time in 2016.

# Overview: inward and outward

China's Annual FDI Flows: 1990-2016 (\$ billions)

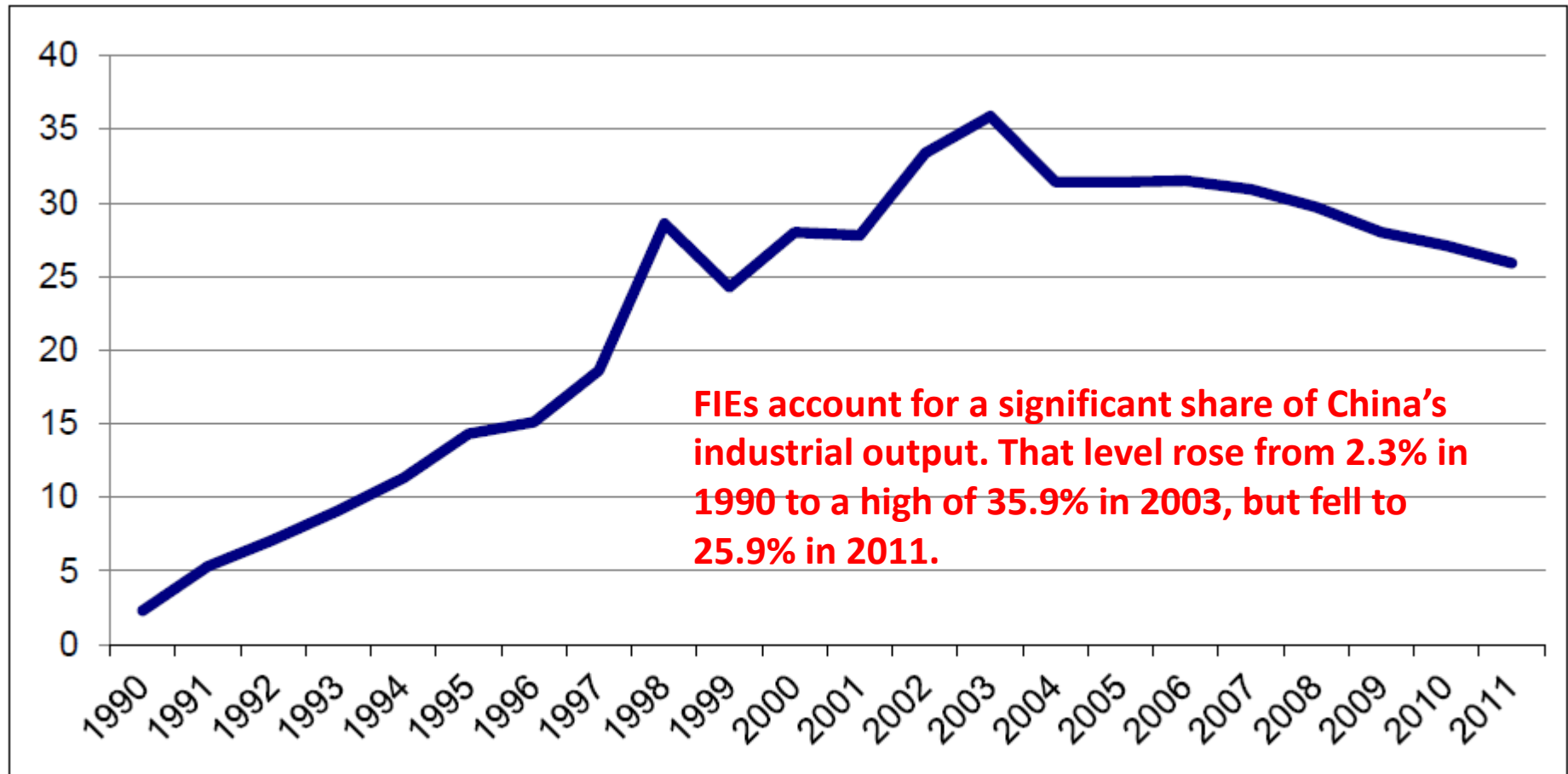


**Source:** UNCTAD Data Center.

**Notes:** UNCTAD FDI data differ from that reported by China. Data exclude Hong Kong which is treated separately.

# China's inward FDI

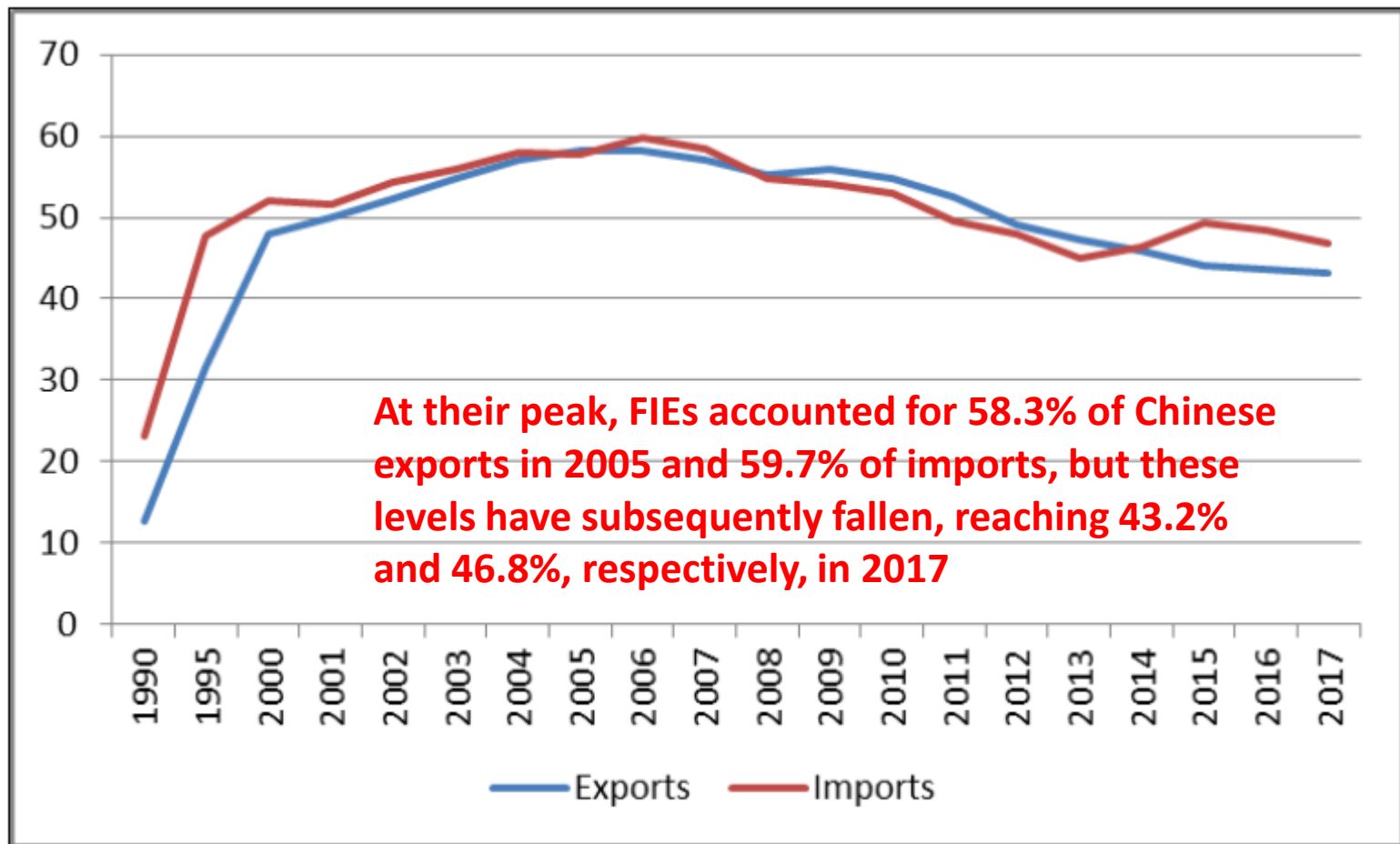
Industrial Output by Foreign-Invested Firms in China as a Share of National Output Total: 1990-2011



Source: Invest in China (<http://www.fdi.gov.cn>) and China's 2012 Statistical Yearbook.

# China's inward FDI

Share of Chinese Merchandise Exports and Imports by Foreign-Invested Enterprises in China: 1990-2017 (percent)



# China's inward FDI

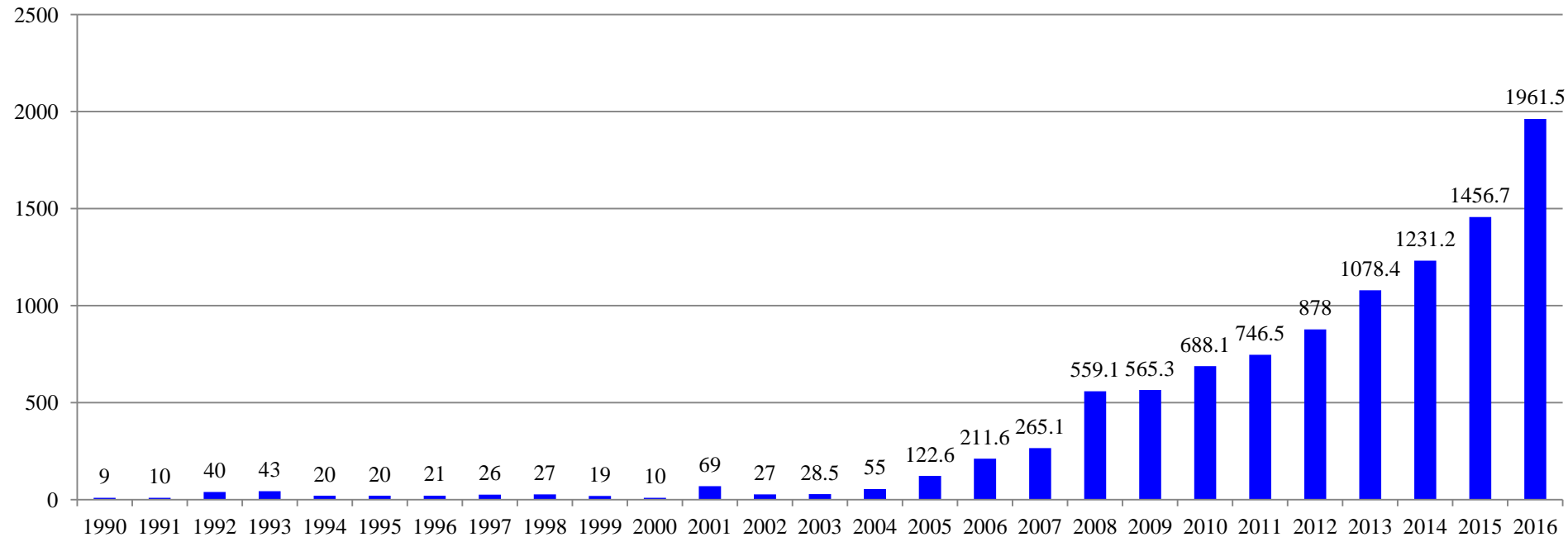
Chinese Data on Top Ten Sources of FDI Flows to China: 1979-2016  
(\$ billions and percentage of total)

Country	Estimated Cumulative Utilized FDI: 1979-2016		Utilized FDI in 2016	
	Amount	% of Total	Amount	% of Total
Total	1,765.5	100	126.0	100
Hong Kong and Macau	928.2	52.6	82.3	65.3
British Virgin Islands	155.9	8.8	6.7	5.3
Japan	104.9	5.9	3.1	2.5
Singapore	85.3	4.8	6.1	4.8
United States	80.0	4.5	2.4	1.9
S. Korea	68.7	3.9	4.8	3.8
Taiwan	64.7	3.7	2.0	1.6
Cayman Islands	35.3	2.0	5.2	4.1
Germany	28.2	1.6	2.7	2.1
United Kingdom	15.7	0.9	1.4	1.1

**Source:** Cumulative data are from the IMF Coordinated Direct Investment Survey. Annual data are from the Chinese Ministry of Commerce.

# China's outward FDI

Chinese outward FDI flows (\$ 100 millions)



- By the end of 2016, 24,400 Chinese investors have established 37,200 subsidiaries in 190 countries/regions.

# China's outward FDI

Major Destinations of Chinese Non-financial FDI Outflows  
in 2015: Flows and Stock (\$ billions and percentage)

Destination	FDI Flows in 2015	Stock of FDI through 2015	Share of FDI Stock through 2015 (%)
Total	145.7	1,098.0	—
Hong Kong	89.8	656.9	59.8
Cayman Islands	10.2	62.4	5.7
British Virgin Islands	1.8	51.7	4.7
United States	8.0	40.8	3.7
Singapore	10.5	32.0	2.9
Australia	3.4	28.4	2.6
United Kingdom	1.8	16.6	1.5

**Source:** Chinese Ministry of Commerce.

**Note:** Ranked according to the top seven destinations of the stock of Chinese FDI outflows through 2015.



# China's outward FDI

## Source country distribution of Fortune 500

	1990	1995	2000	2005	2010	2014
United States	164	153	185	170	133	128
European Union	129	148	136	165	149	121
<b>China</b>	<b>0</b>	<b>2</b>	<b>10</b>	<b>20</b>	<b>61</b>	<b>100</b>
Japan	111	141	95	70	68	57
Canada	12	6	13	14	11	10
South Korea	11	12	8	12	10	17
Switzerland	11	16	10	12	15	13
Australia	9	4	7	8	8	8
Brazil	3	4	3	4	7	7
Russia	0	0	2	3	7	8
India	0	1	1	5	8	8
Others	50	13	30	17	23	23
Total	500	500	500	500	500	500

# The origins of OBOR

- Origins: Two eyes of China toward the outside World
  - Ancient Silk Road:
    - The ancient transcontinental trade from Han Dynasty (200 BC) and named by German geographer Ferdinand von Richthofen, 1833—1905.
    - Comedies:
    - Output: silk, jades, tea, china, traditional medicines.....
    - Input: perfumes, medicines, fruits, vegetables.....
    - Exchanges of culture, religion and politics
  - Ancient Maritime Silk Road:
    - The ancient shipping route also from Han Dynasty (200 BC) with significant 7 trips in Ming dynasty, the 15th century.
    - Task: mainly to show the prestige and ambition of China. Many gifts, few returns. Shipping trade was forbidden at that time.
    - Exchanges of culture, religion and politics



The Belt and Road Initiative  
 “Silk Road Economic Belt” and the  
 “21<sup>st</sup> Century Maritime Silk Road”

# The new perspective of OBOR

- Launched by the Chinese government as the development strategy in 2013.
- The conception refers to
  - the New Silk Road Economic Belt, which will link China with Europe through Central and Western Asia;
  - the 21st Century Maritime Silk Road, which will connect China with Southeast Asian countries, Africa and Europe.
- Imaginative and significant strategy of the Chinese government on connectivity
- Promoting economic co-operation among countries along the Belt and Road routes

## China



China

## Southeast Asia



Brunei



Cambodia



Indonesia



Laos



Malaysia



Myanmar



Philippines



Singapore



Thailand



Timor-Leste



Vietnam

## South Asia



**Bangladesh**



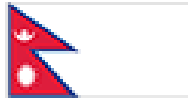
**Bhutan**



**India**



**Maldives**



**Nepal**



**Pakistan**



**Sri-Lanka**

## Central and Western Asia



**Afghanistan**



**Armenia**



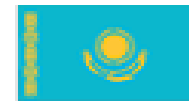
**Azerbaijan**



**Georgia**



**Iran**



**Kazakhstan**



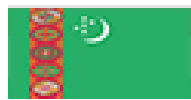
**Kyrgyzstan**



**Mongolia**



**Tajikistan**



**Turkmenistan**



**Uzbekistan**

## Middle East and Africa



**Bahrain**



**Egypt**



**Iraq**



**Israel**



**Jordan**



**Kuwait**



**Lebanon**



**Oman**



**Palestine**



**Qatar**



**Saudi-Arabia**



**Syrian Arab Republic**



**Turkey**



**United Arab  
Emirate**



**Yemen**

## Central and Eastern Europe



**Albania**



**Belarus**



**Bosnia and Herzegovina**



**Bulgaria**



**Croatia**



**Czech**



**Estonia**



**Hungary**



**Latvia**



**Lithuania**



**Macedonia**



**Moldova**



**Montenegro**



**Poland**



**Romania**



**Russia**



**Serbia**



**Slovakia**



**Slovenia**

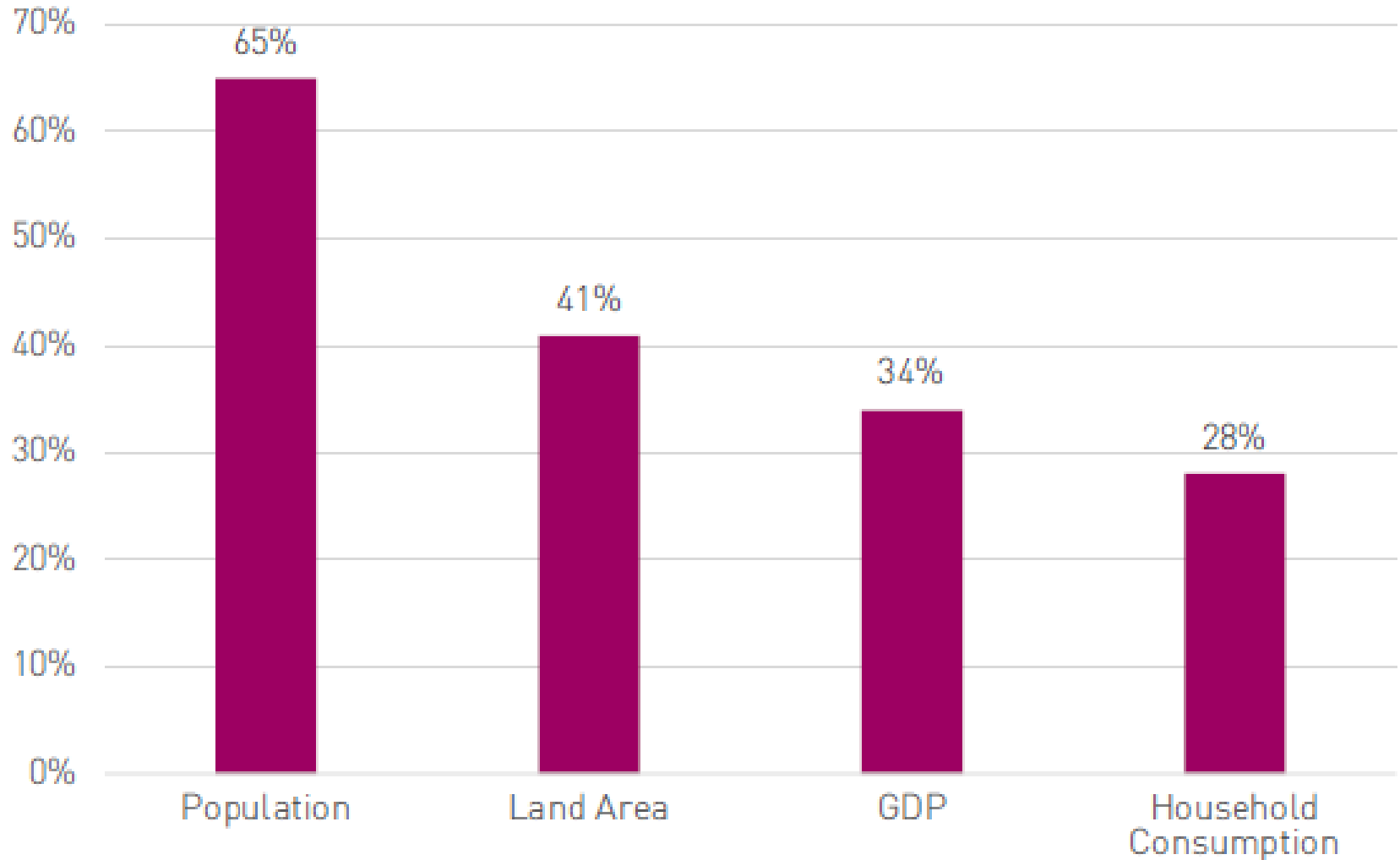


**Ukraine**



# Countries along OBOR

OBOR Countries as % of world as of 2016

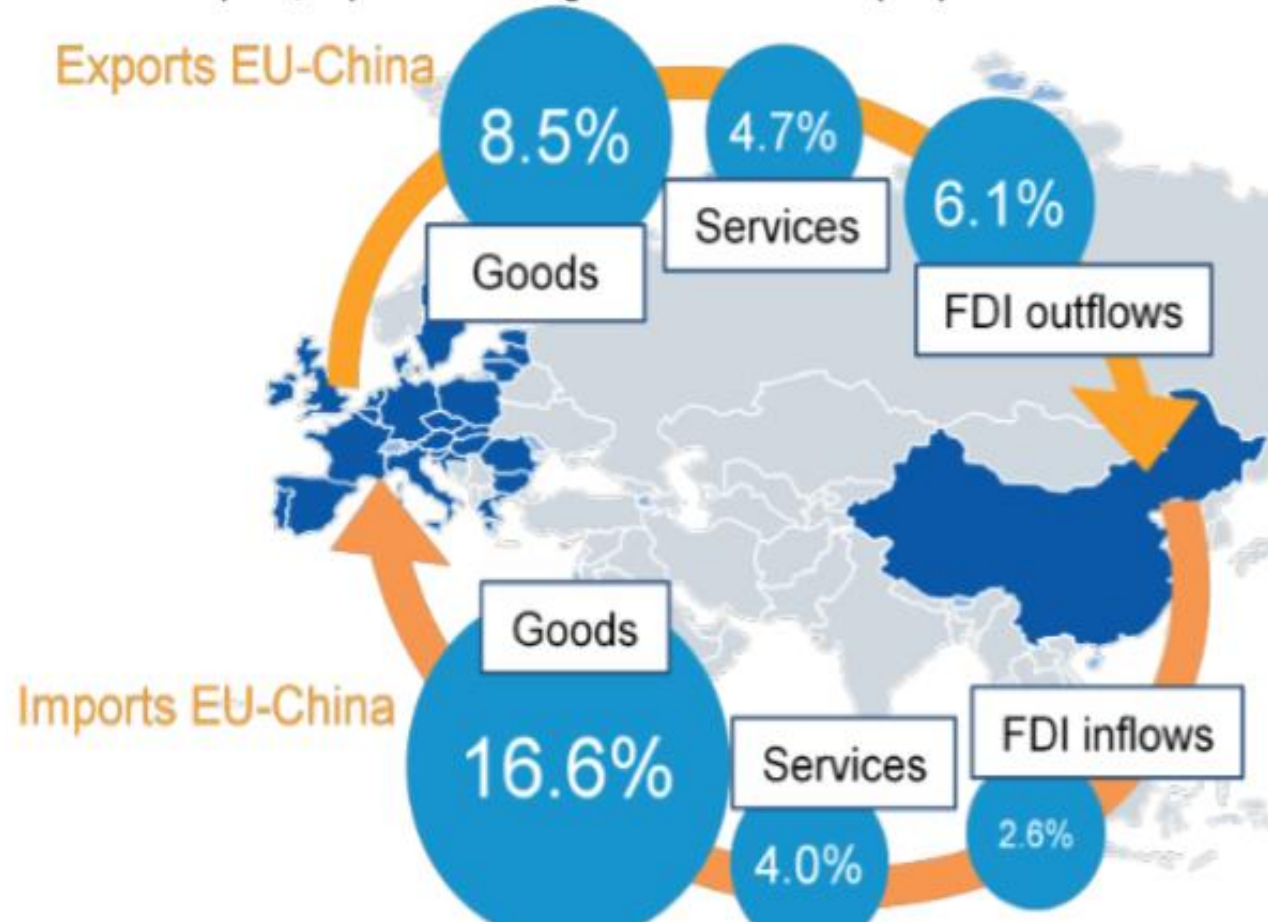


# Countries along OBOR

## The EU: at the end of the road..

EU: 1st China trade partner  
China: 2<sup>nd</sup> trade partner after the US  
End of land (Duisbourg) and sea (Pearus) roads

% of total EU exports, imports and foreign direct investment (FDI) flow



# Five major goals

- Policy co-ordination
- Facilities connectivity
- Unimpeded trade
- Financial integration
- People to people bonds

# OBOR Economic Dimension

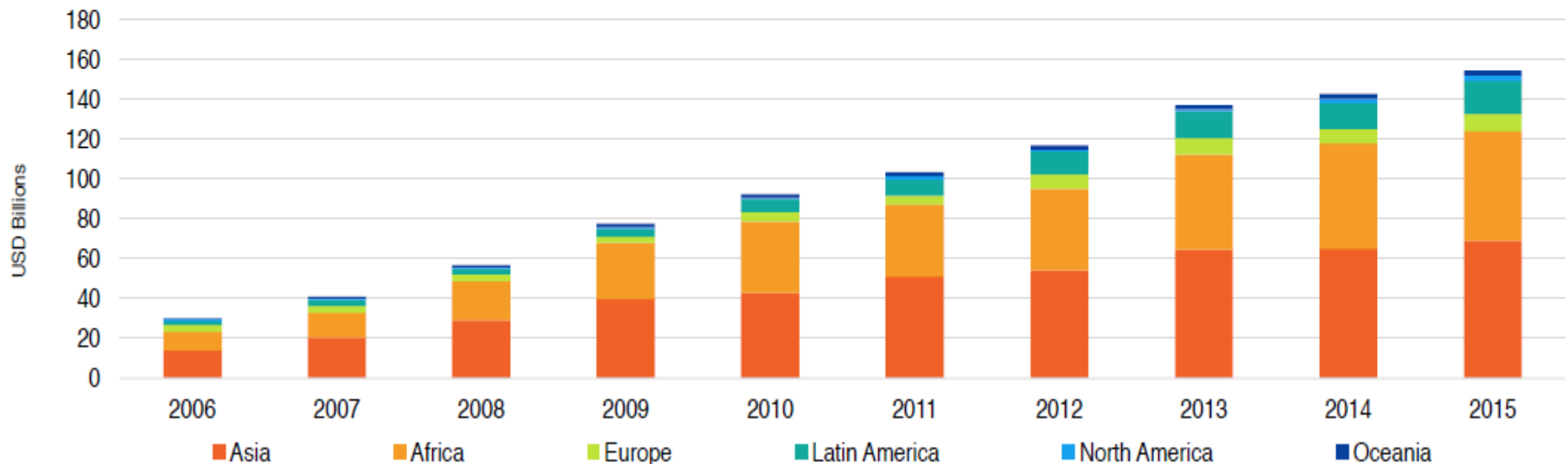
- 1. Aspects of cooperation:
  - Transportation
  - Infrastructure development
  - Trade and investment
  - Energy and natural resources
  - Financial security
- 2. Principles of cooperation:
  - Mutual trust
  - Mutual benefits
  - Mutual learning
  - Inclusiveness
  - Equality

# OBOR Economic Dimension

## China is steadily increasing the value of its overseas projects

- Chinese firms have experience conducting business along the OBOR routes and countries participating in the OBOR Initiative are the largest recipients of Chinese investment.
- We believe the OBOR initiative may accelerate the rate of growth in China's overseas projects over the next decade.
- Since the OBOR initiative was announced, China has signed 18,346 contracts with OBOR countries (as of Nov 30, 2017)<sup>1</sup>.
- More than 8,000 construction contracts were signed with OBOR countries in 2016 alone, amounting to \$126 Billion<sup>2</sup>.

Completed value of China's overseas contracted projects<sup>3</sup>



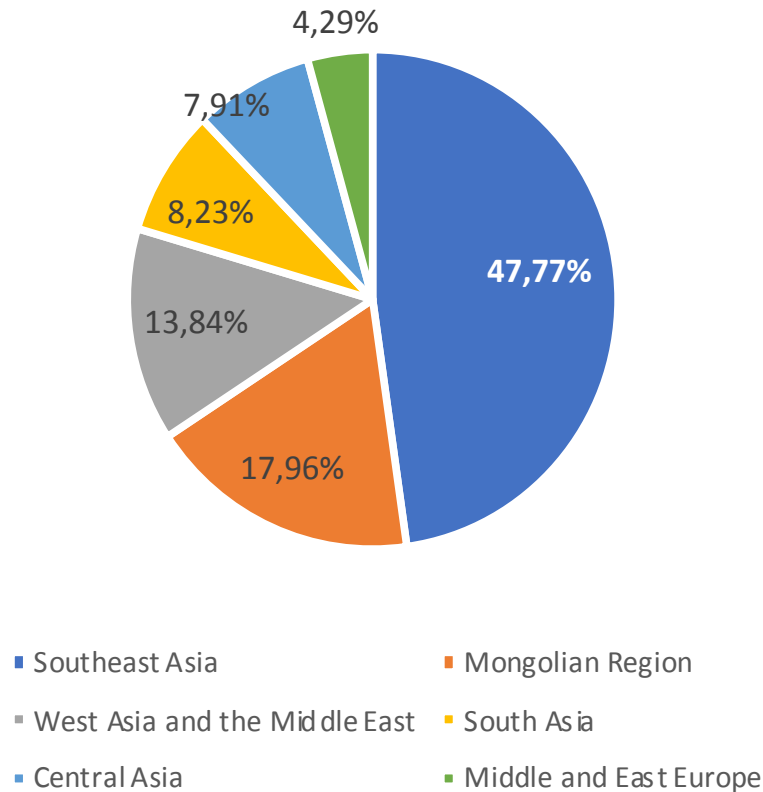
1. "Cooperation statistics with the One Belt One Road countries" [Translated from Chinese], MOFCOM, 11/30/2017

2. DBS Asia Insights, "One Belt One Road Infrastructure Sector", Page 6. 7/24/2017

3. Data from National Bureau of Statistics as of 12/31/ 2015, retrieved 12/29/2017

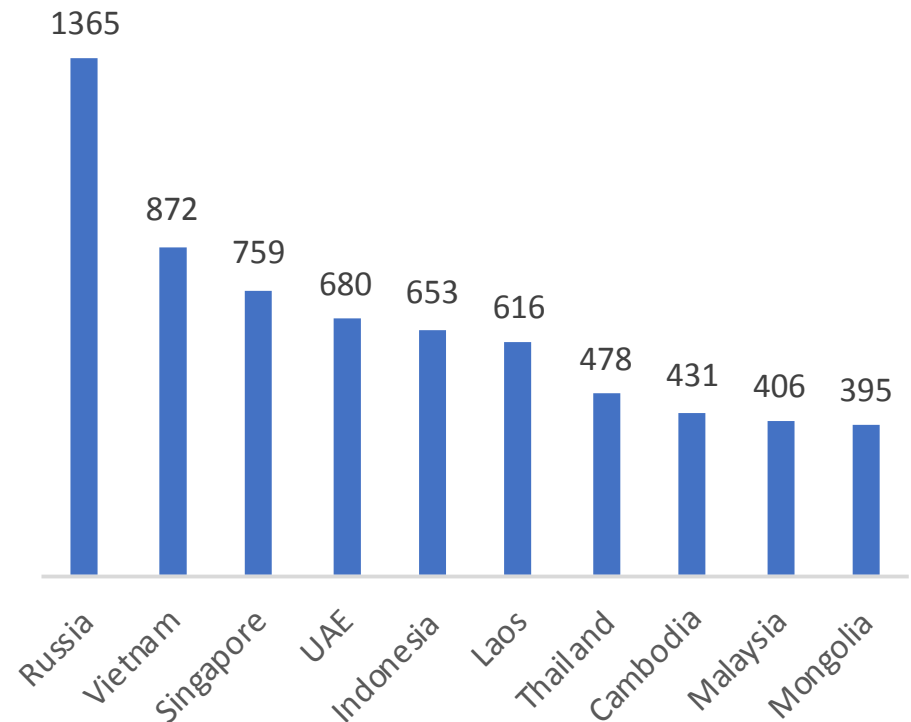
# Chinese OFDI in BRI countries

Number of investments



**Figure 1: China's investment in BRI regions (2003-2015)**

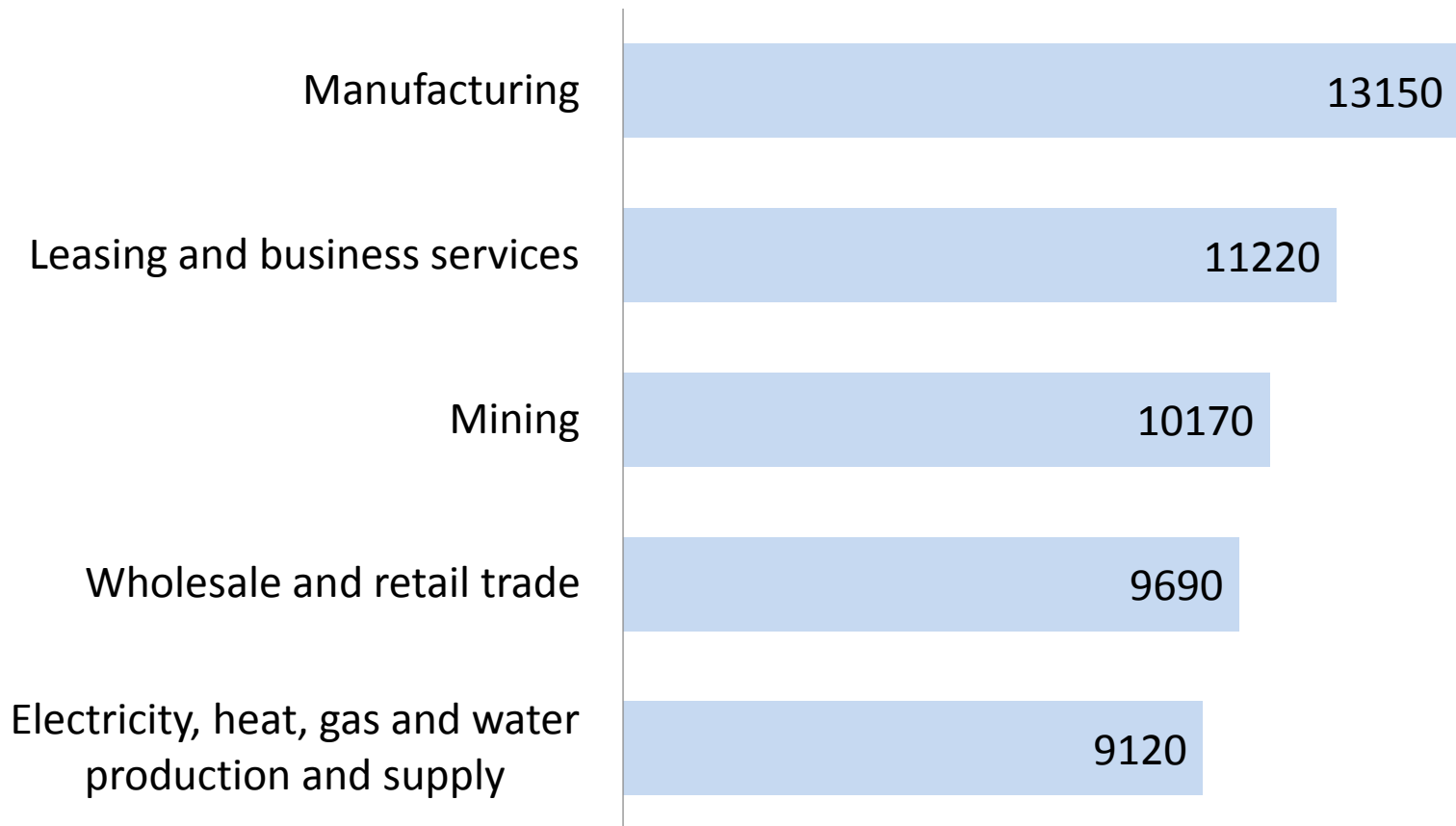
*Source: Mofcom*



**Figure 2: Top ten countries of Chinese OFDI along BRI**

*Source: Mofcom*

# Chinese OFDI in BRI countries



**Industrial Distribution of Chinese OFDI Stock in ASEAN, by the End of 2016 (million dollars)**

*Source: Mofcom*