

# **Chinese Outward Foreign Direct Investment**

**— A driving force for further economic development**

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## **Abbreviations:**

CA: Current Account

CPC: Communist Party of China

DC: developed countries

FDI: Foreign Direct Investment

FBOCs: Foreign Business Oriented Corporations

FTCs: Foreign Trade Corporations

GDP: Gross Domestic Products

IDP: Investment Development Path

IMF: International Monetary Fund

LDC: less developed countries

M&A: Mergers and Acquisitions

MNEs: Multinational Enterprises

NBSC: National Bureau of Statistics of China

OECD: Organization for Economic Co-operation and Development

OLI: ownership, location and internalization advantages

R&D: Research and Development

TNC: Transnational Corporation

UNCTAD: United Nations Conference on Trade and Development

WTO: World Trade Organization

## **Abstract:**

Since the adoption of “Reform and Opening-up” policy in 1978, China’ GDP has maintained robust growth. China’s GDP per capita is approaching 2000 USD. What are the potential driving forces that push the rapid economic growth? The inward FDI was once considered to be the key driver for Chinese dramatic economic growth. However, Chinese outward FDI also expands quickly since the 1990s. China has grown into an important FDI source country among the developing countries. Whether China will be prosperous through the current overseas investment has become a hot topic for discussion in both academic and non-academic sectors. In this thesis, we explore the development, the characteristics and the existing problems of Chinese outward FDI, and find out China’s real investment stage through several theoretical studies, such as the Eclectic Theory of International Production, the Investment Development Path (IDP) theory and the Comparative Advantages. The result suggests that China is by far in the second stage of IDP, where the major task is to attract and take full advantage of inward FDI. However, under the background of keen competition at home and abroad, Chinese enterprises, especially the large industrial ones, should invest actively in the overseas markets and internationalize their operations to maximize profit and meet the needs of Chinese permanent economic growth.

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## Section 1 Introduction

Since the adoption of “Reform and Opening-up” policy in 1978, China’ GDP maintains robust growth. Chinese GDP per capita increased from 311.634 \$US in 1980 to 1,715.94 \$US in 2005 (IMF on-line data base). Chinese economy is gradually transforming from a central planned system to a market system and from a traditional agriculture economy to an industrialized economy. Now, China is playing an increasingly important role in the stage of global economy.

What are the potential driving forces that promote Chinese high economic growth? Inward FDI was once considered as the key driver of the vigorous economic growth. Since 1980s, Chinese investment climates have been greatly improved in diverse aspects, such as market system, enterprise structure, marketing regulations, and law, tax and price systems. More and more labor- and market- seeking inward FDI swarms into the mainland of China, which largely contributes to both the balance of payments and the upgrading of industrial structure. In 1993, China became the second largest FDI recipient in the world, only after the United States.

Although China is still a low-income country with GDP per capita ranking behind the hundredth, Chinese overseas investment has been expanding from the neighboring countries to the rest of the world and from the developing countries to the developed ones since the early 1990s. Plenty of mergers and acquisitions (M&A) carried out by Chinese large enterprises have received a world-wide attention. In 1999, the central government proposed a new outward FDI promoting policy: “Going Global”.

Is the outward FDI another potential economic driver? To well understand this question, we should not only review the foreign direct investment theories, but also investigate the status quo of Chinese specific economy. The traditional FDI theory initiated by Hymer says that the outward FDI is the outcome of market incompleteness. Multinational enterprises from industrial countries usually possess the particular monopolistic advantages. Their outward FDI are mostly capital and knowledge intensive with the purpose of optimizing the use of each country’s comparative



advantages. Vernon's Product Cycle Theory claims that new products are introduced in a "trickle-down" fashion from one developed country to the others ones and later to the developing world. This transfer prolongs the life cycle of the products and makes more profits for the investors. Buckley & Casson's Internalization Theory suggests the multinationals to internalize their productions in the global market in order to reduce the transaction costs resulted from the imperfect market, which directly generates the outward FDI. According to Kojima's Comparative Advantages Theory, the overseas investment should be undertaken from the industries at a comparative disadvantage to the ones becoming less advantageous. Based on the theories mentioned above, John H. Dunning created in 1976 the Eclectic Theory of International Production, which proves that the outward FDI is the outcome of the following three advantages: Ownership Advantages, Location Advantages, and Internalization Advantages. Furthermore, through the analysis of OLI advantages, he advanced the Investment Development (IDP) theory, which avows the existence of a dynamic relationship between the extent of FDI and the level of a country's economic development.

Generally speaking, most of the advanced countries have experienced a transitional economic period: from an inward looking system to an outward looking system. According to IDP theory, there are totally five stages in a country's investment development path. With the statistical data collected from UNCTAD and IMF, we will track Chinese net FDI stock in a growing economic environment to verify that China is now at the second stage of IDP: a transition stage where the large amount of inward FDI is the major factor to promote the economic growth. However, after a detailed analysis of Chinese FDI, we predict that China will enter into the third stage in the near future, where the economy is featured by a dramatic increase of outward FDI.

This article is organized as follows: In section 2, we first glance at the history of FDI in the world, and then focus on Chinese outward FDI development, characteristics, existing problems and counter measures. In section 3, the previous FDI theories are grouped into two types: one for developed countries and the other for developing ones. In section IV, we put an emphasis on the sequential economic development and analyze in detail the OLI theory and IDP theory, which we will use in section V to examine China's IDP. In section V, we analyze empirically the status quo

and the future of Chinese outward FDI and explain finally why Chinese large industrial enterprises need to internationalize their consideration under the background of keen competition both inside and outside of China.

## **Section 2 Background of Chinese outward FDI**

### **2.1. Historical review of outward FDI in the world**

The U.K. had been the largest foreign direct stake holder since the very beginning of international investment in the late nineteenth century. The U.S.A turned to be the largest source country of foreign direct investment (FDI) not until the early sixties of twentieth century. However, the U.S.A focused its investment mainly in the growth sectors, particularly in capital and technology intensive sectors. With reduced transport costs, the U.S.A was building a strong comparative advantage. (Table 1)

	<b>1914</b>		<b>1938</b>		<b>1960</b>		<b>1971</b>		<b>1978</b>	
	\$m	%	\$m	%	\$bn	%	\$bn	%	\$bn	%
<b>DCs</b>	14302	100.0	26350	100.0	66.0	99.0	168.1	97.7	380.3	96.8
<b>USA</b>	2652	18.5	7300	27.7	32.8	49.2	82.8	48.1	162.7	41.4
<b>UK</b>	6500	45.5	10500	39.8	10.8	16.2	23.7	13.8	50.7	12.9
<b>Japan</b>	20	0.1	750	2.8	0.5	0.7	4.4	2.6	26.8	6.8
<b>Germany</b>	1500	10.5	350	1.3	0.8	1.2	7.3	4.2	28.6	7.3

**Table.1: Estimated stock of accumulated FDI by country of origin 1914-78**

**Source: John H. Dunning 1983**

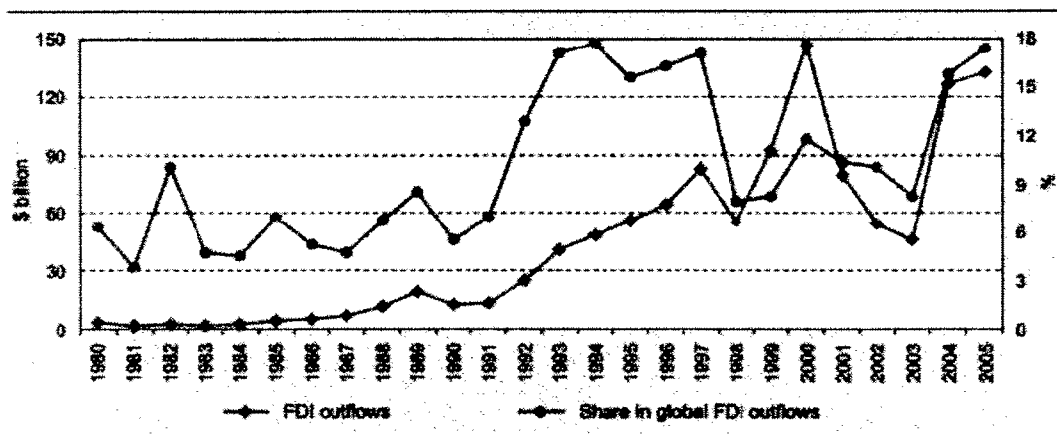
**DCs: Developed countries**

Since the 1950s tremendous progress had been made in the field of FDI, which facilitated the reconstruction of the new world order. European countries and Japan from the late 1970s increased considerably their shares in the world's stock of FDI so that the U.S.A was no longer the only largest international investor in the world.

Based on the report of *recent trends in foreign direct investment in OECD countries* published by the Organization of Economic Co-operation and Development on the 11th April 2006, these countries remain the major net exporters in direct investment capital. In 2005, the net outflow stood at USD 112 billion, which equals the capital outflow of 696 billion USD minus the capital inflow of 584 billion USD.

From the 1980s, the FDI outflow from developing and transition economies started to grow quickly: from an amount of 4.8 billion USD in 1980 to 133 billion USD in 2005 and its share in the global FDI outflows is increased from about 5.2% in 1980 to 17% in 2005 (Figure 1). Whereas, it is noteworthy that, on the one hand, the regional distribution of outward FDI from the third world is not even. According to *world investment report 2004*, the top four FDI home countries in 1980 (Brazil, South Africa, Argentina, and Singapore) accounted for 81.38% of the total stock of outward FDI from the developing countries; the top four in 1993 (Hong Kong, Taiwan, China and Singapore) accounted for 66%; and the top five in 2003 (Hong Kong, Singapore, Taiwan, Brazil and China) accounted for 63.69%.<sup>1</sup> On the other side, there is a distinctive trend that more and more FDI (excluding offshore financial centers) from the third world is flowing into others developing and transitional economies with the share to the developed ones less and less (table 2).

Based on the analysis above, it is obvious that most of the developing countries are net FDI recipients while the developed countries are both important home and host countries of FDI. Of course there are exceptions. We observed some amounts of two-way FDI flows among the ASEAN (Association of Southeast Asian Nations) countries (D. Hiratsuka, April, 2006)



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

Figure 1: FDI outflow from developing and transition economies 1980-2005

Source: world investment report 2006, UNCTAD

Year	Total FDI from all developing and transition economies	FDI from developing and transition economies excluding offshore financial centres		
		Total	To developed countries	To other developing and transition economies
1985	4.3	3.8	1.9	2.0
1986	5.1	5.0	2.9	2.1
1987	6.7	6.3	4.2	2.1
1988	12.1	11.6	6.8	4.8
1989	19.6	15.2	6.7	8.5
1990	12.7	11.6	5.0	6.5
1991	13.7	10.7	3.7	7.0
1992	24.8	23.0	5.1	18.0
1993	40.8	34.1	2.6	31.5
1994	48.6	39.3	4.1	35.2
1995	56.0	46.3	4.6	41.8
1996	64.8	50.5	5.0	45.5
1997	82.7	54.5	11.0	43.5
1998	54.9	16.3	1.1	15.2
1999	91.9	38.7	7.5	31.2
2000	146.9	73.3	24.7	48.6
2001	79.4	46.5	10.7	35.9
2002	54.4	43.5	12.2	31.2
2003	46.3	36.6	9.6	27.0
2004	126.8	60.8	1.0	59.8

Table 2: FDI from developing and transition economies, 1985-2004 (billions of USD)

Source: World investment report 2006, UNCTAD

## **2.2. Overview of Chinese outward FDI in recent years:**

### 2.2.1 Development:

Since the adoption of “Reform and Opening-up” policy in 1978<sup>2</sup>, China has been successful in the economic construction over the past three decades: By 2006, China’s GDP had reached 20.9407 trillion Yuan (2.7 trillion USD, source: NBSC), with the economic aggregate ranking sixth in the world and the GDP growth rate of 10.7%. Participating actively into the global and regional economic activities, China has become the world’s third largest trade power and second largest FDI recipient. Since the early 1990s, it has grown into an increasingly important FDI source country among all the developing countries, though China as a whole is a low-income country with the world’s GDP per capita ranking behind the hundredth.

Ever since the establishment of People’s Republic of China in 1949, Chinese economic system had been highly controlled by the central government, even after the “open door” policy in 1978. This operating environment in China was very restrictive and complicated not only for the foreigners but also for the local investors.

In the early 1980s, China’s outward FDI was quite limited and mainly focused on transport service, engineering contract, catering service and financial insurance. From 1979 to 1983, “only 77 non-trade projects with a total investment of 50 million \$US were approved” (Haiyan Zhang & Danny Van Den Bulcke, 1996). The first generation of Chinese transnational companies (TNCs) could be divided into the following two kinds: State-owned foreign trade corporations (FTCs) and newly created foreign business oriented corporations (FBOCs). For FTCs, there are, for example, China Ocean Shipping Company and Sinochem. For FBOCs, China International Trust and Investment Company is the most famous in the world (World Investment Report 2006-Overview, p27)

To construct a more efficient market economy, the Central government created in 1980 four special economic zones: Shenzhen, Zhuhai, Shantou, and Xiamen, then opened 14 coastal cities in 1984: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai. In 1985, three River Deltas followed up:

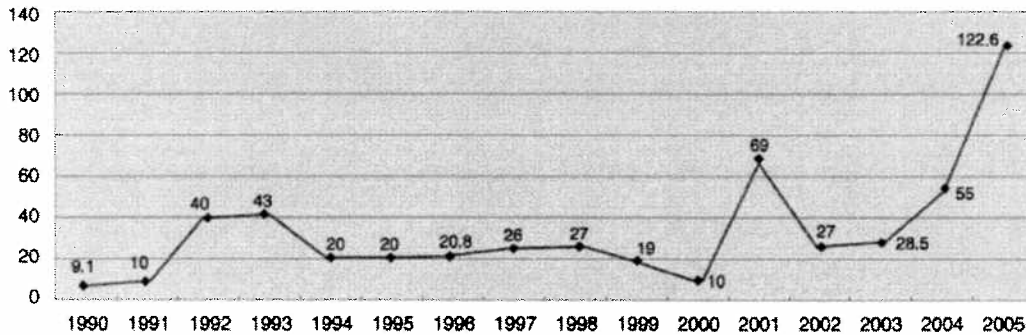
Pearl River Delta, Yangtze River Delta and Fujian Delta. The other coastal and inland provinces launched on economic reforms subsequently one after the other, which are highlighted not only in the aspect of macroeconomic decisions, but also enterprise's system, banking system, tax, and price reforms, etc.

After 1984, with the decentralization of Chinese economic management system, many local governments increased their overseas activities (especially in Hong Kong) in order to support the local development. In 1987, China became the largest foreign investor in Hong Kong, whose affiliates surpassed 2,000 with a total investment amount of 10 billion USD. (Haiyan Zhang & Danny Van Den Bulcke, 1996) Meanwhile, Chinese large industrial enterprises, relying on their strong production technology and skills, started to exploit their overseas markets. In fact, Chinese industrial enterprises were often allied with FTCs & FBOCs. On the one hand, FTCs & FBOCs are helpful for the industrial enterprises to access foreign business contacts and have bureaucratic approvals. On the other hand, the industrial enterprises could direct FTCs & FBOCs as technology experts in their overseas investments.

From 1989 to 1991, institutional reforms were frequently undertaken by the inefficient domestic state-owned enterprises (Harrold & Lall, 1993). These reforms allowed them more management autonomies than ever before, though still restrictive (particularly in the aspect of corporate reorganization decisions). Therefore, Chinese state-owned enterprises could, to a great extent, reconsider their business abilities and development strategies in both domestic and foreign markets.

In 1992, Chinese outward FDI experienced its first peak with 4 billion USD, which was probably due to Deng Xiaoping's (Chief architect of China's reform and opening up) speeches made in the spring of this year during his southern mainland China inspection tour. China's GDP growth rate in this year reached to 12.8%. In 1992, Shougang Group (previously, Capital Iron and Steel Co.) purchased Herrio Peru Mining Ltd. at 120 million USD as the first case of mergers and acquisitions (M&A) committed by Chinese company. Later that year, an excess of capital outflow emerged. Chinese government enhanced thereafter his control over capital outflows to avoid the inefficient overseas investments. Hence, we can see obviously from Figure 2 a downturn of FDI

outflow between 1994 and 2000.



**Figure 2: 1990-2005 Chinese FDI flow (100 Millions USD)**

**Source: 2005 Statistical Bulletin of China's Outward Foreign Direct Investment**

After the early 1990s, the second generation of Chinese TNCs came into being in the competitive manufacturing industries, especially those related to electronics, information and communication technologies. For example, Haier, TCL, Lenovo, Huawei, and ZTE (World Investment Report 2006-Overview p27). The small and medium-sized enterprises also began to participate actively into the overseas investment activities. In 1995, China is recognized by the UN Economic and Trade Development Organization as one of the most important overseas investment source countries<sup>3</sup>.

Unfortunately, the East Asian Financial Crisis which started from Thailand and South Korea in July 1997 shortly spread to the whole South and East Asia. China had to confront with this serious challenge: weak domestic demand, descending export and exhausted investment motivation. The problems arising from the blind reconstruction over a long time were highlighted under the background of the international economic disorder. During this hard period, Chinese TV producers, like Konka Electronics, Skyworth and Changhong Electric Group, and household appliances manufacturers, such as Haier and Midea Group, all encountered the conflict between the sluggish domestic demand and the excess productive capacity. In the autumn of 1997, the Central government shaped a new course at the 15<sup>th</sup> National Congress of Communist Party of China(CPC): "promotion of Chinese FDI outflows based on comparative advantages to make full use of two markets and two resources"<sup>4</sup>. In 1998, President Jiang Zemin pointed out that while we

work hard at expanding the export, some large and strong state-owned enterprises should be encouraged to go abroad, especially to invest in Africa, Middle Asia, Middle East, Middle Europe and South Africa” The General Office of State Council published a new FDI promoting policy in 1999 and issued successively a number of documents to support the “Going Global” strategy. Therefore, with the efforts from the governments as well as the enterprises, China was sufficiently prepared for its accession to the World Trade Organization (WTO) in November 2001.

After the success of Chinese economy’s soft landing (from 1996 to 2001, China’s GDP growth rate decreased slowly with an average of 8.1% per year), Chinese FDI outflow experienced in 2001 its second peak with 6 billions USD. At the 16<sup>th</sup> National Congress of CPC held in 2002, President Jiang Zemin emphasized the combination of two strategies: “Attracting FDI” and “Going Global”. To encourage the overseas direct investment, the Central government modified and established a series of new laws and regulations to simplify the examination & approval procedures. In 2005, the outward FDI from others developing and transition economies experienced an overall decline, but that from China jumped sharply, which was mainly due to an 83% increase in the value of cross-border M&As (World Investment Report 2006, Chapter II, p16) According to *2005 Statistical Bulletin of China’s Outward Foreign Direct Investment*, by the end of 2005, there had been totally 6426 Chinese TNCs directly investing in around 164 countries and regions with the annual outward FDI flux of 122.6 billion USD (financial section excluded) and the stock of 572 billion USD.

According to the research report released by Deutsche Bank on Jan 15, 2007<sup>5</sup>, to insure energy security & resource sustainability and to exploit the overseas markets, the annual average growth rate of Chinese FDI outflow will probably exceed 20% in the next five years. China will become the largest FDI source country in Asia with an amount of FDI outflow reaching to 60 billion USD in 2011, of which two-thirds will be accounted by the resource industry.

#### 2.2.2. Recent characteristics:

In this subsection, we will observe the recent development characteristics of Chinese



outward FDI from two perspectives: the flow and the stock.

For the annual Chinese outward FDI flow from 2003 to 2005, the regional distribution became wider and wider; the industrial distribution was increasingly concentrated on business services; and the local FDI outflows expanded rapidly with local governments more and more outward-looking.

First, the variation in regional distribution: in 2005, Latin America became for the first time the largest investment destination for Chinese multinational enterprises, although Asia had always headed the list before. More than 90% of Chinese capital flow into the developing world. Europe and North America, abundant in modern technologies and capital, were two challenging continents that China needs to exploit further in the future. (Table 3)

Second, the variation in industrial distribution: Manufacturing, mining and business services were the three main sectors that Chinese FDI focused on. In 2005, the share of business service reached 40.3% which far exceeded that of the others. (Table 4)

Third, the increasing local FDI outflows: Compared to the level recorded in 2003, the outward FDI flows in 2004 from local provinces increased by 28.5%. Compared to 2004, the flows in 2005 increased by 111.5%. Besides, more and more provinces in backland also turned to be overseas investors, though the coastal provinces, such as Shanghai, Guangdong, Zhejiang, Shandong and Heilongjiang, were still the most active regions in the field of international investment.

(%)	2003	2004	2005
<b>Asia</b>	53	55	36
<b>Latin America</b>	36	32	52
<b>Europe</b>	5	3	4
<b>Africa</b>	3	6	3
<b>North America</b>	2	2	3
<b>Oceania</b>	1	2	2

**Table 3: Variation in regional distribution of Chinese outward FDI flow from 2003 to 2005**  
**Source: 2003, 2004, 2005 Statistical Bulletin of China's Outward FDI**

(%)	manufacturing	mining	Business service	Transport & Storage
<b>2003</b>	27	4	14	7
<b>2004</b>	13.8	32.7	13.6	15.1
<b>2005</b>	18.6	13.7	40.3	4.7

**Table 4: Variation in industrial distribution of Chinese outward FDI flow from 2003 to 2005**  
**Source: 2003, 2004, 2005 Statistical Bulletin of China's Outward FDI**

For the cumulative stock of Chinese outward FDI by the end of 2005, we will take a glance at the investment size, the regional and industrial distribution, the composition of stock, and the share of investment from local provinces.

First, quickly expanding investment size and increasingly extensive regional distribution: by the end of 2005, Chinese outward FDI stock reached 57200 million USD. Compared to the level recorded in 2004, it was increased by 12400 million USD. These overseas investments were distributed around 163 countries and regions. (Figure 3)

Second, more than 90% of Chinese outward FDI were invested in Asia and Latin America: Asia accounted for 71% of Chinese FDI outflow with the stock of 40630 million USD by the end of 2005, where the major destinations were Hong Kong, South Korea, Macao, Singapore, Vietnam and Thailand. By 2005, the stock of Chinese outward FDI in Latin America reached 11480 million USD with the share of 20%, where the main recipients were Cayman Islands, British Virgin Islands.

Third, based on the investment industrial distribution, business service and wholesale & retail accounted for a half of the total stock. (Figure 4) By 2005, the investment stocks in the sectors of business service (mainly focused on investment holdings) and wholesale & retail were respectively 16550 million USD and 11420 million USD which accounted for 28.9% and 20% of the total outward FDI stock.

Fourth, based on the composition of the stock, the profit re-investment accounted for the largest part. By the end of 2005, the stock of equity investment was 19730 million USD with the share of 34.5%, and that of profit re-investment was 27040 million USD with the share of 47.3%. The other kinds of investments were 10430 million USD in all which accounted for 18.2%.

Finally, 81.8% of Chinese outward FDI stock was explained by state-owned enterprises' investments. The share of investment from local provinces increased a lot. Compared with the last year, Chinese overseas investment from local provinces reached to 9380 million USD in 2005, increased by 2880 million USD, which accounted for 16.4% of the stock. Guangdong province stood first in the list with Shanghai, Beijing, Shandong, Zhejiang, Jiangsu, Heilongjiang, Hebei,

Fujian and Henan following behind.

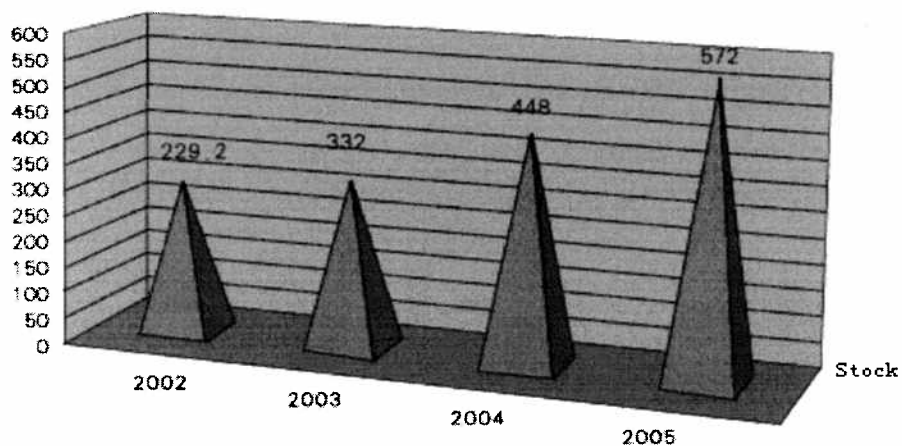
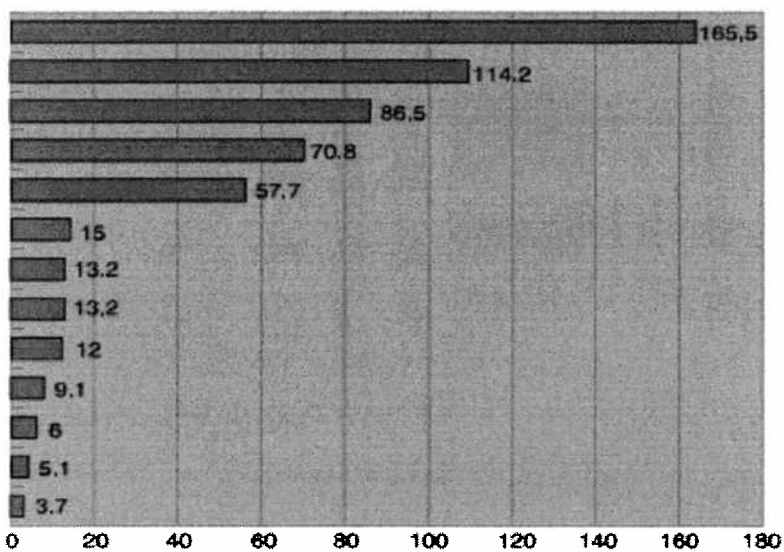


Figure 3: 2002-2005 Chinese FDI stock (100 Millions USD)

Source: 2005 Statistical Bulletin of China's Outward FDI



1. Business service 2. Wholesale & retail trade 3. Mining 4. Transport storage & post 5. Manufacturing 6. Real estate 7. Information transmission, computer service and software 8. Hotels and catering service 9. construction 10. Environment & infrastructure 11. Scientific research & technology 12. Agriculture, forestry, animal husbandry and fishing 13. Others

Figure 4: Chinese FDI regional distribution by the end of 2005 (100 Millions USD)

Source: 2005 Statistical Bulletin of China's Outward FDI

### 2.2.3. Existing problems:

First, the stock of Chinese outward FDI is still insignificant. According to *World Investment Report 2005*, the world's outward FDI flow in 2004 is 7,302.6 billion USD and the stock is 97,322 billion USD. However, the flow and the stock of Chinese outward FDI were just 1.68% and 0.59% of them. Also, it is noteworthy that the ratio of inward FDI to outward FDI in China is 1/0.23, which is much larger than that in developed countries (In developed countries, this ratio is on average around one. A detailed explication is available in Section 3). Figure 5 to 8 help us to further realize the development level of Chinese outward FDI.

Second, the scale of outward FDI from each Chinese enterprise is on average small. The overseas investment from each Chinese enterprise is on average lower than 1.4 million USD<sup>6</sup>, while the average level of enterprises from the developed countries is 6 million USD. As a result of small scale investment, it is really hard for Chinese multinational enterprises to benefit from the scale advantage, to enforce effectively R&D, and to fully support the distribution and after-sales service. Therefore, a vicious circle is generated: Lack of scale advantage, the production cost becomes much higher. Then, some shortsighted entrepreneurs choose the lower quality products at a lower price. This will consequentially lead to a lower market occupancy ratio as well as a smaller scale investment.

Third, the technical contents of China's overseas investment projects are not high. The quality of Chinese overseas investment has been greatly improved in recent years. Some high-tech enterprises establish R&D institutions or technique centers in more advanced countries. For example, in 1997, Galanz set up a micro-wave oven research center in USA; Holley Group purchased in 2001 the CDMA R&D center from Phillips Company in USA; Haier Group established six product design centers in USA, France, Netherlands, Canada and Japan, and ten information centers in Korea, Australia, Japan, USA, Taiwan, and Hong Kong; Huawei Company set up eight regional headquarters, thirty two branch offices and a host of customer support and training centers in the world.

However, most of China's outward FDI lay stress on primary products' investment rather than high-tech industries' investment. Among the non-trade overseas investments, nearly 40% of

them pertain to low-add-value, low-tech and labor-intensive projects, such as resource exploitation and primary processing. But these investments have nearly no future because of fierce competitions of similar products from others developing countries.

Fourth, the regional distribution of Chinese enterprises is not well-proportioned. According to *2005 Statistical Bulletin of China's Outward FDI*, 45.6% of Chinese companies concentrate in Hong Kong, U.S.A, Russia, Japan, Vietnam, Germany and Australia. Among them, Hong Kong accounted for 16.5%, U.S.A 10.3%, Russia 5.8%, Japan 3.8%, Vietnam 3.5%, Germany 3.1% and Australia 2.6%. On the whole, Chinese enterprises spread in less-developed countries are still a relative small part.

Fifth, the benefits of overseas investment projects need to be further enhanced. A number of state-owned enterprises carry out overseas investments in response to the "Going Global" policy. Therefore, not enough attention is paid to the research on market entry, workers' training, industrial concentration, supply chain, intellectual property rights protection and operations of bureaucratic system. Besides, with the shortage of self-owned capital, the management of Chinese multinational enterprises often gets into a hobble.

Finally, under the background of economic globalization, "private enterprises" should grow into the main force of Chinese outward FDI. Although overseas investments made by Chinese private enterprises are expanding rapidly, the FDI outflows from state-owned enterprises still accounted for 81.8% of the stock in 2005. Dianqing Xu and Weiyang Zhang<sup>7</sup> said that it is nearly impossible to promote Chinese outward FDI through state-owned enterprises, whose success rate is not that high. "Going Global" strategy is venturesome for them in an increasingly competitive international environment. The governments are the largest shareholders in the state-owned enterprises. Once their overseas projects prove abortive, the current political situation would be influenced. Further, the motivation of state-owned enterprises to invest abroad is much different from that of private ones. The state-owned investors usually attach more importance to political interests, while the private ones are mostly profit-driven. Therefore, the main force of Chinese outward FDI should be represented by the private enterprises.

Over the past twenty years, some private companies have already grown into the main force

of Chinese outward FDI, such as Wanxiang, Huawei, New Hope Group, and Chint. In some developed provinces, thousands of private enterprises entered bravely into the international market with the self-support import and export rights. We have reasons to believe that the success rate of private enterprises in overseas investments will be much higher.

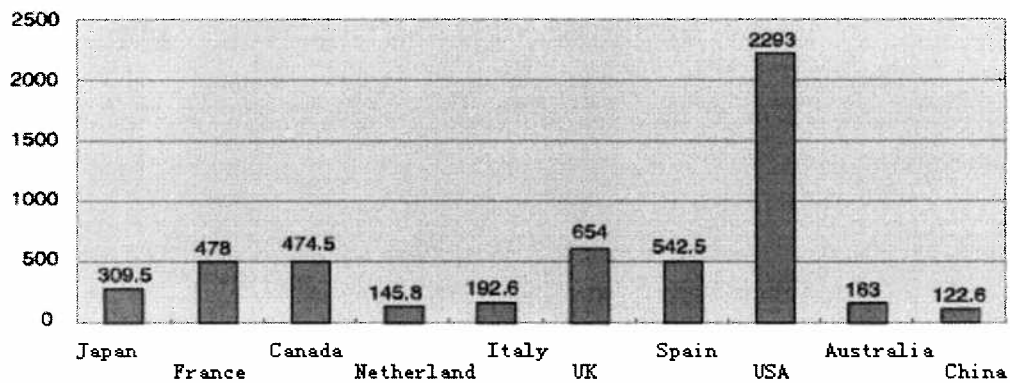


Figure 5: Comparison of the outward FDI flow in 2005 between China and selected developed countries (100 Millions USD)

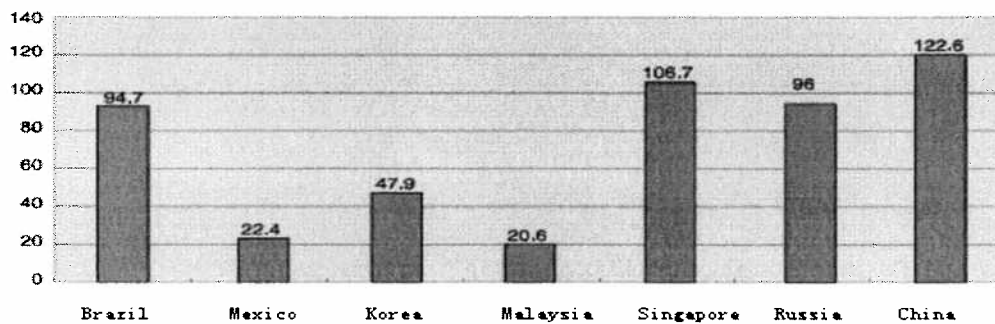
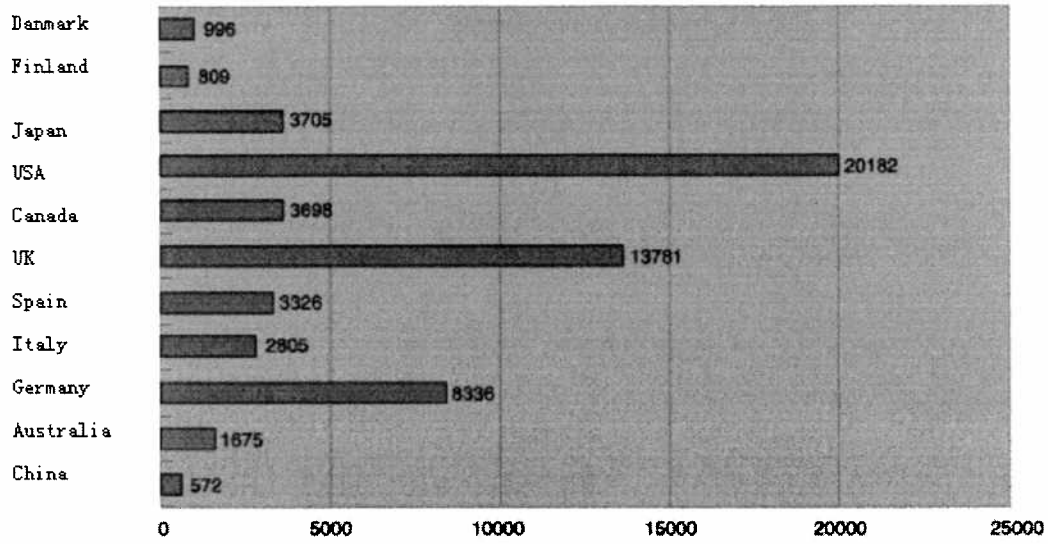
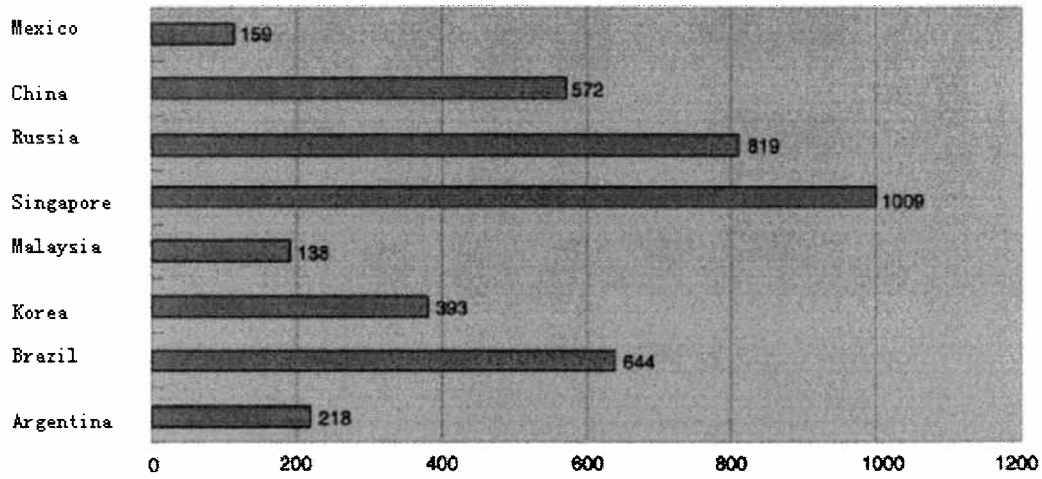


Figure 6: Comparison of the outward FDI flow in 2005 between China and several less developed countries (100 Millions USD)



**Figure 7: Comparison of outward FDI stock between China and selected developed countries by 2005 (100 Millions USD)**



**Figure 8: Comparison of outward FDI stock between China and selected less developed countries by 2005 (100 Millions USD)**

Source: figure 5 to 8 come from 2005 Statistical Bulletin of China's Outward FDI.



#### 2.2.4. Effective measures:

First, the objective of outward FDI is to capture economic profit. Chinese private enterprises will for certain do their best to achieve it. Therefore, the governments at all levels should facilitate their overseas activities and help them to make full use of “two resources and two markets”.

Second, the overseas direct investment accords with China’s economic safety requirement. The sustainable economic growth is the same important as the current high reward investment. To insure domestic economic construction, we must firmly seize the key opportunities in the global market and strengthen the strategic materials’ storage, such as petroleum, copper, iron, forest and latex.

Third, “Going Global” strategy corresponds to China’s industrial development requirements. In recent years, some industries in China have already shaped mature production technologies so that the domestic competition is increasingly furious. Therefore, these technologies and the production lines should be gradually transferred into others less developed countries. In this aspect, China had already learned experiences from Japan and South Korea and applied them in practices, such as transferring bicycle production to Ghana and video players to South-East Asian countries.

Finally, the country should speed up the construction of the modern enterprise system, perfect the operation mechanism, and direct the regional and the industrial distributions of Chinese outward FDI based on the country’s comparative advantages and economic profit objectives.

To sum up, advanced technologies and modern management skills are concentrated in North American and West European countries, where it also exists vast market spaces, stable polities and harmonious legal systems, but the market entry requirements for foreign investors are usually higher. While, the developing countries in Asia, Africa, Middle East and Latin America are rich in natural resources and cheap labor force, though the overseas exploiters have to overcome some others unstable factors.

## Section 3 Review of literature

### 3.1. FDI theories for developed countries:

The studies of FDI theories are initiated by Stephen H. Hymer, American economist, with the Monopolistic Advantage Theory (1960). He declared that FDI is the outcome of market incompleteness. After him, some scholars continued to renew this theory, such as Charles P. Kindleberger, H. G. Johnson, and R. E. Caves. The theory of Product Cycle proposed by Raymond Vernon in 1966 succeeds in explaining the FDI phenomenon at that time in the manufacturing industry in United States. Peter J. Buckley & Mark Casson, illumined by R. Coase's Transaction Costs Theory (1937), put forward the Theory of Internalization (1976). They figured out that to overcome the obstacles from the intermediate products trading, such as technology patents and brand names, the enterprises need to produce within their own firms, thereby the multinationals come into being.

Because of the difficulty to explain FDI outflows from Japanese small and medium-sized enterprises with the existing transnational company theories, Kiyoshi Kojima propounded the Theory of Comparative Advantage in 1978. He classified the motivations of Japanese enterprises' overseas investments into four groups: natural resources oriented, labor force oriented, market oriented, and international production & distribution oriented. He alleged that the outward FDI should be undertaken sequentially from the industries in disadvantage position to the ones becoming less advantaged.

Based on the synthesis of the Monopolistic Advantage Theory, the Internalization Theory, and the Theory of Location, John H. Dunning put forward in 1976 the Eclectic Theory of International Production, so-called OLI theory. This theory shows that the outward FDI is the outcome of the following three advantages: Ownership Advantage, Location Advantage, and Internalization Advantage. With different extent of the three advantages, enterprises decide specific way to access the international market: exportation, permission commerce or foreign direct investment.

Before 1980s, the Currency Variation Theory (1970) developed by R. Z. Aliber was also famous in the field of international investment. He analyzed qualitatively the choice of multinational enterprises between technology licenses and FDI, and then indicated generally that when the host country's market is relatively small, it is better to choose the technology licenses; when the market expands gradually with the passing of time, FDI is much better. However, if the multinational enterprise possesses a hard currency, for the same amount of cash inflow, its discount rate is higher than that of the enterprises in the host country. In this context, even if the host country's market is small, it is better for the multinational enterprise to adopt FDI.

In the 1980s, on the basis of the Eclectic Theory of International Production, Dunning put forward the Investment Development Path Theory, namely IDP theory(1981a, 1988), which gives us a general explication for the phenomena of outward FDI from either developed or developing countries. In this theory, the author maintained that the magnitude of a nation's outward FDI correlates positively with the nation's economic development level, which is measured in terms of GDP per capita. He divided the economic development into five stages according to particular characteristics of FDI in different time periods: In the first stage of pre-industrialization, GDP per capita is inferior to 400 USD. The country never involves in outward FDI and attracts few inward FDI. The net FDI stock, which equals the outward FDI stock minus the inward FDI stock, is around zero. In the second stage, GDP per capita is superior to 400 USD but inferior to 2000 USD. The inward FDI starts to augment quickly, while the outward FDI is still insignificant. In the third stage, GDP per capita is more than 2000 USD but less than 4750 USD. Although the net FDI stock is still negative, the growth rate of outward FDI is becoming much higher than that of inward FDI. In the fourth stage, when GDP per capita exceeds 4750 USD, the net FDI stock turns to be positive and the outward FDI keeps mounting up rapidly. In the last stage, the country's economy shifts into an advanced period, when the ratio of outward to inward FDI fluctuates around one, such as the two-ways FDI in the leading developed countries. In part 4, we will examine China's development stage with this theory.

After the 1980s, new theories and paradigms of FDI studies, which have well complemented and developed the previous, emerged in endlessly. For example, Michael Porter published the

Theory of the 'Diamond' of Competitive Advantage in 1990. He created a paradigm within which the determinants of national competitive advantages can be identified. On the basis of his "stages theory of competitive development", a country's economic development are distinguished by four stages: (1) factor-driven (e.g. natural resource extraction or labor-intensive manufacturing); (2) investment-driven (e.g. intermediate & capital goods manufacturing, and infrastructural building); (3) innovation-driven (e.g. human-capital-abundant and active in research and development); and (4) wealth-driven, "the first three of them are in fact a successive upgrading of a nation's competitive advantages and will normally be associated with progressively rising economic prosperity" (M. Porter 1990, pp 546). He pointed out that each stage of competitive development is matched with a particular pattern of FDI, both inward and outward. On the side of outward investment, the transition from the first to the second stage generates a capital outflow towards lower-wage countries, and most of the investments are focused on the natural resource extraction and labor-intensive manufacturing industries; the transition from the second to the third stage gives rise to outward FDI focused on intermediate goods industries (Ozawa 1992, Figure 9).

### **3.2. FDI theories for developing countries:**

It is noteworthy that all the theories mentioned above manage to explain the developed countries' overseas direct investments. Hence, not all of them adapt to the phenomena of outward FDI from the developing countries, especially the Monopolistic Advantage Theory, whose research objects were American large multinational companies in 1950s.

Since the late 1970s, more and more developing economies have emerged as the net FDI investors. To sum up, the outward FDI theories applied to the developing and transition economies have two ways to follow up: the one is to seek competitive advantages; the other is to maximize the inter-period profit.

Louis T. Wells (1977, 1983) stated that the advantages of overseas investments from developing countries consist in small scale production (small market, small-scale technology and low-cost management fees), local purchases, special products (use of local resources, materials and innovations), and closing to the market; the objectives of their outward FDI is to protect

export markets and quota, to strive for low-cost production and to diversify assets, etc. Actually, this theory, which manages to explain the phenomena of outward FDI from a less developed country to others least developed countries, still follows the principle of monopolistic advantage.

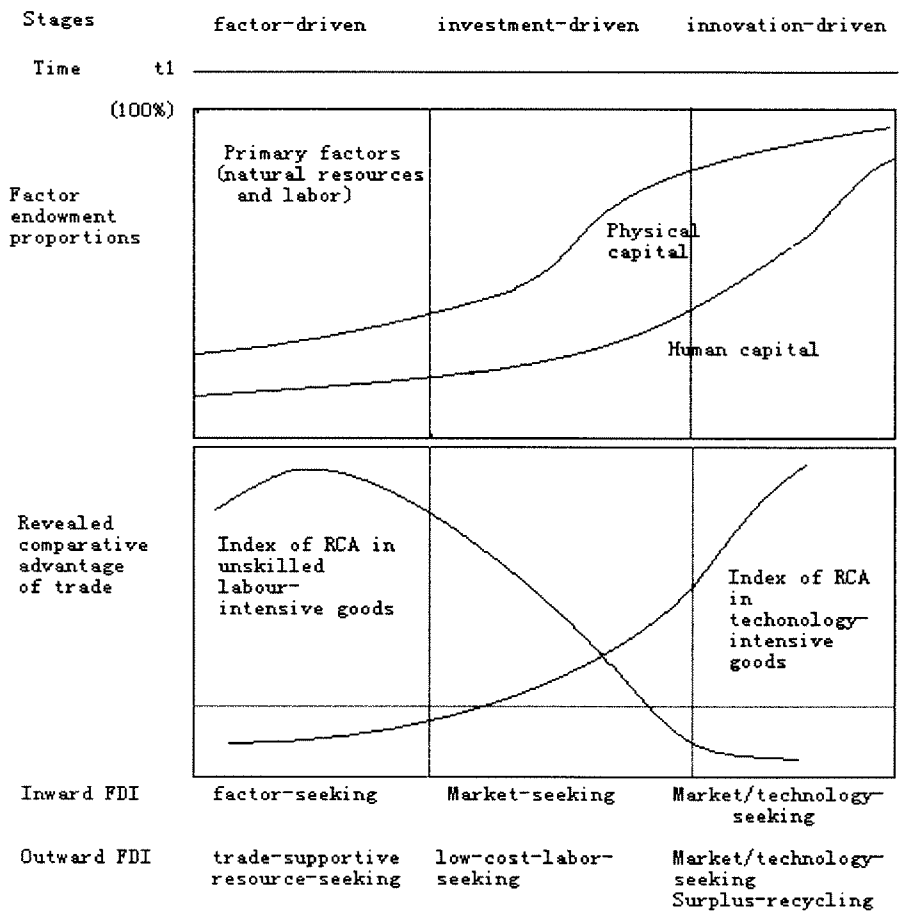
Sanjaya Lall (1983) studied the competitive advantages and investment motivations of Indian transnational corporations, and then advanced the Theory of Technological Localization. According to his research, although the technologies from developing countries are characterized by small scale, standardization and labor-intensive, it is easy to adapt them to new conditional variations. In general, these technologies accommodate properly to the needs of others developing countries' markets. Hence, the investors usually benefit a lot from them.

John A. Cantwell and his student Paz Estrella Tolentino published in 1990 the Theory of Technological Accumulation and Third World Multinationals. They avowed that the technology accumulation in less developed countries has never ceased, and this relates to their development of outward FDI and claimed that the technology innovation is the fundamental driving force of industry and enterprise development. Comparing with the developed countries, the technology innovations in the developing world are mainly to master and improve the existing technologies. Therefore, with the influence of technological accumulation, the regional and the industrial distributions of the developing countries' outward FDI will vary through time.

As a developing country, China's outward FDI needs to be studied. In recent years, Chinese scholars have made a lot of efforts in this field. Gongmin Bao (1996) claimed that seeking markets and scale economies are the basic objectives for the multinational corporations from developing countries. Haiyun Liu (1998, 2000) analyzed that Chinese FDI outflow is a continuous process, which can be divided into two stages: the first is to learn and accumulate experiences by the chance of overseas investment; the second is to make the best of companies' competitive advantages through FDI. Yaming Ma & Yangui Zhang alleged in 2000 that the monopolistic advantage is neither a sufficient condition nor a necessary condition for outward FDI. In the face of global strategies proposed by the multinational enterprises from developed countries, developing countries' overseas direct investment is an active response to the keen global

competition. Jianbo Chu & Gang Hu advanced in 2003 the FDI Threshold Theory, according to which the behavior of outward FDI from developing countries is determined by both the company's investment capabilities and the 'threshold' of foreign direct investment.

Actually, most of the FDI theories, either for developed countries or developing countries, relate to the behavior and growth of multinational corporations. However, our interest is to discover the relationship between the outward FDI and China's economic growth. Thus, in part 4, we will study China's outward FDI by means of Dunning's IDP theory.



Source: Terutomo Ozawa (1992), Figure 1

**Figure 9: Stages of development, changing factor proportions, and dynamic comparative advantage**

## Section 4 Theoretical Analysis

The dramatic economic growth taking place in East Asia in the later half of the last century has interested many social scientists worldwide. Economists gave it a lively name, the “flying geese” theory, which explains the sequential economic development in East Asia. Japan, as the “lead goose”, transferred its backward technologies to the neighboring countries when it caught up with the western competitors, such as US and West European countries. The four Asian Tigers (Hong Kong, South Korea, Singapore, and Taiwan), followed the lead of “mother goose” to construct an outward-oriented market economy and to phase out the “incompatible” industries into their neighbors (Indonesia, Malaysia and Thailand)<sup>8</sup>.

Does any potential and natural rule influence the rapid economic growth? Does the economy grow in regular sequence? Or, is it possible for any country to achieve its final economic goal at one blow by overstepping some development stages?

Raymond Vernon revealed in fact in the Product Cycle Theory (1966) “a hierarchy of economies”<sup>9</sup>. According to this theory, new products are introduced in a “trickle-down” fashion from one developed country to others developed countries, and later to developing countries. On second thoughts, it is the comparative advantages and technologies that change and transfer during each particular time period. Yet, how does this transfer correlates with the economic development is out of explanation in Vernon’s theory<sup>10</sup>.

Adam Smith and David Ricardo, the two founders of international trade theory, first illuminated the way by which the later generations could uncover this enigma. Smith emphasized in the *Wealth of Nations* the importance of “a natural order of things” during the economic development. “The greater part of the capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and, last of all, to foreign commerce.”<sup>11</sup> Through the extended export market, the country is building an absolute advantage on the basis of scale economies. While, David Ricardo propounded the doctrine of comparative advantages in the

example of the international trade of clothes and wine between England and Portugal. As the result of different factor endowments, Ricardo advanced an effective specialized production model: Countries should specialize in producing the goods which use their relative abundant factors, and then exchange them with each other to realize the effective allocation and to benefit more from the international trade.

It is widely recognized that the outward-oriented economy is much more effective than the autarkic economy. Any developing country that will want to improve its economic strength in a shorter time period must open up its economy and integrate into the global economy. Ever since the success of Industrial Revolution in UK, West Europe, U.S.A and Japan learned from and emulated their outrunner(s) by way of international trade and investment. Thereafter, whether some Latin American countries, Asian newly industrializing countries, China, or the Former Soviet Union countries, switched from the inward-looking and import-substituting economic system into the outward-looking and export-oriented type. We extract experience from these facts that there is never a masterstroke for any of the countries during their economic development. The wealth accumulation is formed step by step and stage by stage.<sup>12</sup> A country must first of all focus on the comparative advantage industries ( the labor-intensive production, for instance) and export its competitive goods to accumulate rapidly sufficient physical and human capital for the domestic infrastructure construction and the amelioration of investment climate. Then develop greatly the capita- and technology- intensive industries in order to improve the standard of living in the whole country.

After the introduction of the Eclectic Theory of International Production (so called OLI theory), John H. Dunning created in 1981 the concept of “investment development path” (IDP), which analyses the process of economic development from three angles: ownership advantages, location advantages and internalization advantages.

#### **4.1. Ownership, location, and internalization advantages model:**

This theory suggests that the outward FDI is one of the synthetic influence results of the following three advantages: Ownership, Internalization, and Location. “The OLI advantages vary



with the countries, the nature of activities and the firm specific characteristics.”<sup>13</sup> With different OLI advantages, specific approaches are adopted by the enterprises to access the foreign market: exportation, permission commerce or foreign direct investment (FDI). More OLI advantages possesses a firm, higher control level will be selected to entry the foreign market, such as wholly owned venture.

<b>O advantage</b>	Owner-specific advantages, such as human capital, patents, technology, know-how, brand names and reputation
<b>L advantage</b>	Different locations provide the investors with different resources, institutions and regulations etc. For example, “Jumping” barriers to trade ( tariff, quotas), lower factor prices
<b>I advantage</b>	To resolve the problems arising from transferring O advantages across national boundaries, the company needs to internalize its production. Examples: impossible to write complete contracts for every possible event, difficult to enforce, risk of opportunistic behavior

**Table 5: OLI advantages<sup>14</sup>**

#### **4.2. Investment Development Path model:**

According to the IDP theory, while the country develops (in terms of GDP per capita), the conditions (or the OLI advantages) for domestic and foreign multinational corporations change, which have a direct influence on both inward and outward FDI flows. What’s more, FDI flows react to the economic development by improving market and industrial structures. This theory also avows the government’s contributions on the sides of infrastructure construction, legal system, and other public works. These contributions will definitely enhance the host country’s location advantages, domestic companies’ ownership advantages, and then help the country accelerate the economic development.

According to different characteristics of outward FDI during different time period, Dunning divided a country's economic development into five stages (Buckley & Castro 1998, Dunning, Hoesel, and Narula 1997):

**Stage 1:** Pre-industrialization time. The domestic economy is completely inward-looking, the market mechanism does not appear; the labor force is poorly educated; the public infrastructure and the legal system are in dire need of improvement; there are few international economic activities. Hence neither inward nor outward FDI flows.

**Stage 2:** The infrastructure construction has achieved significant progress under the policies of the current government. Hereby, the domestic investment climate has been greatly improved. More and more foreign capital flows into domestic comparative advantage industries, such as labor intensive industries, (like textile industry) or resource-intensive industries (like minerals exploitation). In this stage, the growth rate of inward FDI is evidently higher than that of GDP. The objective of foreign investors is basically resource-seeking (minerals, raw materials or unskilled labor) and market-seeking.<sup>15</sup> However, the country's outward FDI begins emerging in the neighboring countries and other less developed countries. Lacks of sufficient human and physical capital, the domestic firms do not possess enough ownership advantages (fundamental Oa advantages, no Ot advantages<sup>16</sup>) to invest in industrialized countries. Besides, most of these outward FDI are natural resource intensive and based on small scale productions in light industries. As a result, the net FDI stock, which equals the outward minus inward direct investment stocks, is becoming increasingly negative.

**Stage 3:** A dramatic and rapid outward FDI growth features largely in this stage, whose growth rate ultimately surpasses that of inward FDI. Thereafter, the net FDI stock begins to rise though it is still negative during this time. A significant increase of ownership advantages experienced by some of the domestic firms enables their products more competitive not only in the domestic markets but the foreign markets. The objectives of the outward FDI in this period are primarily resource and market seeking in developing countries and strategic asset and market seeking in

industrial countries.

**Stage 4:** The net FDI stock turns out to be positive in this stage. Created assets determine the location advantages. Both Oa and Ot advantages have been greatly improved, despite that the Ot advantages become much more important than the Oa advantages. The outward FDI tends to be capital and knowledge intensive. The overseas investments of efficiency-seeking are in purpose of optimizing the use of each country's comparative advantages. The global intra-firm activities have experienced a notable augmentation. Countries in this stage are usually called "newly developed countries", such as Hong Kong, Taiwan, South Korea and Singapore during the 1990s.

**Stage 5:** The net FDI stock revolves around zero<sup>17</sup>, since either inward or outward FDI flows have gone through a huge and permanent growth in the last stages. This corresponds appropriately to the two-ways FDI in today's leading developed countries. The overseas investments concentrated on capital and high-tech intensive industries, for instance, automobile manufacturing. The primary difference between stage 4 and 5 is reflected in the capacity to generate direct investment (Juan & Femando, 2007).

However, in practice, not every individual country's investment development fulfills strictly the five-stage characteristics. Possibly, it is because of dissimilar government policies, different market size and various factor endowments, etc. Furthermore, the lack of long term FDI statistical data makes the empirical test of individual country's IDP quite difficult.

## **Section 5 Empirical Analysis**

### **5.1. Examination of China's investment development path :**

Before the implementation of "open door" policy in 1978, China was basically self-reliance and economic independence. We consider the time before 1978 as the first stage, when the net FDI stock is around zero and GDP per capita is quite small, even far behind the world's average

level. After 1978, large numbers of inward FDI swarm into China and expand rapidly. However, China's outward FDI stock in the 1980s was almost negligible, and not until 1992 did it experience its first peak with 4 billion USD which is four times of that in 1991, probably due to Deng Xiaoping's speeches made during his southern mainland China inspection tour, which put stress on the acceleration of "reform and opening". However, compared with the amount of China's inward FDI, China's outward FDI was still insignificant. In the following eleven years, the outward FDI flux underwent several ups and downs (Table 6). Finally, in 2004, it restarted to expand quickly. By 2005, the stock of Chinese FDI outflows had reached 57.2 billion USD (Figure 3 in Section 2).

We would like to track the movement of China's net FDI stock from 1980 to 2005 in a growing economic environment through a planar rectangular coordinate system:

X-axis: the net FDI stock  $t = \text{outward FDI stock } t - \text{inward FDI stock } t$ , where  $t$  stands for the year;

Y-axis: GDP per capita

Though the growth of GDP could explain in a way a country's economic development, GDP per capita better reflects the country's real economic development level. Therefore, we choose GDP per capita to denote China's growing economic environment. Chinese GDP per capita grows persistently since the open-door policy in 1978. On the one hand, from 1979, China's GDP growth rate rises permanently. In 1992, Chinese economic reform pace accelerated, and the GDP growth rate climbed onto another higher level. China's GDP per capita first exceeded 400 USD in this year. On the other hand, Chinese population natural growth rate has slowed down since the one child family policy in the late 1970s: from 12‰ in 1978 to 5.89‰ in 2005 (National Bureau of Statistics of China).

Dunning's IDP model shows that a country's economic development correlates positively with its magnitude of outward FDI. Does China properly accord with the general IDP model? We collect Chinese FDI data from the United Nations Conference on Trade and Development (UNCTAD) and Chinese GDP per capita Data from the International Monetary Fund (Table

7-11 ). The figure 10 clearly proves that China's Net FDI stock becomes increasingly negative, which indicates that at the present period the growth rate of Chinese inward FDI is obviously faster than that of outward FDI and China will keep this trend in the future until Chinese TNCs possess quite a few ownership advantages and solid financial strength to invest abroad. In fact, compared to Chinese inward FDI stock, Chinese outward FDI stock is still insignificant up to nowadays, though the country has already become, in the 1990s, one of the major FDI source countries in the developing and transition economies. Hence, we judge that China is at present in the second stage of IDP.

In the table 7-10, we list the flow and the stock data of FDI from Hong Kong (China) and Taiwan province of China from the year 1979 to the year 2005. Since the 1980s, Hong Kong and Taiwan have become the two significant destinations of inward FDI in the world. They emerged as the leading overseas direct investors in the developing world from the early 1990s. Hong Kong's GDP per capita exceeded 4750 USD in the early 1980s, while, Taiwan province in the late 1980s. From the late 1990s, Hong Kong's inward and outward FDI both experienced a remarkable increase except for the year 2001, 2002 and 2003. However, the inward FDI's increase is faster than that of the outward FDI so that Hong Kong's net FDI stock appeared again in the very negative area in his investment development path (Figure 11). In the side of Taiwan, it has consistently been an FDI source economy since the 1980s, whose inward and outward FDI pattern seems somewhat different from Dunning's. (Robert Read 2002).

Actually, it is much easier to explain outward FDI in Hong Kong and Taiwan through Kojima's Comparative Advantage Theory, which first aimed to explain FDI outflows from Japanese small and medium-sized enterprises. These enterprises are all involved in the difficult domestic investment environment: high labor cost and land prices. Ever since the implementation of the "open-door" policy in China, Hong Kong and Taiwanese investors are all attracted by the abundant labor supply and cheap land prices in the mainland of China. This directly resulted in a big transfer of labor-intensive manufacturing industries from Hong Kong and Taiwan to the mainland of China and an upgrading of the domestic industries' structure: Hong Kong specializes in real estate and various business services and Taiwan in the high-tech industries, such as electric

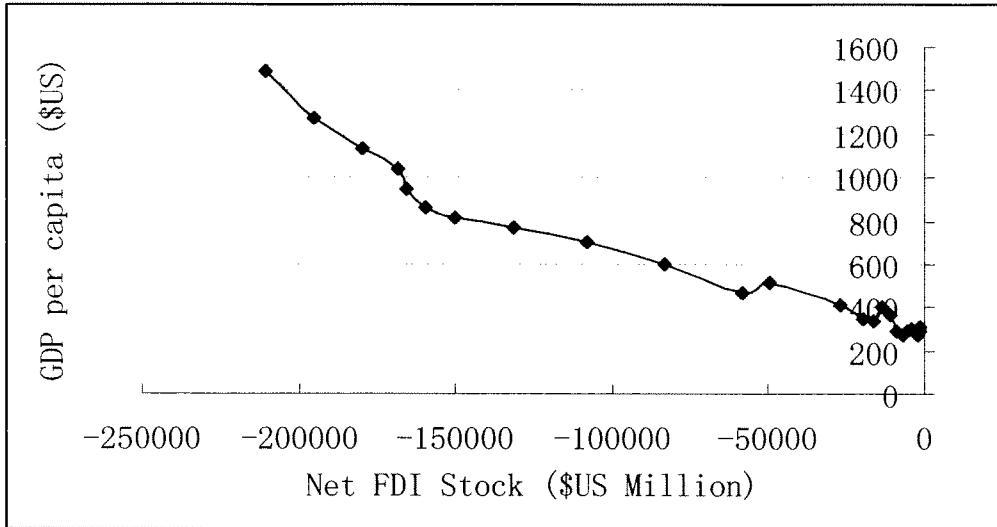
and chemical products productions.<sup>18</sup>

However, Dunning, Hoesel and Narula (1997) suggested that the newly industrialized East Asian economies (Hong Kong, Taiwan, Singapore, South Korea) are actually in the second wave of the IDP, which can be considered as an intermediate stage between the stage 1 and the stage 4 and 5 (Table 14). Their economic activities are increasingly globalized: They invest in less developed countries to take advantage of the local abundant natural resources as well as the cheap labor costs; they exploit the markets and engage in the strategic asset-seeking activities in the advanced countries. Their overseas direct investment activities are *“a result of government-assisted upgrading of L advantages of the home country which in turn helped create O advantages of their firms and while these O advantages were initially primarily country-of-origin specific, they have been supplemented through the using of strategic asset-acquiring FDI”* (Dunning, Hoesel and Narula ,1997, p3)

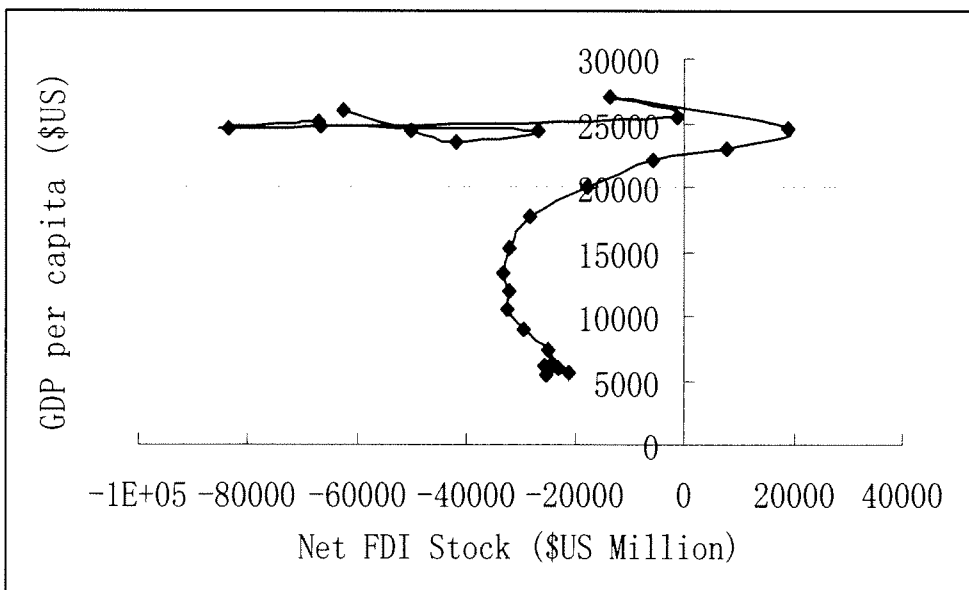
	2000	2001	2002	2003	2004	2005
Low income	1.9	2.7	1.5	5.1	5.5	5.6
Middle income	4.6	2.0	2.7	4.2	6.3	5.4
High income	2.8	0.4	0.7	1.4	2.6	2.1
China	7.6	7.5	8.4	9.3	9.4	9.2
Hong Kong	9.2	-0.3	0.9	3.0	7.3	6.3

**Table 6: Growth rates of GDP per capita, 2000-2005 (%)**

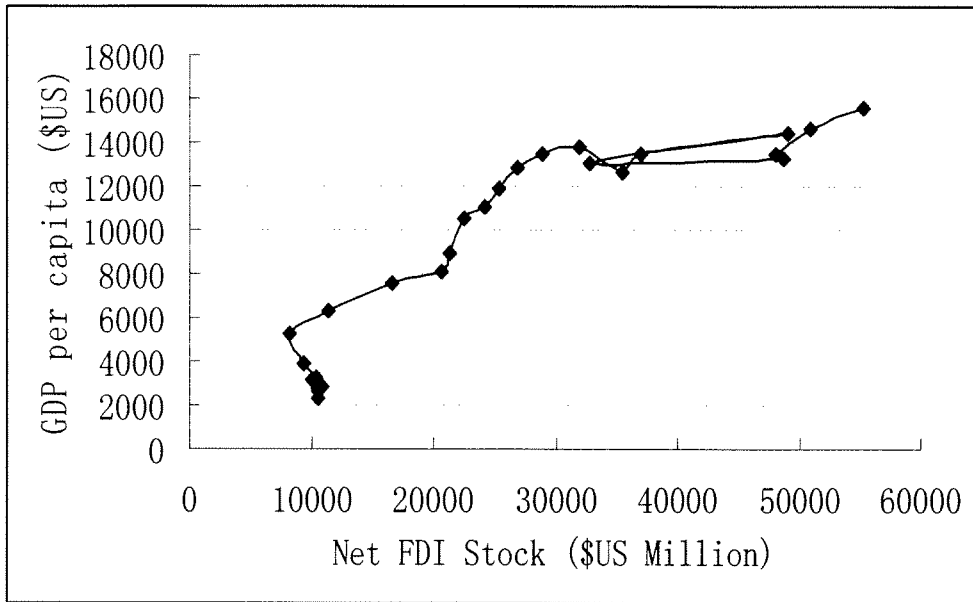
**Source: World Bank, world development indicators database**



**Figure10: Investment Development Path of China, 1980-2005**



**Figure 11: Investment Development Path of Hong Kong, 1980-2005**



**Figure 12: Investment Development Path of Taiwan, 1980-2005**



	China	Hong Kong	Taiwan
1979			4
1980		82	42
1981		31	60
1982	44	52	32
1983	93	566	19
1984	134	1076	72
1985	629	961	79
1986	450	1372	65
1987	645	2318	705
1988	850	2533	4121
1989	780	2740	6951
1990	830	2448	5243
1991	913	2825	2055
1992	4000	8254	1967
1993	4400	17713	2611
1994	2000	21437	2640
1995	2000	25000	2983
1996	2114	26531	3843
1997	2562	24407	5243
1998	2634	16985	3836
1999	1774	19369	4420
2000	916	59352	6701
2001	6885	11345	5480
2002	2518	17463	4886
2003	-152	5492	5682
2004	1805	45716	7145
2005	11306	32560	6028

**Table 7: Outward FDI Flows, 1979-2005, China, Hong Kong, and Taiwan**

Source: UNCTAD, on-line database (USD million)

Note: FDI Outflows from East Asian economies experienced a significant decline in 2001, 2003 and 2005. However, Chinese overseas direct investment surged in 2005.

	China	Hong Kong	Taiwan
1979	-	-	-
1980	-	148	13009
1981	39	169	13069
1982	44	229	13101
1983	137	324	13120
1984	271	1407	13192
1985	900	2344	13271
1986	1350	3441	13336
1987	1995	5366	14041
1988	2845	7388	18162
1989	3625	9653	25113
1990	4455	11920	30356
1991	5368	13977	32411
1992	9368	21699	34378
1993	13768	39114	36989
1994	15768	58767	39629
1995	17768	78833	42612
1996	19882	99710	46455
1997	22444	235763	51698
1998	25078	223811	55534
1999	26853	321636	59954
2000	27768	388380	66655
2001	34654	352602	70758
2002	37172	309430	76850
2003	33200	339649	84096
2004	35005	403094	91265
2005	46311	470458	97293

**Table 8: Outward FDI stock, 1979-2005, China, Hong Kong, and Taiwan**

Source: UNCTAD, on-line database (USD Million)

	China	Hong Kong	Taiwan
1979	0	648	126
1980	57	710	166
1981	265	2063	151
1982	430	1237	104
1983	916	1144	149
1984	1419	1288	199
1985	1956	-267	342
1986	2244	1888	326
1987	2314	6250	715
1988	3194	4979	961
1989	3393	2041	1604
1990	3487	3275	1330
1991	4366	1021	1271
1992	11008	3887	879
1993	27515	6930	917
1994	33767	7828	1375
1995	37521	6213	1559
1996	41726	10460	1864
1997	45257	11368	2248
1998	45463	14768	222
1999	40319	24578	2926
2000	40715	61924	4928
2001	46878	23777	4109
2002	52743	9682	1445
2003	53505	13624	453
2004	60630	34032	1898
2005	72406	35897	1625

**Table 9: Inward FDI flow, 1979-2005, China, Hong Kong, and Taiwan**

Source: UNCTAD, on-line database (USD Million)

	China	Hong Kong	Taiwan
1979			
1980	1074	21175	2405
1981	1339	23238	2537
1982	1769	24475	2574
1983	2685	25619	2261
1984	4104	26907	3048
1985	6060	26639	2930
1986	8304	28528	3974
1987	10617	34778	5739
1988	13811	39756	6801
1989	17204	41798	8405
1990	20691	45073	9735
1991	25057	46093	11006
1992	36064	49981	11885
1993	63579	56911	12802
1994	74151	64739	14177
1995	101098	70952	15736
1996	128069	80662	17600
1997	153995	249360	19848
1998	175156	225078	20070
1999	186189	405266	22996
2000	193348	455469	17581
2001	203142	419348	38025
2002	216503	336278	28150
2003	228371	381342	36056
2004	245467	453031	40304
2005	317873	532956	41929

**Table 10: Inward FDI stock, 1979-2005, China, Hong Kong, and Taiwan**

**Source: UNCTAD, on-line database (USD Million)**

<b>Year</b>	<b>Net FDI stock</b>	<b>GDP per capita</b>
1980	-1074	311.634
1981	-1300	290.821
1982	-1725	275.215
1983	-2548	291.607
1984	-3833	296.185
1985	-5160	288.385
1986	-6954	274.844
1987	-8622	294.045
1988	-10966	361.241
1989	-13579	398.481
1990	-16236	339.16
1991	-19689	350.613
1992	-26696	412.258
1993	-49811	517.415
1994	-58383	466.605
1995	-83330	601.01
1996	-108187	699.414
1997	-131551	770.589
1998	-150078	817.144
1999	-159336	861.211
2000	-165580	945.601
2001	-168488	1,038.03
2002	-179331	1,131.81
2003	-195171	1,269.83
2004	-210462	1,486.02
2005	-271562	1,715.94

**Table 11: Chinese Net FDI stock (USD Million) and GDP per capita (USD)**

**Source: Net FDI stock: the author's calculation**

**GDP per capita: IMF on-line database**

Year	Net FDI Stock	GDP per capita
1980	-21027	5649.147
1981	-23069	5928.612
1982	-24246	6064.221
1983	-25295	5522.762
1984	-25500	6064.077
1985	-24295	6368.096
1986	-25087	7350.351
1987	-29412	9016.055
1988	-32368	10508.675
1989	-32145	12006.118
1990	-33153	13367.544
1991	-32116	15275.566
1992	-28282	17665.597
1993	-17797	20000.792
1994	-5972	22148.759
1995	7881	23003.191
1996	19048	24582.598
1997	-13597	27055.498
1998	-1267	25352.976
1999	-83630	24600.419
2000	-67089	25144.016
2001	-66746	24744.986
2002	-26848	24340.51
2003	-41693	23428.222
2004	-49937	24393.918
2005	-62498	26000.112

**Table 12: Hong Kong's Net FDI Stock (USD billion) and GDP per capita (USD), 1980-2005**

**Source: Net FDI stock: the author's calculation**

**GDP per capita: IMF on-line database**

Year	Net FDI Stock	GDP per capital
1980	10604	2367.055
1981	10532	2705.877
1982	10527	2680.264
1983	10859	2845.735
1984	10144	3168.703
1985	10341	3284.326
1986	9362	3939.209
1987	8302	5276.16
1988	11361	6308.973
1989	16708	7584.341
1990	20621	8077.355
1991	21405	8947.513
1992	22493	10512.813
1993	24187	11003.998
1994	25452	11912.554
1995	26876	12830.309
1996	28855	13441.844
1997	31850	13835.276
1998	35464	12600.951
1999	36958	13526.161
2000	49074	14426.461
2001	32733	13027.532
2002	48700	13220.735
2003	48040	13512.355
2004	50961	14594.204
2005	55364	15598.626

**Table 13: Taiwanese Net FDI Stock and GDP per capita, 1980-2005**

**Source: Net FDI stock: the author's calculation**

**GDP per capita: IMF on-line database**

	<b>'First Wave'</b>  [STAGE 2]	<b>'Second Wave'</b>  [STAGE 3]	<b>'Conventional' MNEs</b>  [STAGE 4 AND 5]
Destination	regional FDI: neighbouring countries and other developing countries	Majority still regional, but expanding to a global basis	Global basis
Motivation	resource seeking & market seeking in developing countries	<u>In developing countries</u> resource and market seeking in <u>In industrial countries</u> asset-seeking and market seeking in .	Efficiency-seeking - MNE motivation aimed at optimising use of each country's comparative and competitive advantages
Type of outward FDI	<u>In developing cities</u> natural-asset intensive, small scale production in light industries (Heksher-Ohlin, moving towards undifferentiated Smithian industries	<u>In developing cities</u> : natural asset intensive sectors as in first wave; <u>In industrialised cities</u> (a) assembly-type, market-seeking FDI primarily in Smithian industries (b) asset-seeking investment in schumpeterian industries	Capital- and knowledge-intensive (schumpeterian) sectors capital/labour ratio dependent on natural/created asset of host.
Ownership advantages	Primarily country-of-origin-specific. Fundamental Oa advantages, no Ot advantages	Both firm- and country-specific	Mainly firm-specific Advanced Oa and Ot advantages.
Examples of ownership advantages  [adapted and modified version of Lall (1983) page 7]	1. Conglomerate group ownership 2. Technology (mostly adapted) 3. Management adapted to third world conditions 4. Low cost inputs (including managerial and technical personnel) 5. 'Ethnic' advantages	1. Conglomerate group ownership 2. Management adapted to third world conditions 3. Low cost inputs (including managerial and technical personnel) 4. 'Ethnic' advantages 5. Some product differentiation 6. Limited marketing skills 7. Vertical control over factor/product markets 8. Subsidised capital	1. Large size - economies of scale 2. Access to capital markets 3. Technology 4. product differentiation 5. Marketing know-how 6. Cross-country management skills 7. Globally efficient intra-firm activity 8. Vertical control over factor/product markets

Table 14: Characteristics of outward FDI at different stages of the IDP

Source: Table 4, Dunning, Hoessel and Narula (1997)



## **5.2. The comments:**

### **5.2.1. China is still in the second stage of IDP:**

First, although the growth rate of China's outward FDI has generally increased from the early 1990s, especially in recent years, its annual augmented absolute quantity is often lower than that of the inward FDI, except for the year 2005. Besides, China's inward FDI expand all the while vigorously. These facts demonstrate that the trend line of China's net FDI stock is increasingly negative.

Secondly, by the end of 2005, more than 90% of Chinese outward FDI stock was invested in Asia and Latin America (Part 2). According to Dunning's analysis, when a country focuses most of their investment in neighboring and other developing countries, that country is still in an earlier stage of the development (Dunning, Hoessel, and Narula, 1997). A direct reason for this is that the country is scarce in international business experiences. Professionally speaking, in the earlier stage of the investment development, the host country has no transaction ownership (Ot) advantages but asset ownership (Oa) advantages. Ot advantages are intangible, for instance the effective communication abilities intra and inter firms. While, Oa advantages consist of both tangible and intangible assets, such as technologies and skills.<sup>19</sup> To a certain extent, the neighbors' or others developing countries' investment climates are similar to those in domestic markets, and the investment costs are relatively lower than that in the industrialized countries where the host country needs to save a lot of business abilities except for sufficient capital and technologies. This theory corresponds exactly to the lion's share of Chinese overseas direct investment in Hong Kong which is partly influenced by geo-cultural affinity <sup>20</sup>(E-brief, UNCTAD, 2003, pp4).

Thirdly, from the perspective of industrial distribution, the investment stock of mining and manufacturing far exceeds that of telecom, infrastructure and others high-tech industries. (Figure 4 in Section 2). Among which, mining accounted for 15.1% of the total outward FDI stock in 2005; manufacturing accounted for 10.1% and mainly distributed in textile industry, telecommunication equipment, computer and electronic equipment, traffic and transportation equipment manufacturing, and others processing industries.

Fourthly, China's GDP per capita is far away from the world average level. Although China's GDP per capita has experienced a dramatic growth, from 1,690.51 Yuan in 1991 to 15,930 Yuan in 2006 (according to the author's calculation), there is still a long distance for China to go in order to be an important FDI source country in the world.(Table 2, Dunning, Hoesel and Narula, 1997).

#### 5.2.2. China will enter into the third stage of IDP in the near future.

First, Chinese multinational enterprises have gradually expanded their businesses to every continent in the world, including developing countries and developed countries. Their motivations are no longer just resource- and market- seeking, to develop global brand names, to acquire local capabilities, to study market knowledge, to improve R&D abilities in virtue of technology spillover ... come to be more and more important for companies' further development.

Second, the industrial distribution of Chinese overseas direct investment becomes increasingly diversified. Apart from manufacturing and mining industries, business service became the largest part in 2005. Others capital and technology intensive sectors are also outspreading vigorously. Such as Huawei, Zhongxing in telecom industry, they have already constructed business relationship not only in developing countries, but the most advanced countries.

Third, Chinese governments at all levels encourage their local enterprises to invest abroad in order to bring back capital, technology and market information which will in a great extent support the local economic development. New policies, regulations and laws are emerging in endlessly. This shows that China's outward FDI will experience much higher growth rates in the near future.

In addition, numerous Chinese- and Overseas Chinese- owned enterprises disperse around the world and densely cover in mainland China, Hong Kong, Taiwan, and others South-east Asian countries, so-called the "Great China Economic Region". The needs to further develop their business require the entrepreneurs to strengthen as soon as possible the business interactions between each other. According to the Eclectic paradigm, these ethnic ties belong to ownership advantages (the common cultural background and the same language).

Finally, China's human resources are growing quickly. Chinese labor force is generally better educated than others developing countries' and the costs of employing a managerial talent are increasingly high in China. China's competitive advantage of employment costs is eroding little by little. Samsung Group expressed in 2006 that they will transfer some of the assembly plants in China to Vietnam in the near future. Taiwan Taisu Group increased their manufactories in Vietnam, which were supposed to be constructed in China. Nike Company also started to send their order forms to Vietnam and others developing countries rather than China. These phenomena, which usually happened in the industrial upgrading process: from Heckscher-Ohlin industries to Smithian industries, are named "Ricardian bottlenecks". Lack of low-skilled labor pushes the wages up, but no productivity increase are accompanied simultaneously.<sup>21</sup>

### 5.2.3 The determinants of Chinese outward FDI

Let us consider Chinese overseas investment from the macroeconomic variables of the host countries. Benwu Xiang (2005) explained in *The empirical studies on determinants and effects of China Direct Investment Abroad* that the host country's market scales, exchange rates, and gross national income, all of them have negative effects on Chinese overseas direct investment; however China's exportation to that country positively influences China's FDI outflow. Benwu used the following regression equation with data from *the Almanac of China's Foreign Economic Relations and Trade* for the year 2001 and the year 2002 to reach his conclusion:

$$\ln FDI_{i,t} = \beta_0 + \beta_1 \ln GDP_{i,t-1} + \beta_2 \ln Expo_{i,t} + \beta_3 \ln Exch_{i,t} + \beta_4 \ln GNIP_{i,t} + \mu_{i,t}$$

Where  $GDP_{i,t-1}$  is the host country  $i$ 's market scale in the period  $t-1$ ;  $Expo_{i,t}$  is China's exportation to the country  $i$  in the period  $t$ ;  $Exch_{i,t}$  is the host country  $i$ 's exchange rate vs. Chinese currency in the period  $t$ ;  $GNIP_{i,t}$  is the host country  $i$ 's gross national income in the period  $t$ ;  $\mu_{i,t}$  is the error term, FDI stands for Chinese outward foreign direct investment in country  $i$  in the period  $t$ .

This conclusion indicates that Chinese outward FDI has poor sensitivity for detecting the host country's market scale. However, the outward FDI from the developed countries are much more sensitive to the host country's market scale. As a developing country, Chinese overseas

direct investment is therefore not fully developed until now. Besides, Benwu pointed out that the depreciation in the developing as well as the least developed countries leads an increase of Chinese overseas direct investment there. In this way, Chinese multinationals raise Chinese currency value through the fixed assets investment in these host countries, which implies that Chinese multinationals are gradually growing up. Chinese outward FDI facilitates Chinese exportation to the host country, but restrains Chinese importation from that country.

### **5.3. Why internationalized operations?**

Why enterprises will integrate into international businesses? The theoretical research in the past concluded that it is monopolistic advantages, comparative costs, and transaction costs of the multinationals that promote the appearance of international business and the generation of foreign direct investment. According to Hymer's theory, multinational corporations possess some monopolistic advantages, such as the control of specific technologies, distribution channels, and some raw and processed materials' source, the abilities of exploitation and innovation, or the scale economies. The OLI configuration proposed by Dunning considers that ownership, location, and internalization advantages are the three essential determinants of FDI. Ownership advantages are the heritage of the monopolistic advantage theory; Location advantages absorb the idea of comparative costs from traditional international trade theories; Internalization advantages, which claimed that the internalization in an imperfect market reduces transaction fees, origin from Coase's Transaction Costs Theory.

Kojima (1973, 1975) argued that there are two types of FDI: one substituting international trade, such as outflows from Japan, and the other complementing international trade, such as outflows from the U.S. Because the macroeconomic conditions change, it is hard for some Japanese enterprises to continue their production at home. They start to invest abroad to make full use of the host country's comparative advantages and promote finally the international trade. Basically, Hong Kong and Taiwan enterprises, especially those involved in labor-intensive industries follow the same way that Japanese have experienced. Because of increasingly high labor costs and land prices in the domestic market, more and more investors in manufacturing industries from Hong Kong and Taiwan move into the mainland of China since the open door

policy in 1978. This trend drives Hong Kong towards the specialization of the services and Taiwan to the high-tech industries. However, the overseas investment from the US is concentrated in capital- or high-tech-intensive industries, where the US has comparative advantages. Therefore, a trade reduction effect is generated.

The theories mentioned above well explained the phenomena of numerous FDI inflows in China: first, the foreign investors possess sufficient monopolistic advantages in the aspects of capital, technology, and administration management; second, the cheap costs of Chinese labor are in the comparative advantage; third, FDI reduces the transaction costs of some technologies or products transferring among different markets. But how to explain that Chinese enterprises, especially industrial enterprises, need to develop outward FDI? On the one side, Chinese industrial enterprises do not possess monopolistic advantages in general, and China's comparative advantage resides in domestic labor intensive industries. According to IDP paradigm, China is at present in the second stage of IDP, so the key point of development is to attract inward FDI into China in order to resolve the problems, such as the lack of capital and employment opportunities, or the infrastructure constructions. On the other side, the direct capital contribution of overseas investments by small and medium-sized multinational enterprises is very limited (Haiyan Zhang & Danny Van Den Bulke, 1996, p315-316).

However, Chinese large industrial enterprises have to participate actively into the global business activities:

First, market seeking: (1) sluggish domestic demand puts large industrial enterprises to preempt foreign extensive markets. China has a large agricultural population, but is poor in cultivated land. Farmer's earning level is so low that many industrial products, whose competition in town's markets has already become fiercer and fiercer, can not penetrate rural markets. (2) The restructure reforms have made several Chinese industrial enterprises oligopolists. The deepening competition among them will certainly be vicious. The wise entrepreneurs should transfer their attention to the foreign markets. (3) New products need to be improved through continuous customer information feedbacks. So, it is better to innovate and produce in the developed

countries, where new products are easier to be accepted by customers due to a relative higher income level. (Changwen Zhao & Daowei Mao, 2000)

Second, strategic-consideration: China's comparative advantage resides in the labor intensive industries. However, only the large industrial enterprises are capable to ameliorate the labor intensive industries with enough capital and technologies. Their overseas activities will not only strengthen the firms' reputation in the global markets, but also acquire the leading technologies which finally promote the upgrading of domestic market and industry structures.

Third, resource-seeking: Given the population size, China is poor in natural resources. Before 1991, Canada and Australia are the two largest recipients of Chinese resource-oriented outward FDI, with the respective stocks of US \$360 million and US \$313 million. From the early 1990s, China's rapid economic growth and the domestic infrastructure construction lead to a significant increase in demand for fuel and other natural resources. Chinese overseas investment has swarmed into numerous countries in Southeast Asia, Latin America, Africa and Middle East. (Dennis Pamlin & Long Baijin, April 2007) Here, we list some Chinese large state-owned enterprises whose outward FDI are mainly resource seeking (Table 7)

Fourth, international competition: The sharp depreciation of currencies in Southeast Asian countries after the financial crisis in 1997 has provided them with much lower export costs. While, in order to narrow the huge trade surplus Chinese government reduced the export drawback rates for several times in recent years, which reflected relative higher production costs of Chinese export goods. Consequently, the low cost comparative advantage of labor intensive products in several less developed countries is further deepening. Therefore, Chinese outward FDI should be undertaken first from the industries in disadvantage, which helps prolong the product life cycle and support the exportation.

Fifth, opportunities: After the access to WTO in 2001, China is confronted with more challenges and opportunities in the global economy. The challenges are more reflected in domestic markets: with the fulfillment of WTO commitments, trade barriers are largely reduced,

protection effects of national boundaries are unceasingly weakened, and the domestic market spaces are increasingly limited. The opportunities mainly lie in the overseas markets: Chinese enterprises obtained to the greatest extent equal opportunities and treatment to enter into others countries' markets, and the international development space is gradually broadening. From the 1990s, many underdeveloped countries also speed up their economic progress by liberalizing and globalizing their investments. Therefore, Chinese large industrial enterprises must go abroad and actively develop their overseas businesses to seize the opportunities and to enjoy the rights obtained after the access to WTO.

In fact, the host countries' favorable investment environments are also important motivating factors of Chinese outward FDI. Table 8 list some answers given by 100 Chinese TNCs about the following three questions: Why invest overseas? What is most attractive factor in host country? Where is your priority region?

Acquiring firm	Target firm/activity	Industry	Host location	Equity interest and acquisition value
Huaguang Forest Co. Ltd.	Rayonier Inc. (East Coast Timberland operations)	Timber tracts	New Zealand	100% equity stake for \$ 7.7 million
China Petroleum & Chemical Corporation	Oil field	Oil	North Africa	75% equity share for \$394 million
Petro China Co. Ltd	Devon Energy-Indonesian Oil	Oil	Indonesia	100% stake for \$262 million
Baosteel	Joint venture with Rio Tinto's Hamersley Iron Unit in iron ore mining	Iron ore	Australia	46% stake for \$30 million
CNODC and CNPC	Salyan Oil Ltd	Oil	Azerbaijan	30% stake for \$52 million in 2 oil fields
China National Offshore Oil Company Ltd	Repsol-YPF SA	Oil	Indonesia	Nine subsidiaries in five oil and gas fields for \$585 million
CNOOC	Tanggung Gas Fields	Gas	Indonesia	12.5% stake from BP for \$275 million
China National Chemical Import and Export Corporation	Atlantis subsidiary	Oil field service	Norway	\$105 million

Table 15: Selected Chinese resource-seeking outward FDI, 2002

Source: UNCTAD, cross-border M&A database



Why invest overseas?	What is most attractive factor in host country?	Where is your priority region?
47.1%: expanding overseas markets	32.0%: host country's privileged policies	32.0%: Africa
16.9%: better profits		20.0%: Southeast Asia
14.5%: sluggish demand in China	28.7%: requiring relatively small amount of investment	18.0%: Latin America
12.1%: export to third country		9.3%: Middle East
9.3%: competition with export from China	22.5%: cheap labour	8.7%: Eastern Europe
	8.4%: cheap land and proximity to raw materials	8.0%: Central Asia
		4.0%: Others

Source: Research Team of MOFTEC's Offshore Plant Project, "Inward flow should be accompanied by outward flow: policy analysis of China's offshore plant operations," *International Trade*, 5 (2000), pp. 9-13 (in Chinese), cited in Mark Yaolin Wang, "The motivations behind China's Government-initiated industrial investment overseas", *Pacific Affairs*, 75 (2002), 2, p. 187-206.

<sup>a</sup> 100 out of the 170 enterprises surveyed replied.

Table 16: Summary of survey results for 100 Chinese TNCs, 2000

Source: E-brief: *China: an emerging FDI outward investor*, UNCTAD, 4 December 2003

## Section 6 Conclusion

What are the potential driving forces that promote Chinese high economic growth? The inward FDI was once considered as the major factor for the high economic growth. However, China has emerged as one of the major FDI sources in the developing countries since 1990s. This thesis attempts to explain the existence of the dynamic relationship between the stock of the outward FDI and the country's economic development level.

Dunning's Eclectic Theory of International Production (1976) says that with the government-assisted outward-looking policy, the inward FDI flows are attracted by the upgrading of the domestic L advantages, which in turn help the domestic enterprises to own more O advantages. With sufficient financial strength and O advantages, domestic enterprises begin to invest abroad with the purpose of natural resource-seeking, market-seeking or strategic

asset-seeking. To reduce the costs of the international production and facilitate the transfer of O advantages across national boundaries, TNCs internalize their production.

In 1981, Dunning put forward the Theory of Investment Development Path. This theory suggests that the net FDI stock, which equals to the stock of the outward FDI minus that of the inward FDI, is an explicative variable of the country's economic development level, which is measured in terms of the GDP per capita. There are five stages in a country's investment development path: The first stage is the pre-industrialization time with the GDP per capita inferior to 400 USD and the net FDI stock equal to zero. In the second stage, the GDP per capita is between 400 USD and 2000 USD. The domestic enterprises are short of O and I advantages so that the stock of outward FDI is insignificant. A gradually improved domestic investment climate (L advantages) attracted large numbers of inward FDI, which results in an increasingly negative net FDI stock. In the third stage, the GDP per capita is more than 2000 USD but less than 4750 USD. A dramatic outward FDI growth features largely in this period due to the rapid increase of O advantages of the domestic enterprises. Meanwhile, the inward FDI flows keep growing vigorously. Hence, the net FDI stock begins to rise though it is still negative. The country in the fourth stage is usually called "newly developed economies", such as Hong Kong (China), Taiwan province of China, Singapore and South Korea, whose GDP per capita has already exceeded 4750 USD. In this stage, the domestic TNCs have been much better integrated into the global and regional economies than before with the increasingly evident O and I advantages. The country's inward and outward FDI have both experienced a substantial growth. In the last stage, the net FDI stock revolves around zero. This corresponds appropriately to the situation in today's leading developed countries. In all, the extent of outward FDI becomes larger and larger with the domestic economic growth.

With the "opening-up" policy, Chinese economic system switched from inward-looking to outward-looking. Before 1978, Chinese economy was self-reliance. We consider that time period as the first stage of China's IDP. After 1978, large numbers of inward FDI swarmed into China and expanded rapidly. However, Chinese outward FDI stock in the 1980s was almost negligible. Not until 1992 did it experience its first peak with 4 billion USD. However, compared with the

stock of inward FDI, Chinese outward FDI was still insignificant. In the following eleven years, Chinese outward FDI flows underwent several ups and downs, but it restarted to expand quickly from 2004.

According to the statistical data we collected from UNCTAD, IMF and NBSC, we observed that: First, the annual augmented absolute quantity of Chinese outward FDI is still insignificant compared with that of inward FDI; Second, the regional distribution is inclined to the developing world: by the end of 2005, more than 90% of Chinese outward FDI stock was invested in Asia and Latin America; Third, the industrial distribution of Chinese overseas investment is not even: mining accounted for 15.1% of the outward FDI stock in 2005; and manufacturing 10.1%; Fourth, Chinese GDP per capita is approaching 2000 USD but still far away from the world average level. Hence, we confirm that China is at present in the second stage of its IDP.

However, it is predictable that China will enter into the third stage in the near future based on following reasons: First, the regional distribution of Chinese overseas investment has been greatly spread since the 1990s, including both the developed economies and the developing and transition economies in all over the world. Second, the industrial distribution of Chinese overseas investment becomes increasingly diversified. Business service and others capital and technology intensive sectors are outspreading into the oversea markets rapidly. Third, Chinese governments at all levels encourage their local enterprises to invest abroad in order to bring back capital, technology and market information which will in turn greatly boom the local economic construction. Fourth, the ethnic ties between Chinese and Oversea Chinese generate the "Great China Economic Region" which further develops their business interactions. Finally, Chinese human resources are growing quickly.

However, is it an appropriate time for Chinese industrial enterprises to participate actively into the global business activities? The answer is yes. We consider this question from the five aspects: market seeking, resource seeking, strategic consideration, international competition and opportunities. In all, Chinese enterprises, especially Chinese large industrial enterprises, should integrate as soon as possible into the global business in order to maximize their profit and

ultimately promote Chinese economic growth

In this thesis, we have successfully tracked the movement of China's net FDI stock from the year 1980 to the year 2005 in a growing economic environment to prove that China's economy is in the second stage of its IDP. However, to forecast the future effect of Chinese outward FDI to Chinese GDP per capita growth, we need to do a time series analysis by regressing Chinese GDP per capita on Chinese inward FDI, outward FDI, export, foreign exchange reserve and other permanent factors. And we also need to investigate the multicollinearity problem between the outward FDI and other permanent factors that influence GDP per capita growth, such as export and foreign exchange reserve. We expect that the future researchers could do more effort in this field in order to provide more empirical statistical data to the previous theories.

**Notes:**

1. "It is interesting to note that the dominant countries of the early 1980s or the 'first wave' investors (primarily South American) seemed to have stagnated relative to the dominant investors in the early 1990s, which tend to come from Asian NIEs and 'new' NIEs." From *Explaining the 'new' wave of outward FDI from developing countries: the case of TAIWAN and KOREA* (Dunning, Hoessel and Narula, 1997). We explain the "first and second wave" of FDI from developing countries according Dunning's IDP theory in the part 4.

2. Before the establishment of PR. China in 1949, China had opened some of its coastal cities under the unequal treaties from imperialistic countries. After 1949, Chinese government even prevented the foreign capital to enter into the domestic market, having a fear that the foreign investment and culture would fluctuate and finally destroy the socialist economy and polity.

3. Wu & Chen (2001), *An assessment of outward foreign direct investment from China's transitional economy*, Europe-Asia Studies, Vol. 53, No. 8, 1235-1254

4. Two markets: domestic and international markets

Two resources: domestic and foreign resources

5. [http://www.cs.com.cn/xwzx/04/200701/t20070116\\_1039405.htm](http://www.cs.com.cn/xwzx/04/200701/t20070116_1039405.htm)

6. <http://finance.sina.com.cn/g/20050910/16311958225.shtml>

7. Dianqing Xu: professor in Western Ontario University, Canada

Weiyang Zhang: professor in Peking University, China

8. Ludo Cuyvers & Michel Dumont, *“Tigers, Pussycats and Flying Geese: The faunal Characteristics of Economic Growth in South-East Asia”*, in *Transnational Corporations and Economic Development*, p122-138, Palgrave Macmillan, 2005, ISBN-13: 978-14039-4783-3

Dunning & Narula (1997,p15):“ The explanations behind the second wave of Korean and Taiwanese FDI are almost all directly or indirectly related to shifts in the structure of the world economy and especially the transformation of their own economies. This transformation has implied a simultaneous upgrading of the domestic industrial structure and phasing out of ‘incompatible’ industries.”

9. “There is a hierarchy (and sub-hierarchy) of economies, globally as well as regionally, with respect to economic development; ‘leader’ economies serve as growth centers for a cohort of ‘follower’ economies. In other words, the individual economies in the world are at various stages of industrial upgrading and per capita income.” Ozawa (1992), p29

10. Raymond Vernon (1966). International investment and international trade in the product cycle, *Quarterly Journal of Economics*, 80 (May), pp.190-207

11. <http://www.classicreader.com/read.php/bookid.770/sec.19/>

12. “This means that, when a country is still scarce in human and physical capital but abundant in

labor (unskilled and semi-skilled), any attempt to build a capital-intensive, and skill-requiring industry is ineffective and unachievable.” Ozawa (1992), p34

13. John H. Dunning, *The globalism of business*, Routledge, 1993, p81

14. [http://www.econ.jhu.edu/people/Contessi/MNC06/MNC06\\_3\\_Theories\\_f4.pdf](http://www.econ.jhu.edu/people/Contessi/MNC06/MNC06_3_Theories_f4.pdf)  
<http://stdev.unctad.org/un/Glass.ppt>

15. [http://www.econ.jhu.edu/people/Contessi/MNC06/MNC06\\_3\\_Theories\\_f4.pdf](http://www.econ.jhu.edu/people/Contessi/MNC06/MNC06_3_Theories_f4.pdf)

16. After the introduction of the Ownership specific advantage, Dunning classified it further into two types: Asset advantages that are home country-specific and Transaction advantages arising from appropriate management of geographically dispersed assets.

17. “The net outward investment position of stage-5 countries will revolve around zero, alternating between positive and negative balances, depending on the short-term evolution of exchange rates and economic cycles.” Buckley & Castro (1998) p3

18. <http://www.icrier.org/pdf/25-26April07/Session4/Nathalie%20Aminian.ppt>

19. <http://hel.org.uk/business/essay.doc>

20. “The outward FDI by Chinese enterprises in Hong Kong prior to Hong Kong’s return to China in 1997 are obviously motivated by political and diplomatic interests” (Bacher, Lorz&Schuknecht, 1992, pp645-654)

21. Dunning, Hoesel & Narula, 1997, p15-16. “‘Heckscher-Ohlin’ type: labor-intensive manufacturing as the leading export sector, such as textiles, sundries and other light industry goods); ‘Undifferentiated Smithian’ type: based on scale economies, such as heavy and chemical industries; ‘Differentiated Smithian’ type: assembly based, subtracting dependent, such as

automobile and electronic goods.”

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