THE EVOLUTION OF CHINA'S FOREIGN DIRECT INVESTMENTS INFLOWS AND OUTFLOWS SINCE THE BEGINNING OF THE XXIst CENTURY

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Abstract

Since the beginning of 2000, China has been leading the top of the destinations for the inward FDI and, meanwhile, the outflows of the Chinese companies have taken off spectacularly. Although its outward investments are still at an early stage of development, China's overseas companies have been gaining importance as new sources of international capital. Moreover, China's FDI inflows and outflows remained stable and robust, despite the global financial and economic downturns. Therefore, the purposes of the paper are to analyse the evolution of China's inward and outward FDI between 2000 and present, underlying their main features, to identify the factors that have influenced these flows, to determine the impact of the present crisis on the investments and to see how the FDI contributed, during time, to the economic growth of the country. The method used to achieve these objectives consisted in an exploratory research. We have collected, tabulated and interpreted the data included in various statistical reports and we have analysed different studies conducted both on the multinationals' subsidiaries, which reflect the advantages considered by them when choosing China as a location for their production, and on the Chinese firms, which present the arguments of their foreign investments.

Key words: FDI inflows, FDI outflows, multinational corporations, Chinese firms

JEL Code: F21, F23

Introduction

During the last decade, China has been leading the top of the FDI destinations, fact that allowed it become one of the worlds' biggest producers. Looking at the statistical data, we can see that while in 1990 FDI inflows totalled 3.5 billion dollars, this value was around 70 billion dollars in both 2005 and 2006, representing about one-third of total developing-country FDI inflows and 10% of the world flows (UNCTAD, 2005). These inflows are by far the largest of any developing country and have remained remarkably stable and robust despite substantial fluctuations in the global economies.

There has been a growing literature about the role of FDI in Chinese economy and in its export (for example Poncet, 2007 or Naughton, 1996). Most of the analysts underline the fact that China became the new “workshop of the world” due to the foreign investors, since over half of its exports originate today from foreign affiliates located in the country and the total exports rose from 149 billion US$ in 1995 to 1.2 trillion US$ in 2009 (Poncet, 2007).

The literature on FDI determinants is very extensive, a primary source of information about the motivations behind the investments made by multinational corporations in China coming from studies based on interviews and questionnaires (Grub et al., 1990). Studies conducted by US-China Business Council estimate that 75% of Western and Japanese multinational corporations are in China to sell to the domestic market. Export back to their national market is often specific for Hong Kong, South Korean and Taiwan firms.

One of the most important factors that have attracted the foreign investors to China was the low cost of land and labour. The low wages can be easily explained through the fact that this market has a great number of available labour force. Actually, China has the greatest labour force in the productive sector, from all over the world: almost 104 million people, which represents the double of the number of workers employed in the productive sector in USA, Canada, Japan, France, Germany, Italy and Great Britain, considered together (Lett and Banister, 2006). Apart from the cheap and abundant labour force and the low cost of the land, China has also the advantage of an offer deficit. This is why the government, which is looking for the economic growth and development of the country especially through the FDI, uses various methods to attract the foreign investors, such as the taxes on the capital goods and imported raw materials; strict requirements regarding the technology transfer; consistent governmental incentives to the multinationals – for example: tax exemptions to the exports, easy access to the local resources and to the advantageous banking loans; a good transport and telecommunications infrastructure and also the possibility to avoid the law (Diaconu, 2009).

Although most of the literature on FDI was focused on inward flows, China is not just a magnet for FDI but it has also become lately a source of FDI. Although its outward direct investments (ODI) are still small in absolute terms, especially compared to the huge inward flows, China’s overseas enterprises have been gaining importance as new sources of international capital. However, the ODI have been less studied, partly because the database is less comprehensive, less subject to regulatory scrutiny and less contentious politically (Hill and Jongwanich, 2009). But they are not less important than the FDI because the data about outward investments is revealing the country's changing economic structure, its development dynamics and its international commercial engagement. In the case of China, the rapid development of the ODI activities reflects not only its economic maturation and integration into the global marketplace but also its need to expand overseas to supply the country with natural resources, new markets and advanced technology. Fable domestic demand inside China and the excess of industrial productive capacity, starting with 1990s, have encouraged the Chinese firms to look for growth opportunities abroad. Moreover, the opportunity of avoiding trade quotas for exports to developed countries has certainly stimulated some Chinese firms to invest abroad, especially in the textile products: typical destinations include Cambodia and Africa to take advantage of quota-free access for exporting to the United States and the European Union (Wong and Chan, 2003). There are also cases in which the host country has favourable investment policies, including incentives and other location-specific advantages. For example, a number of Chinese companies are reported to have chosen the United Kingdom to take advantage of investment grants (UNCTAD, 2003). Another key driver for Chinese investments overseas is the access to knowledge and R&D in the development of new technologies.

From the very beginning, the Chinese ODI has been initiated or approved by the state, which still retains a great measure of control. The government has selected certain strategic industries for overseas expansion and has chosen the markets where this expansion should take place, in order to ensure that foreign investments would align with the country's long-term development strategies. The government encourages Chinese enterprises to invest overseas in order to gain access to raw materials and advanced technology from abroad, increase foreign exchange earnings and promote China's exports. Moreover, during the last three years, the Chinese government has been promoting an international campaign against trade and investment protectionism as part of its strategy for mitigating the impact of the global crisis on China.

Considering all these aspects, we may say that the strategies adopted by the government, related to the foreign investments (inwards and outwards) proved to be successful: the expansion of FDI into and from China has been accompanied by a rapid economic growth and an increasing openness to the rest of the world. In order to sustain this statement with statistical evidence, we have structured the present paper in two main chapters: in the first one we analyse the inwards of the foreign direct investments in China between

2000 and present and in the second one we present the outwards of the FDI from China, in the same period of time.

1 The evolution of the foreign direct investments' inflows in China during the XXIst century

1.1 FDI inflows in China between 2000 and 2007

If we analyse the situation of the FDI that have entered in China between 2000 and 2007 we notice that 300 from the first 500 world largest companies have created production subsidiaries in this low-cost market. Only in 2005, the subsidiaries of the multinational companies that have invested in China employed more than 24 million workers (UNCTAD, 2006). After a drop caused by the Asian crisis, FDI inflows into China increased again, so that by 2003 this country received investments that totalled 53 billion dollars.

China is the country which challenged the conventional theory of comparative advantage due to the fact that on its territory it is possible to make both commodities and high-tech products - computers, iPods or mobile phones. Because of the large diversity of the industries in which act the companies that have relocated the production in China, in 2005 the share of the exports of this country to U.S. has increased in 41 industries, compared to 1990.

The peak of the FDI inflows in China was reached up in 2005 (72 billion $) and was partly related to the changes in the methodology underlying Chinese FDI statistics - for the first time, data on Chinese inward FDI included inflows to financial industries (UNCTAD, 2006). The value of the FDI inflows remained almost the same in 2006, when it represented 10% of world inward investments.

Naughton (2007) emphasizes that three distinctive characteristics have marked the inflows of the foreign investments attracted by China between 2000 and 2007. The first feature underlined by the analyst is that the foreign direct investments have been the predominant form in which China has accessed the global capitals (as opposed to portfolio capital or bank loans). The second particularity is that an unusual large proportion of Chinese FDI inflows are in manufacturing industry, as opposed to services or resource extraction. The third specific characteristic is the predominance of other East Asian economies, especially Hong Kong, Taiwan and Macao as sources of China's FDI inflows.

Another feature that we could add to these three is that, until 2007 most of the foreign investments' inflows in China were mainly concentrated in the Eastern coastal regions (Guangdong, Fujian, Shanghai, Jiangsu and Beijing).

As we have also mentioned in the introduction, the FDI have played a significant role in China's economy, accounting for 27% of value-added production, 4.1% of national tax revenue, more than 58% of foreign trade in 2005 and 88% of high-technology exports (UNCTAD, 2006). Manufacturing accounted for 63% of registered foreign capital, in the end of 2005. In the service sector, the incoming FDI in China is highly concentrated in real estate, specifically in property development. This sector, accounting for 11% of total investment in 2005, has become a hot spot for FDI. The real estate industry has attracted almost 9 billion $ annually, between 2004 and 2006 (UNCTAD, 2006).

In 2007, the high tech sector was just at the beginning. However, the shift between the investments in China’s manufacturing sector and the more advanced technologies seemed to be inevitable. The number of foreign-invested research and development centres has risen to 750 in China by the end of 2005, with at least 107 set between October 2004 and September 2005 (UNCTAD 2006).

1.2 FDI inflows in China after 2007

In 2008, the consequences of the economic and financial crisis could be noticed in the values of the macroeconomic indicators of the states and, implicitly, in the level of the foreign direct investments. According to UNCTAD (2009), after global FDI flows reached a historic record of 1.9 trillion $ in 2007, they have declined by 15% in 2008. However, in 2008, the negative impact on FDI flows has been concentrated in developed countries, the overall picture of the foreign investments being reshaped in favour of the developing economies. For example, cross-border mergers and acquisitions (M&A) into the largest emerging economies - Brazil, Russia, India, Indonesia, China and South Africa - increased by 5% while they declined by 26% in the OECD countries.

If, in the end of the 1990s, India and China accounted for 28% of the inward international investments into the largest emerging economies and for 1.3% of global inward M&A activity, during the first five months of 2009, these percentages rose to 65% in the case of the international investments into the largest emerging economies and to 6.6% of global M&A activity (UNCTAD, 2009). These values are very important especially if we consider the percentages from 2008 when, for example, India and China accounted for only 5.1% of the global M&A activity.

In the East Asia, through the second quarter of 2009, FDI inflows showed a continuing downward movement for most of the economies, except for Taipei, China, Korea, India and Singapore, where the inflows rose slightly over the first quarter.

Some studies, conducted by UNCTAD in 2009 regarding the multinational companies' intentions for investing, ranked China on the first place in the list of the preferred destinations for future foreign investments. Almost 60% of the surveyed firms have placed China on the first place among the most attractive economies for FDI location, before United States, India, Brazil and Russian Federation. According to these studies, the orientation of the investors to China is generated by the same main factors of attraction as before 2007: the large size of the market with promising growth perspectives and the cheap and abundant labour force.

In 2010, a research conducted by Ernst & Young on 814 companies reflects the same dominant orientation of the investors: China is ranked on the first place, being followed, at a large distance, by Central, Eastern and Western Europe. Moreover, the researches foresee a substantial increase in the amount of FDI attracted by China in the next three years (taking into account the fact that approximately 80% of companies that already have manufacturing subsidiaries in this market plan to increase their value in the next years with at least 10%) and, also, an orientation of the investors towards east.

Therefore, we may argue that China has reinforced its dominant position as a leading host country for international investments during the global economic crisis.

2 The evolution of the foreign direct investments' outflows from China during the XXIst century

2.1 FDI outflows from China between 2000 and 2007

From the beginning of the XXIst century, China has gradually increased its FDI outflows. The "going global" strategy, envisaged in the middle of the 1990s, was formally adopted in 2000 and, consequently, important legislation was enacted to aid investments' outflows. The strategy intends to promote the "international operations of capable Chinese firms with a view to improving resource allocation and enhancing their international competitiveness" (UNCTAD, 2006). The responsible for implementing and coordinating the strategy is the Ministry of Commerce (MOFCOM), which encourages ODI through provision of information about foreign locations, the granting of incentives and a gradual relaxation of foreign exchange controls. Moreover, in October 2004, the National Development and Reform

Commission and the Export-Import Bank of China issued a circular to stimulate the overseas investments in specific areas.

Wong and Chan (2003) consider that China's outward direct investments have passed through four stages of development, until 2007. The last stage, which started at the beginning of the XXIst century and ended in 2006, corresponds to the consolidation of China's "going global" strategy.

The conjunction of the preferential measures with the successful penetration of Chinese manufactured exports into the world market increased the number and the volume of the ODI every year since 2000. In 2006, their value, excluding the financial sector, reached up 16.1 billion $, which represented an increase of 32%, compared to 2005 (Poncet, 2007). Actually, in 2006 China had the fourth largest value of the outflows, from the developing and transition countries. Considering the fact that China does not have to spend time building up brand names because it can simply acquire the existing well-known brands through government funded firms, it is easily to understand why an increasing number of Chinese firms are now among the largest transnational corporations from developing countries, in terms of foreign assets.

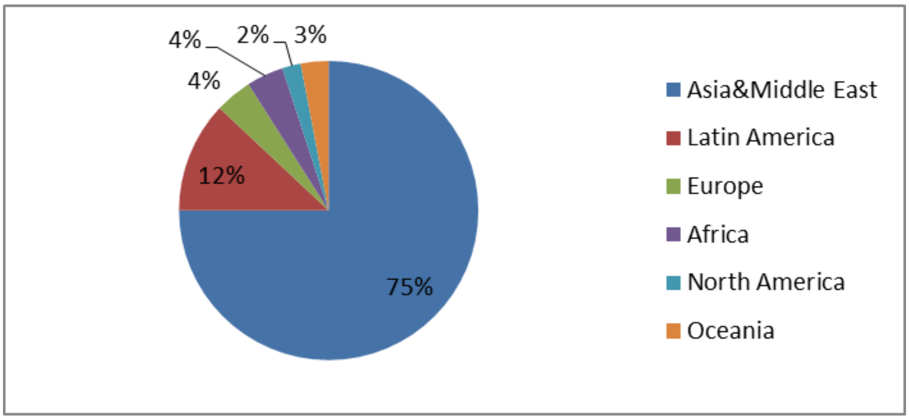
The main regions of China, from where the companies have invested abroad, were the coastal and border provinces (Fujian, Guangdong, Heilongjiang, Jiangsu, Shandong, Shanghai and Zhejiang), which together accounted for 62.5 % of China's outwards FDI (Poncet, 2007). The diversified nature of the country's domestic industries determined the Chinese ODI to be focused on a wide variety of business areas. The main sectors attracting Chinese outward investments are trade, mining, business activities and, recently, manufacturing.

2.2 FDI outflows from China after 2007

The statistics for 2008 show that, whereas outward FDI from developed economies declined by 11.9%, the FDI outflows from developing states increased by 2.0%. The difference in the values registered by mergers and acquisitions in 2008 is also significant: they declined by 31.9% in developed economies and only by 9.1% in the developing ones (UNCTAD, 2009). Despite the global economic downturn caused by the financial crisis, East Asia was the major source of the FDI outflows, accounting for two thirds of the total, and also an important global player in the mergers and acquisitions' activity. From all the East Asian countries, China was one of the most important sources of outward FDI after 2007. Significant changes in the volume of the outflows could be noticed every year since 2007: China's ODI increased from 26.51 billion $ in 2007 to 55.91 billion $ in 2008 (an increase of over 110%) and by the end of 2009, China's FDI abroad reached 56.5 billion $ (MOFCOM, 2010). However, despite these impressive growth trends, the Chinese outward FDI remain relatively small: China, including Hong Kong and Macau, accounts for just 6% of global ODI stock in 2010 (MOFCOM, 2010).

Regarding the geographical distribution of the Chinese ODI, the "tax havens" represent a main destination of these investments. In 2009, Hong Kong, the Cayman Islands and the British Virgin Islands together received 79% of China's net, nonfinancial FDI outflows (OECD, 2009). Among other attractive destinations of the ODI made by China could be mentioned Australia, Singapore, United States, Luxembourg, South Africa and Russia. In figure 1 it can be seen the percentages of the Chinese ODI attracted by various continents in 2009.

Fig. 1: Chinese ODI, by region, in 2009



Source: MOFCOM, *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*, 2010, http://chinainvests.org/2010/12/22/2009-statistical-bulletin-of-chinas-outward-foreign-direct-investment

According to MOFCOM, *2009 Statistical Bulletin of China's Outward Foreign Direct Investment*, after 2007 it could be seen a change in the sectorial composition of the ODI: if the percentages of the investments outflows remained almost the same for business activities, it has increased in manufacturing sector and significantly decreased in the case of the investments made in natural resource extraction (if in 2003 they accounted for about a half of the total, one third in 2004, nearly 40% in 2006, in 2009 they dropped to less than 16%).

One of the most important driving forces of the Chinese ODI during the last five years remained the need to secure access to overseas energy resources and raw materials to support the high economic growth rate of the country. This is why the government has been taking further steps to simplify and encourage the foreign investments made by the Chinese firms.

Based on the statistical data, some analysts assumed that, over the next few years, it is possible that China's outward FDI may exceed, for the first time, its FDI inflows. This situation reflects both the country's gathering economic might and the more open policies towards outward investments adopted in recent years.

Conclusion

During the last decade, China has become one of the most important destinations for the FDI and, gradually, it started to be a source of foreign investments.

Regarding the FDI inflows, we notice that the Chinese investment climate for foreign enterprises has systematically improved over the years due to the fact that the Chinese policy makers had a preference for FDI, primarily because they brought technology, commercial expertise, job offer as well as capital. The peak of the FDI inflows in China was reached up in 2005. Despite the nowadays economic downturn, China has remained in the top of the destinations preferred by the foreign investors. The huge expansion of FDI attracted by China was correlated to a rapid economic growth and an increasing openness to the rest of the world.

Encouraged by continuous growth of China's economy and by the favourable policies, the FDI outflows have been augmenting with a considerable rate every year since 2000, even after 2007, when all the countries were affected by the economic and financial crisis. However, the Chinese outwards FDI remain relatively small compared to its inflows. Among the main reasons that determined the Chinese firms, in the XXIst century, to look for growth opportunities abroad could be mentioned the fable domestic demand of the country, the excess of industrial productive capacity and the opportunity of avoiding trade quotas for exports to developed states.

Considering all the aspects mentioned before, we may conclude by saying that China is likely to exit the nowadays crisis as an even more significant player in the world economy and a major opponent of investment protectionism.

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