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# Emerging Markets' Outward Foreign Direct Investment

**THIS ISSUE DEALS WITH THE INTERSECTION** of two critical spheres of international business research, emerging markets and foreign direct investment (FDI). Traditionally, research on these intersecting topics has dealt with inward FDI into emerging markets. Increasingly, however, emerging markets, outward foreign direct investment is attracting attention. Hailing from the United Nations, The Heritage Foundation and academic institutions, three different perspectives on outward foreign direct investment from emerging markets are given in this issue, with a focus on China's increased visibility in this area.

Foreign direct investment flows have slowed dramatically since the great recession hit, but seem to be turning the corner, according to the first article written by James Zhan and Guoyong Liang of the United Nations Conference on Trade and Development (UNCTAD). The article also shows that emerging markets with strong fundamentals are leading the FDI flow recovery. BRIC outward FDI flows are especially impressive. Concerns over rising protectionism due to the crisis have, so far, not materialized. The article raises some interesting implications and needed research on modes of exit, dynamic contextual variables for emerging economies, and post crisis paradigm shifts in FDI explanations, among others.

Focusing more narrowly on Chinese foreign investments, the second article in this issue, written by Derek Scissors from The Heritage Foundation, speaks against the lack of disclosure and transparency in various data sources about Chinese foreign investment, and the misinformation communicated through various channels about existing or future investments. Scissors' analysis suggests that (1) the State Administration of Foreign Exchange (SAFE) hides exposure to low yield American bonds by routing monies through third countries, (2) China Investment Corporation (China's Sovereign Wealth Fund) reporting on money holdings is incomplete, (3) the PRC does not buy/sell currencies for leverage, but rather for a need to neutralize money obtained through balance of payment surpluses, (4) Hong Kong and other offshore financial centers are transit points that need to be factored in the reported statistics, (5) much of the foreign investments are in energy and energy related industries, while financial investments are mostly in developed financial areas (e.g., USA, UK), and (6) failed investments are frequent and sizeable.

The third article, written by academics from Europe and the USA, professors Philippe Gugler and Marc Fetscherin, attempts to frame the expansion of Chinese foreign investment into a 2x2 table consisting of two key dimensions: government interest and Chinese corporate interest. Through the lens of this framework, they are able to categorize the motivation of the investment and give examples of firms operating in these spheres.

The globalization of emerging markets' companies, government entities (as in the case of China), and non-for-profit organizations is a new and still under-researched field. Emerging markets are the bright-spot in the current global economic malaise, and their increasing foreign investments are reflective of their strengthened position in the global political economy. Modeling emerging markets' outward foreign investment can be tricky given data reporting practices and accuracy. The interests of the reporting agency and the involved industry have to be evaluated. As emerging markets are developing, parallel economies consisting of both private and public interests grow. It may be worth examining the outcomes of such interactions when the actors' interests converge/diverge.



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# Latest Trends in Global FDI Flows and Policies: A Synthesis of Recent Research by UNCTAD

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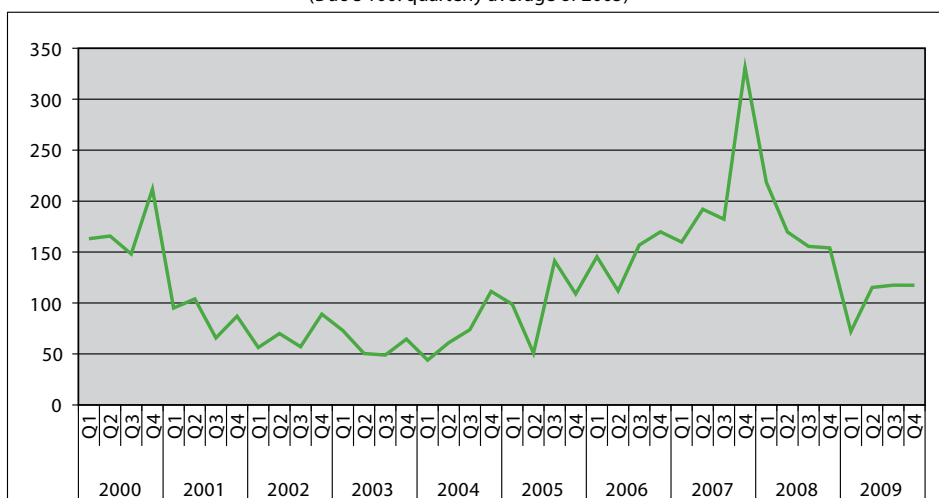
**IN RESPONSE TO ITS MANDATE AND** growing needs of its customers, the Investment and Enterprise Division of UNCTAD has launched a number of new periodic publications. Among them, two core products—the *Global Investment Trends Monitor* and the *Investment Policy Monitor*—aim at providing the international investment community with timely information and analysis on the latest global foreign direct investment (FDI) trends and prospects, and investment policy developments.<sup>1</sup> Based partly on the latest issues of the two new series, this article aims to present the recent trends and developments in global FDI flows and policies to international business (IB) scholars. It pays particular attention to a few topical issues, including the timing of global FDI recovery, the growing strength of emerging economies in the FDI arena, and the potential risks of investment protectionism. It then discusses the implications of these issues for IB research.

## Global FDI Bottoms out from Worst Time

The global financial crisis has brought to an end the recent four-year growth cycle in global FDI (UNCTAD, 2009). UNCTAD estimates show that global FDI inflows fell by 39 percent from US\$1.7 trillion in 2008 to a little over US\$1.0 trillion in 2009. The decline in FDI was widespread. After a significant fall in 2008, inflows to the developed world continued their dramatic decline in 2009, by a further 41 percent. With regard to the negative impact of the crisis on FDI to developing economies, there was a time lag: inflows still grew in 2008 and started to decline in 2009 (by 35 percent). All components of FDI—equity capital, reinvested earnings and intra-company loans—were affected by the downturn. The decline was especially marked for equity capital flows, which are more closely related to foreign investment strategies of transnational corporations (TNCs). Regarding the mode of entry, cross-border mergers and acquisitions (M&As) were severely affected (-61 percent), while the number of recorded greenfield projects declined to a much lesser extent (-23 percent).

The Quarterly FDI Index newly introduced by UNCTAD illustrates that the global FDI downturn has been bottoming out. After a “freefall” during Q1 2008–Q1 2009, worldwide FDI flows “turned the corner” in the second quarter of 2009 and remained relatively stable in the third and fourth quarters of the year (UNCTAD, 2010a) (Figure 1). However, the index also shows that global flows were at a level much lower than those in 2007 and 2008. During the last quarter of 2009, only a handful of economies—including China, Hong Kong (China) and Ireland—received more inflows than the 2007 average.

**Figure 1: UNCTAD's Global FDI Quarterly Index, 2000 Q1–2009 Q4**  
(Base 100: quarterly average of 2005)



Source: UNCTAD.

There are signs of a rebound in global FDI flows in 2010: in particular, global cross-border M&As have picked up in the first quarter. Despite the uncertainties, a recovery in global FDI seems to be on its way. FDI flows worldwide are expected to be out of recession in 2010 and to gain momentum in 2011 (Zhan, 2010).

## Emerging Economies Lead the Recovery

Compared with FDI to developed economies, that to developing economies was less and later affected by the global financial crisis, and has

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been recovering earlier and in a stronger manner. Within the developing world, countries with healthy macroeconomic fundamentals and robust financial systems recover sooner, while those with fragile financial systems, strong reliance on external demand and high dependency on natural resources are still vulnerable (Zhan, 2009). The preference given by TNCs' investment plans to large emerging economies continues to increase. According to UNCTAD's recent estimates, all the four BRIC economies were among the world's top 15 FDI recipients in 2009 (Table 1). Currently, developing and transition economies as a whole may account for nearly half of global FDI inflows (Zhan, 2010).

**Table 1: Top 15 Recipients of FDI in the World, 2008 and 2009**  
(Billions of dollars)

Rank	Host economy	FDI inflows in 2008	Estimated FDI inflows in 2009
1	United States	316	136
2	China	92	96
3	France	101	65
4	Russia	70	41
5	Netherlands	-4	38
6	Hong Kong, China	63	36
7	Belgium	60	35
8	Germany	25	35
9	India	42	34
10	Italy	17	30
11	Spain	66	26
12	Brazil	45	23
13	Singapore	23	18
14	Sweden	44	16
15	Ireland	-20	14

Source: UNCTAD.

Emerging economies have gained ground as sources of FDI as well. In 2008, the growth rates of FDI outflows from Brazil, China, India and Russia were 190 percent, 132 percent, 6 percent and 22 percent, respectively. In 2009, outflows from China (not including those in financial services) rose again by 7 percent in 2009, reaching \$43 billion. Currently, though M&A opportunities related to low stock prices and exchange rate fluctuations triggered by the global financial crisis have been fading away, the ongoing global industrial restructuring still provides good chances for developing-country firms to buy strategic assets in developed countries. As highlighted by a number of mega deals in the past few years (Table 2), acquirers from the BRICs have still been on a buying spree in 2009 and 2010, and the pursuit of natural resources by oil and mineral companies, as well as by sovereign wealth funds, continues to be the main driver. However, it seems that they have changed their focus from financial to manufacturing assets, perhaps due to the lessons learnt from their money-losing investments in foreign banks. For instance, M&As opportunities in developed countries and high profitability and abundant bank lending at home have helped boost Chinese outward FDI in the automotive industry. In the meantime, as a result of its resource-seeking FDI, China has become the leading foreign investor in countries like Australia.

## Investment Protectionism: Not Yet a Serious Concern?

There has been a widespread concern in the international economic community that the global financial crisis and its economic aftermath may result in protectionism by favouring domestic over foreign producers and investors. Various monitoring and reporting exercises have been undertaken, and the results demonstrate that an escalation of protectionist reaction to the crisis has been more or less avoided. Despite this overall positive observation, the situation is quite different in trade and investment areas: there has been policy slippage in the trade area, and recourse to new trade restrictions by some G20 members has been in contradiction to their pledges in London and Pittsburgh (UNCTAD-OECD-WTO, 2009),<sup>2</sup> while no systematic evidence exists concerning restrictive investment measures, and the thrust of policy changes has been pointing towards greater openness.

This has been confirmed by the second *Investment Policy Monitor* published by UNCTAD in April 2010, according to which most of the investment-specific measures introduced between December 2009 and March 2010 aimed at a greater degree of liberalization and facilitation. During this period, 28 economies adopted investment-specific measures, most of which aimed at liberalizing the entry of foreign investment into previously closed sectors or to facilitate investment conditions; 43 economies enacted measures related to foreign investment, most of which related to the adoption of new or the prolongation of existing State aids and stimulus packages implemented to counter the continuing financial and economic crisis (UNCTAD, 2010b).

However, this does not mean that the risk of investment protectionism has disappeared. The potential for "hidden protectionism", namely the informal, non-transparent and discriminatory actions in investment policy implementation, is still a challenge. With regard to the increased role of the State in businesses, including through the partial or complete nationalisation of ailing enterprises, concerns have been expressed that "the government bases its operational decision not only on economic, but also on political considerations with potentially detrimental effects for foreign investors" (UNCTAD, 2010b: 3).

## Implications for IB Research

The global financial crisis and its impact on the internationalization of TNCs in general and their foreign investment/divestment activities in particular have posed theoretical as well as empirical challenges to IB scholars. What are the short- and long-term implications of the sudden external shock of financial and economic crises on the internationalization strategies and practices of companies? In the short run, global supply chains are under stress (Mefford, 2009), and firms' survival strategies have to address immediate threats (Meyer, 2009). To understand this better, we need to explore the transmission channels of such threats as lack

**Table 2: Largest Cross-Border M&A Deals Undertaken by Companies Based in the BRICs, 2006-2008, 2009-2010**

Acquirer		Target			Value (\$ m)	Shares (%)	Year
Company	Country	Company	Country	Industry			
2006-2008							
CVRD	Brazil	Inco Ltd	Canada	Mining	17150	76	2006
OAO GMK Norilsk Nickel	Russia	LionOre Mining	Canada	Mining	6287	100	2007
ICBC	China	Standard Bank Group Ltd	South Africa	Finance	5617	20	2008
China Investment Corp	China	Morgan Stanley	United States	Finance	5000	10	2007
Evrast Group	Russia	IPSCO-Canadian Tubular Operations	Canada	Mineral	4025	100	2008
Sinopec Group	China	OAO Udmurtneft	Russia	Oil and gas	3500	97	2006
China Investment Corp	China	Blackstone Group	United States	Finance	3000	10	2007
China Development Bank	China	Barclays PLC	United Kingdom	Finance	2980	3	2007
CNOOC	China	Nigerian National Petroleum-OML 130	Nigeria	Oil and gas	2692	45	2006
Ping An Insurance	China	Fortis	Belgium	Finance	2672	4	2007
Investor Group	India	Sabiha Gokcen International Airport	Turkey	Airport services	2656	100	2008
OAO Gazprom	Russia	Beltransgaz	Belarus	Oil and gas	2500	50	2007
CVRD	Brazil	Inco Ltd	Canada	Mining	2316	13	2007
Tata Motors	India	Jaguar Cars Ltd	United Kingdom	Automotive	2300	100	2008
Evrast Group	Russia	Sukhaya Balka GOK	Ukraine	Mining	2189	99	2008
2009-2010 (Q1)							
Sinopec Group	China	Addax Petroleum Corp.	Switzerland	Oil and gas	7157	100	2009
Beijing Automotive	China	Saab	Sweden	Automotive	2930	100	2009
Yanzhou Coal Mining	China	Felix Resources Ltd	Australia	Mining	2807	100	2009
CNPC	China	OAO MangistauMunaiGaz	Kazakhstan	Oil and gas	2604	100	2009
CNPC	China	Singapore Petroleum Co Ltd	Singapore	Oil and gas	2230	88	2009
OAO Surgutneftegaz	Russia	MOL Magyar Olaj es Gazipari	Hungary	Oil and gas	1852	21	2009
Geely Automobile Group	China	Volvo Cars	Sweden	Automotive	1790	100	2010
CNPC	China	Athabasca Oil Sands Corp	Canada	Oil and gas	1737	60	2009
China Investment Corp	China	AES Corp	United States	Electricity	1581	16	2009
Minmetals	China	OZ Minerals	Australia	Mineral	1386	100	2009
OAO Gazprom Neft	Russia	Sibir Energy PLC	United Kingdom	Oil and gas	1001	33	2009
Grupo Votorantim	Brazil	Cimpor Cimentos	Portugal	Cement	982	17	2010
China Investment Corp	China	KazMunaiGas	Kazakhstan	Oil and gas	939	11	2009
Sinochem Resources	China	Emerald Energy PLC	United Kingdom	Oil and gas	877	100	2009
CVRD	Brazil	Rio Tinto PLC-Potash Assets	Argentina	Mining	850	100	2009

Source: UNCTAD.

of resources at headquarters to businesses in subsidiaries worldwide. In addition, we should examine the “mode of exit” (a concept mirroring the “mode of entry”), as well as various related strategic decisions. A dataset with a wide coverage of divestment projects during the crisis would facilitate empirical studies on those issues. However, a multi-disciplinary theoretical underpinning is needed in the first place. The policy implications of such research are important: its results will help policy makers understand better the decision making mechanisms of companies facing crisis, and will help host countries retain existing investment and avoid widespread divestments in similar future scenarios.

The rising significance of emerging economies as both recipients and sources of FDI flows as indicated above has further highlighted the importance of studies on the determinants of inward and outward FDI in the context of emerging economies. Contextualisation offers an opportunity for the development of IB theory (Toyne and Nigh, 1998), and the emerging market context provides insights for such development. What is important is to identify the economic and institutional features of emerging economies, to link the specific, dynamic “contextual variables” to existing IB theory, and, if necessary, to develop the theory (Liang, 2004). In terms of the determinants/motives of outward FDI from emerging economies, for instance, specific country-level factors (e.g. government support, credit condition and State ownership) and their implications for firm-level advantages deserve particular attention.

As noted earlier, the global financial crisis has given rise to concern over the risks of investment protectionism. Why, up to now, this did not happen; what were the economic and political forces behind this? In the long run, the crisis may have an ideological influence inasmuch, as it triggers large public support for a stronger role of the State in the economy and a preference of domestic ownership in industries. Will this lead to a “paradigm shift” in terms of our understanding of the role of FDI for development and pave the way for more restrictive FDI policies in the future? Beyond these research questions directly related to the issues addressed in this article, other important questions include, for instance: what are the long-term implications of the general policy responses to the financial crisis (such as those on global imbalance and financial system reform) for the internationalization strategy of companies and the formation of their global production networks; what are the implications of international climate change agenda on the global operations of TNCs; and what are the associated challenges and opportunities. All these are questions that we propose for the consideration of our readers.

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## Endnotes

- <sup>1</sup> All these publications are available online at: [www.unctad.org/diae](http://www.unctad.org/diae).
- <sup>2</sup> According to some observers (e.g. Evenett, 2009), trade protectionism has gained momentum, G20 pledges have been violated, and damage done by discriminatory policy state measures has been significant.

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# Chinese Outward Investment<sup>1</sup>

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**THE DEBATE OVER THE NATURE** and implications of Chinese investment around the globe suffers from too few facts. It is in the PRC's interest to remedy the situation, but domestic political motives appear inhibit Beijing from increasing transparency in outbound investment. Other means of promoting transparency must be pursued.

For Chinese purchases of American bonds, the U.S. government has done a poor job of providing public information in timely fashion. This failure has contributed to an unproductive discussion of the meaning of Chinese investment in the U.S. In particular, Chinese bond purchases are not nearly as important as their size seems to dictate.

For spending outside of bonds, The Heritage Foundation tracks large transactions starting in 2005, when Chinese outward investment accelerated (Scissors, 2010). The trend over time, regional distribution, and industry breakdown are provided below, supplanting unhelpful Chinese government information and in lieu of closely held data at consulting services.

Australia is the largest target for Chinese non-bond investment, followed by the U.S. Energy is the leading sector but metals is nearly as important. And Chinese investment shook off the financial crisis by mid-2009 to resume its sharp upward trajectory.

## China's Indirect Purchasing

The numbers showing official Chinese holdings of American Treasury bonds are close to meaningless. There are multiple reasons for this, highlighted in recent data from the Department of the Treasury.

The December 2009 data on foreign holders of U.S. treasuries stirred up a hornet's nest. They seemed to show Chinese holdings declining sharply in December and barely budging over the course of 2009 (Department of the Treasury, 2010), even as the federal deficit soared to \$1.4 trillion. Stark conclusions were drawn from these figures when, in fact, they are unusable.

The monthly Treasury report sorts data by the physical location of the buyer. Coincident with supposed Chinese disinterest was a more than doubling of purchases from Britain and Hong Kong. The magnitude of the increase for Britain and Hong Kong makes no commercial sense. It does, however, make sense for the PRC. China accumulated \$453 billion in additional reserves in 2009 and cannot spend that money at home (Scissors, 2009a). The PRC government body that buys foreign bonds—

the State Administration of Foreign Exchange (SAFE)—has two of its four international offices in London and Hong Kong. Purchases made by some agents in Britain and Hong Kong were on SAFE's behalf.

Unfortunately, exactly how much is unknown. The single biggest problem with Chinese outward investment is SAFE's aversion to transparency (Scissors, 2009b). SAFE's love of secrecy is strong even by the standards of the Chinese state. It refuses to respond to inquiries regarding the existence even of offices it has registered under local regulations, much less any actions taken at the branches.

There are also powerful forces at work within China. The central government has been criticized for wasting "the people's money" in low-return or loss-making investments in the U.S., punctuated by outrage that a poor country is seen to be subsidizing a rich country. This outrage stems from a misunderstanding of the financial relationship, one that is duplicated to some extent on this side of the Pacific.

The Chinese yuan's peg to the dollar is well known. Closely connected to this are capital controls that prevent money from freely entering or leaving the PRC. Together, these have brought considerable benefit to China, but they also mean that Beijing cannot spend foreign currency at home. Any attempt would merely cause an expansion in domestic money supply and end with the foreign cash right back in state coffers.

Due to many kinds of mercantilist policies, China runs by far the world's largest balance of payments surpluses. These cannot be spent at home and are too large to put anywhere other than the United States. No other country has financial markets capable of absorbing them. To hide the unavoidable extent of China's exposure to low-yield American bonds and try to avoid domestic flak, SAFE is routing money through third countries.

## America's Inadequate Monitoring

Perhaps the second-biggest problem with Chinese outward investment is the U.S. government's seeming lack of interest in transparency. Treasury holdings classified by the geographic location of the buyer are not useful for policy formulation. At the least, some effort should be made toward publicly disclosed revisions that track the true nationality of the ultimate bond-holder and, crucially, in a timely fashion.

In June 2008, the PRC's holdings of American bonds outside Treasur-

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ies exceeded holdings of Treasuries (Department of the Treasury, 2009). That was before the financial crisis, which prompted a massive change in the Chinese position out of agency bonds such as from Fannie Mae and Freddie Mac and into Treasuries.

The shift featured \$175 billion in Treasuries bought by SAFE in the second half of 2008, which triggered talk the absurd talk of China as America's banker (see Figure 1). What occurred was not new PRC purchases, but a transfer from risky Fannie and Freddie debt to perceived safe Treasury debt. This was not made plain until Treasury offered its preliminary update in February 2010. Even then the update is only through June 2009. A Chinese portfolio shift resulting from weakness in the euro will not be confirmed in American data until February 2011.

**Figure 1**



Augmenting the point is the case of the other, smaller sovereign wealth fund, China Investment Corp. (CIC). CIC's February 2010 disclosure of roughly \$10 billion in equity holdings was incomplete with regard to equities, much less money market positions.<sup>2</sup> Yet it was superior to anything made public by the U.S. government concerning CIC, despite general expressions of concern about the intentions of sovereign funds.

The first order of business is to for Treasury to devote resources to publishing timely and pertinent data. With proper numbers, the mechanical nature of the relationship between China's external surpluses and holdings of U.S. bonds will be exposed. The PRC does not buy or sell for leverage. It does not act for any reason other than to recycle domestically unusable funds stemming from its currency peg and closed capital account.

## China's Non-Bond Investment

China's purchases of U.S. government bonds have received the most

public attention. The PRC's investment outside those bonds is much smaller but mushrooming and requires more study. As a first step, The Heritage Foundation has created a public dataset of large Chinese business transactions outside bonds starting in 2005. The dataset tracks with official Chinese data on outward investment but is updated faster and more frequently and contains far more useful information.

For example, Chinese non-bond investment did falter in 2009 due to the global financial crisis. However, it began to recover last May and, in fact, was soaring by the third quarter of last year. The peak to date of roughly \$55 billion annually is very likely to be exceeded in 2010. Given the size of China's foreign reserves, non-bond investment has the capacity to exceed \$100 billion annually and eclipse investment into the PRC.

**Table 1: China's Non-Bond Investment, Two Views (\$ billions)**

	Ministry of Commerce	The Heritage Foundation
2005	12.3	8.7
2006	17.6	19.5
2007	26.5	35.0
2008	55.9	56.3
2009	43.3*	54.9
<b>Total</b>	<b>155.6</b>	<b>174.3</b>

\* Not yet revised. Upward revisions have been substantial every year the data have been issued.

**Table 2: Top Destinations**

Country	Total, \$ billion
Australia	29.8
U.S.	21.2
Iran	10.7
Kazakhstan	9.7
Britain	8.2

Source: Heritage Foundation Dataset, China's Outward Investment: Non-bond Transactions Over \$100 Million (2005–2009).

The most politically relevant feature of Chinese non-bond investment may be its geographic distribution. As in its other reporting, the PRC treats Hong Kong and other offshore financial centers as final destinations rather than transit points. This leads to absurd results, which are contradicted by host countries, by the Chinese companies involved, and even occasionally by PRC government officials.

The Heritage dataset overcomes this weakness. Over the past five years, the U.S. has been the second-largest destination of non-bond investment, at \$21.2 billion total. In a \$14 trillion economy, this is negligible. Specific technologies may need to be shielded from acquisition, but general Chinese influence through non-bond investment is minimal.

It is illuminating, as well as unsurprising, that the largest destination for Chinese non-bond investment is also an open economy—Australia.



Another such economy—Britain—is the fifth-largest destination. While SAFE abhors transparency, Chinese firms are no different from other multinationals and seek transparent economies as better for business.

A second set of target countries has received a good deal of attention: resource-rich economies with closed or otherwise troubled political systems. For energy, the Heritage dataset confirms that Iran is the leading example; in metals, the Democratic Republic of the Congo exemplifies China’s willingness, when particular assets are in play, to do business with little regard for local conditions or global sentiment.<sup>3</sup>

Approximately 40 percent of PRC non-bond investment from 2005–2009 was in OECD countries. Sub-Saharan Africa and West Asia (including Iran) attracted another 35 percent, combined. Perhaps surprisingly, East Asia, Latin America, and the Arab world lagged in attracting Chinese investment. Chinese investment in East Asia, especially, is likely to predate the dataset, though pre-2005 totals are far smaller.

There is another important qualifier to the figures on pure investment. During the past five years, the PRC has also inked close to \$50 billion in large engineering and construction contracts worldwide. By far the leading region for this activity is the Arab world. The pursuit of energy has thus taken multiple forms.

Figure 2



Official Chinese data do not provide useful sector breakdowns. In the Heritage dataset, there are clear patterns in the PRC’s behavior, and the conventional wisdom of a focus on commodities turns out to be correct. Energy and power draws over 40 percent of investment and accounts for over one-third of engineering and construction contracts.

Table 3: Sector Patterns (\$ billions)

Sector	Non-bond Investment	Engineering and Construction Contracts	Troubled Transactions
Energy and Power	72.2	16.7	49.3
Finance and Real Estate	33.4	1.2	29.0
Metals	62.5	4.9	32.8
Transport	3.2	20.8	7.6
All other	2.9	5.2	12.1
Total	174.3	48.8	130.9

Source: Heritage Foundation Dataset, China’s Outward Investment: Non-bond Transactions Over \$100 million (2005–2009).

Metals draw another 35 percent of investment. Finance and real estate investment, chiefly in the U.S., takes 20 percent. Transport leads in engineering and construction contracts.

Bumps in the Road

Just as with purchases of American bonds, there is a good deal of misinformation about non-bond Chinese investment. There are multiple, widely varying sources of and motivations for this misinformation. A key facet of Chinese investment over the past five years is that it could have been much higher: Failed investments are frequent and sizable.

The PRC’s outward investment is characterized by the same strategic maneuvering as any other nation’s. A few countries simply fabricate large deals. Other host governments exaggerate the benefits of agreements to win domestic approval. Eyeing stockholders, some corporations partnering with Chinese investors similarly exaggerate. Working in the opposite direction, Chinese firms attempt to minimize or obscure transactions that might have undesirable repercussions—for instance, those involving Iran.

The Heritage dataset excludes transactions that are not confirmed by all parties and those marred by conflicting or missing information. Media coverage of large investments often has a touch of breathlessness, while ensuing reports that nothing has yet occurred are lost in the pile. The “leader” in this field is Venezuela, which explicitly politicizes its energy relationship with the PRC (Petróleos de Venezuela, 2005). Every few years, a new announcement is made concerning development of the same fields. Some money is certainly being spent, but there is far more smoke than fire.

The Heritage dataset tracks a separate category of genuine investments and business contracts that partly or entirely failed. These are not transactions where the Chinese side was outbid—those are rare—but rather where local or PRC regulators objected late in the game or where Chinese firms were unable to fulfill the conditions of their initial offers.

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**Table 4: Failed Investments**

Country	Amount, \$ billions
Australia	27.2
U.S.	25.5
Iran	19.6
Germany	14.0
Nigeria	8.5

Source: Heritage Foundation Dataset, China's Outward Investment: Non-bond Transactions Over \$100 million (2005–2009).

Such transactions turn out to be a major feature of China's "Going Out." From 2005 through 2009, there were 40 failures of \$100 million or more, with aggregate lost value of a weighty \$130 billion. These naturally follow the PRC's geographic priorities in investment. The leading cause of failure is mistakes or the incapacity of Chinese enterprises themselves, but actions by taken by Congress and U.S. Administrations have blocked or contributed to the collapse of at least \$35 billion worth.

There are also notable exaggerations and failures beyond the investment tracked by Heritage. Very large and long-term trade deals, almost all focused on energy supply, have been announced with great fanfare but often mischaracterized. Some merely formalize existing trade relationships; others are not binding and never begin to come to fruition.

## Policy Implications

The obvious theme runs through the PRC's bond investment, non-bond investment, and various other business activities, both failed and successful: China has a lot of money at its disposal.

The much advertised oil-for-loans exchanges, for instance, are as yet trivial in realization but would have no potential at all if the PRC did not have cash and a strong desire to use it. Chinese banks are now active globally, lending to support national acquisition of resources but also joining other multinationals in syndicated loans in aviation and elsewhere (Mueller, 2010). Similarly, China's recent contribution to the International Monetary Fund's capital base is minor in itself but portends a future where the IMF faces more contention among principal donors (as well as standard disagreements with borrowers).

With the variety of options for \$2.5 trillion, and climbing, in official reserves, the need for good information on China's behavior is great. Perhaps surprisingly, this is not yet vital with regard to U.S. Treasury bonds. Until the Chinese government is willing to break its dependence on the dollar—which there is not the slightest indication it is willing to do—the PRC is compelled to hold huge stocks of American bonds.

When China finally does muster the courage to have its own currency, it will be absolutely necessary for Congress and the Administration to

know SAFE's true behavior as it happens, not just what China-based buyers are doing or the state of play 15 months ago. An inescapable need is to improve U.S. monitoring capability.

This will also be helpful beyond bond purchases. At present, policy discussion is generated in good part by rumors of Chinese activity—for instance, in Latin America—that are often poorly founded. Where possible, the U.S. should begin to conduct on-the-ground estimation of the extent of actual Chinese investment or construction. A second step should be global cooperation in information. Australia is the front line of the Chinese investment boom and is holding a serious discussion of the very hefty benefits of the PRC's economic expansion versus the need to hedge in important ways. India has recently struggled with the best response to a perceived flood of Chinese workers employed in legitimate projects but purportedly not with Indian consent.

The PRC's very globalization raises the possibility of a third and related action. With Chinese enterprises now possessing considerable business interests around the world, a coordinated, multilateral effort to enhance disclosure requirements would benefit all parties. The firms themselves would gain from a more open and trusting atmosphere in host and potential host countries, and are coming to realize this.

A fourth policy path will be more difficult. It may be possible to improve investment access to China in ways that were previously unacceptable to Beijing by invoking WTO reciprocity or engaging in bilateral bargaining over mutual investment freedoms and restrictions. China now has a national stake in outward investment and influential domestic actors to make the case that a hospitable welcome for Chinese investment overseas is worth concessions to foreign investors interested in the PRC.

It should be emphasized that the multilateral objective is greater disclosure, not greater restrictions. The PRC has the same right to engage in international commercial activity as any country. Under the right conditions, China's outward investment will benefit much of the planet. The first of these conditions is transparency, and both Chinese and American efforts to shed light on Chinese outward investment should be enhanced.

## Endnotes

<sup>1</sup> This paper is based on testimony submitted to the US-China Economic and Security Review Commission.

<sup>2</sup> For example, CIC's stake in Blackstone and part of its stake in Morgan Stanley were excluded as non-voting shares.

<sup>3</sup> The chief example is Sudan, where the bulk of Chinese investment took place well before 2005.

<sup>4</sup> While not a concern in the U.S., Chinese labor often follows Chinese capital around the globe and is often a more explosive political issue.

<sup>1</sup> The principal difference between the two series is that the Heritage dataset does not include transactions worth less than \$100 million. It nonetheless generates slightly larger figures. One source for the discrepancy is investment funded by Hong Kong subsidiaries of mainland companies. This would not be counted by the Ministry of Commerce but can appear in our dataset.

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# The Role and Importance of the Chinese Government for Chinese Outward Foreign Direct Investments

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**CHINESE OUTWARD FOREIGN DIRECT INVESTMENTS** show a strong positive trend over recent years and have attracted considerable attention from academia and the business press. Many observers and commentators express interest in the role the Chinese government plays in the activities and decision-making of Chinese multinational enterprises (MNEs) in connection with their foreign direct investments (FDI).

This article makes a contribution by investigating the relationship between the Chinese government and MNEs in connection with their outward foreign direct investment (OFDI). We present a 2x2 matrix where one dimension includes the interest (high/low) of the Chinese government and the other the interest of MNEs (high/low). We argue that, in market-seeking and strategic asset-seeking, both interests are aligned and high, while for efficiency-seeking motives Chinese company interests are high but government interests are relatively low. In regard to resource-seeking motives and balancing foreign currency reserves, Chinese government interests are high but company interests relatively low. Our matrix allows us to understand the role and interests of the Chinese government in the decision-making process as well as the relationships with Chinese companies in outward foreign direct investments.

## Trends and Patterns in Chinese FDI

China's OFDIs have shown a strong positive trend over recent years. At the beginning of the 1990s, outflows were only marginal, at about US\$ 800 million (UNCTAD WIR, 2009). But since 2003, Chinese OFDI has demonstrated impressive growth, increasing from US\$ 2.8 billion in 2003 to US\$ 52.2 billion in 2008 (UNCTAD WIR, 2009: 53). However, while Chinese OFDI is clearly accelerating, it is still small by any relative measure. In 2006, Chinese OFDI accounted for only 1.5 percent of the world's total FDI. In 2008, China's share of world FDI reached 2.8 percent (UNCTAD WIR, 2009).

Most Chinese OFDIs are in neighbouring Asian countries, especially those in the Association of Southeast Asian Nations (ASEAN) (MOFCOM, 2008: 67-68). China's Special Administrative Region, Hong Kong, attracts by far the highest amount of OFDI. In 2008 it was the preferred destination of 63 percent of Chinese OFDI (MOFCOM, 2008: 67). A significant amount probably constitutes round-tripping investments or investments to offshore financial centres or to re-investments back to China due to favorable tax situations in Hong Kong and other countries.

Therefore, Hong Kong and other offshore financial centers are transit points for Chinese OFDI that need to be factored into the reported statistics and analyses.

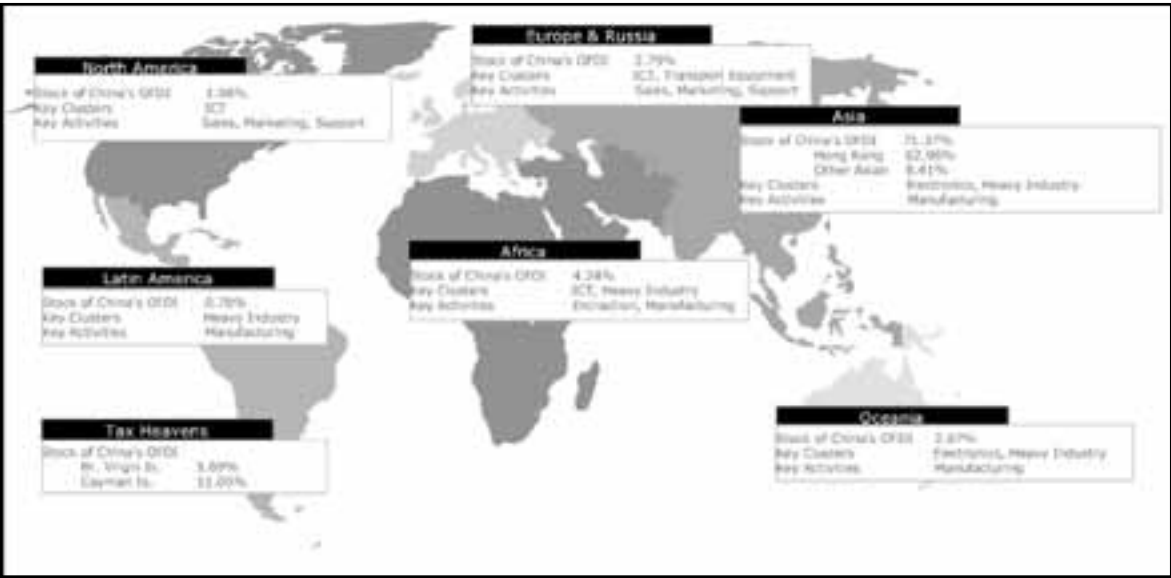
Looking at Chinese FDI in terms of stock flows, leasing and business services are the most popular sectors, accounting for US\$ 54.5 billion, followed by the financial sector (US\$ 36.7 billion), wholesale and retailing (US\$ 29.8 billion) and mining with US\$ 22.8 billion in 2006 (MOFCOM, 2008: 80). The importance of the financial sector may be illustrated by the fact that, according to MOFCOM (Chinese Ministry of Commerce), Chinese state-owned commercial banks had established 47 branch offices, 31 affiliated institutions and 12 representative offices in 19 countries in 2006, including the United States, Japan and Great Britain (MOFCOM, 2006: 51). Our data for this article are based mostly on official data provided by MOFCOM, but some authors cite a lack of disclosure and transparency in data sources about Chinese foreign direct investments (see article from Derek Scissors in this issue).

The best way to understand the strategies of Chinese MNEs is to link their preferred investment destinations with their main investment sectors since a close relationship exists between the sectoral and geographical distribution of Chinese OFDI. Figure 1 illustrates that Chinese OFDI in the Middle East and Africa targets mainly extractive industries. According to UNCTAD (2008), the Chinese government supports the development of Chinese firms' activities in Africa, especially in sectors such as energy and resource exploitation. OFDI in manufacturing is prevalent in Eastern Europe (especially transport equipment), Latin America (mostly heavy industry) and Asia (electronics). Sales, marketing and support activities are generally performed in Western European countries and in North America. International mergers and acquisitions are the primary mode of entry of Chinese firms in developed economies. However, Chinese firms have not yet invested heavily in manufacturing and sectors with high added value. As far as production activities, transport is the key sector in Western Europe, while ICT plays an important role in North America.

Figure 1 suggests that Chinese MNEs follow a regionalization strategy rather than a global one (Rugman & Doh, 2008: 134 ff.). The 12 largest Chinese firms have the highest average percentage of intraregional sales and assets. This observation is not specific to Chinese MNEs but refers to most MNEs as Rugman (2008) found out (see also Sukpanich & Rugman, 2009). This contrasts with the inference of the press that Chinese OFDI is a global strategy led, or at least influenced, by the government.



Figure 1: Share of Chinese OFDI in the World



Source: Own illustration based on MOFCOM, Statistical Bulletin on Chinese OFDI, 2008.

Government Primacy over Foreign Direct Investments

A number of points need to be raised to outline the relationships between the Chinese government and the private sector for Chinese OFDI. For many years, typical private sector business was non-existent in China. With the economic liberalization and the introduction of private ownership in the 1980s, private sector activities took root. They were partially built on individual entrepreneurial initiatives and state policies such as the one on privatization (Gugler & Boie, 2009). Some companies are identified as future “national champions”, and most have a close relationship with the government (Morck et al., 2007). Since the “going global” strategy adopted by the government at the end of the 1990s, both Chinese State-Owned Enterprises (SOEs) and private enterprises are engaged in FDI. But most of the large-scale investment projects that weigh heavily in FDI statistics have so far been executed by Chinese SOEs. The shares of FDI flows coming from SOEs under the Central Government in recent years were 73.5 percent (2003), 82.3 percent (2004), and 83.2 percent (2005). The remaining shares of FDI flows are split among investments of SOEs administered by regional governments, non-SOEs owned collectively, and privately-owned companies. The success of SOEs abroad is quite limited due to their lack of competitiveness and know-how and because the acquisitions usually reflect a political agenda rather than business needs.

Neither the trends nor motives for Chinese OFDI can be understood without reference to government policies and the role of the Chinese government. This is especially true in the case of China. China’s OFDI is still highly regulated, even though policies have shifted from prohibition to gradual opening and finally to active promotion, at least for some SOEs in strategic sectors or industries (Gugler & Boie, 2009: 29-30). Morck et al. (2007) assessed the connections between government and business in China, confirming the government’s central role

in OFDI. FDI by any Chinese firm requires approval by the Chinese authorities, including MOFCOM, the State Administration of Foreign Exchange (SAFE), and the National Development and Reform Commission (NDRC). Through this approval process, the Chinese government ensures that all investment activities, even if executed by privately owned companies, conform to government policies and goals.

Clearly, this needs to be taken into consideration when analyzing the motivations and strategies of Chinese MNEs investing international. The following Figure 2 illustrates a

conceptual framework outlining the interests of the government versus the interests of Chinese companies. This 2x2 matrix maps the four motives of OFDI (market seekers, efficiency seekers, resource seekers and strategic asset seekers [Dunning & Lundan, 2008: 67 ff]) as well as the huge trade surplus and the management of extensive currency reserves Chinese companies, state-owned or private, hold.



Source: Own illustration. Based also on Gugler and Boie, 2008.

Model Implications

(1) Our framework suggests that an area of increasing OFDI might exist where government and company interests are high, such as *market-seeking* and *strategic asset-seeking*.

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As noted by UNCTAD, “*market-seeking FDI is by far the most common type of strategy for developing-country TNCs in their process of internationalization*” (UNCTAD WIR, 2006: 158). Several recent studies point to the rise of *market-seeking* motives driving Chinese MNEs toward large markets (Zhang, 2003). The FIAS/MIGA global survey confirms the prevalence of Chinese market-seeking FDI. In their study of Chinese FDI from 1984 to 2001, Buckley et al. (2007) show that market-seeking was a key motive for Chinese FDI. However, during this period, Chinese firms moved away from market-seeking strategies in nearby foreign markets toward securing raw materials in riskier markets (Buckley et al., 2007). Chinese companies that have invested abroad for market-seeking purposes include Haier, TCL, and Huawei Technologies. They have all made repeated efforts to enter the more affluent developed economies such as the US.

While the UNCTAD global survey indicates that *strategic asset-seeking* FDI is a relatively modest motive for developing-country MNEs (14% compared to 51% for market-seeking FDI), the situation is quite different for Chinese MNEs (UNCTAD WIR, 2006: 162). Among Chinese MNEs, 51 percent regard strategic asset-seeking as an important motive for their FDI, compared to 85 percent for market-seeking, 39 percent for efficiency-seeking and 40 percent for resource-seeking FDI (UNCTAD WIR, 2006: 168). Strategic asset-seeking often seeks to acquire information and knowledge on how to operate internationally. However, as the experience of Chinese firms in this area grows, their goal has turned toward intangible assets, such as advanced proprietary technology and intangible strategic assets such as brand names (Buckley et al., 2007: 505). Chinese firms increasingly use mergers and acquisitions to acquire strategic assets with a view to building their competitive advantage. The acquisition of foreign technologies and brands is often regarded as a shortcut to establish a company as an international player. Prominent examples include Shanghai Automotive Industry Corporation (SAIC) acquiring MG Rover, Lenovo acquiring IBM's PC division, or the recent acquisition in 2010 of Volvo by Zhejiang Geely Holding Group. However, the success of these investments remains to be seen.

(2) Another situation occurs where government interests are high and company interests low. One might also argue that because the government interests are so high, there are almost no private companies in that industry and only SOE which are under the government control. Most *resource-seeking* investments fall into this category, as do *investments balancing foreign currency reserves*. The Chinese government clearly has an interest in a strong economy and therefore supports MNEs' international investments. China's powerful economic development machine requires a steady supply of natural resources, including ferrous and non-ferrous materials, precious metals, minerals, oil and gas. But the country is comparatively poor in most natural resources except coal. Chinese companies have therefore been very active in *resource-seeking*. FDI in natural resources is mainly driven by availability rather than proximity. The destinations for Chinese OFDI include resource-rich countries in Africa and Central Asia, together with Australia, Russia and Canada (Buckley et al., 2007: 511). According to UNCTAD (UNCTAD WIR,

2009), the Chinese government and Chinese MNEs generally regard natural resources as an important reason to invest abroad. Because securing resources for their growing home economy is a strategic priority, a large proportion of Chinese MNEs engaged in these efforts are state-owned. The top three Chinese outward investors are all companies in the natural resources field. In 2002 alone, CNPC acquired two oilfields in Azerbaijan and, together with Petrochina, the companies Devon Energy Corp. (Indonesia) and Salyan Oil (Azerbaijan). CNOOC acquired Repsol-YPF SA (Indonesia). Chinese companies also acquired fishery, timber and agricultural products. For example, Huaguang Forest Co.Ltd. acquired the Rayonier Inc. timberland operation (New Zealand).

(3) Finally, there exist investments where government interests are low, but company interests high. Most *efficiency-seeking* investment falls into this category. For Chinese companies, however, efficiency-seeking FDI is relatively unimportant because of low costs in their home economy (UNCTAD WIR, 2006: 160). This result confirms studies indicating that, given the low production costs in China, efficiency-seeking does not play a major role for Chinese MNEs going global (Buckley et al., 2007: 501). But efficiency-motivated Chinese FDIs may increase in the future (UNCTAD WIR, 2006: 160).

Government involvement has negative implications along with the positive. Corporations need the freedom to base strategic decisions on market requirements rather than fulfilling institutional instructions and goals. Foreign partners may take a critical view of strong government intervention. Child and Rodriguez (2005) state that successful international Chinese firms are non-SOEs or companies that have made arrangements to protect themselves from bureaucratic interference.

There are also many deals that fail and deserve further investigation. From 2005 through 2009, China saw at least 40 business deals, each worth US\$ 100 million or more, fall through. Prominent failed deals include Chinalco, which bid US\$ 19.5 billion for a larger stake in Rio Tinto in 2009; CNOOC attempted in 2005 to buy UNOCAL for US\$ 18 billion but was sidetracked by US politicians. In 2008 the China Development Bank's bid for Germany's Dresdner Bank was killed by Chinese regulators.

## Concluding Remarks

This article briefly presents and discusses the role of the Chinese government in MNE foreign direct investments. We present a 2x2 matrix where one dimension shows the interests (high/low) of the Chinese government and the other dimension the interest of Chinese MNEs (high/low) for their outward foreign direct investments.

For example, where the interest of the Chinese government and Chinese companies are high and aligned, we expect the scale and the speed in which those investments will be conducted and executed to be large and fast. Lenovo, for example, acquired IBM's PC division while Volvo was acquired by Zhejiang Geely Holding Group.

The matrix allows us to classify and distinguish between different FDI



motives and it describes the government role. This helps foreign governments as well as senior executives of non-Chinese companies not only to assess the relationship between them and the Chinese company but the relationship between them and the Chinese government, whether local, regional or national.

But, given the way the Chinese government is using OFDI to strategically support the development of the Chinese economy and companies, it remains to be seen whether this is convincing and the kind and level of foreign government resistance.

Already today, China's pervasive government involvement in its private sector causes foreign policymakers to worry about the impact of non-commercial bidders, national security and economic security. Chinese data on OFDI lack full disclosure and transparency, according to some researchers. We therefore encourage IB researchers to further investigate the relationship among the Chinese government, Chinese companies and their individual and cumulative effect on the success of Chinese FDI. Additional questions for study include: What are the short- and long-term implications for the competitiveness of Chinese MNEs? Is such a tight government involvement in Chinese MNEs sustainable in the long run? What is the role of Chinese SMEs for OFDI? What is the relationship among the different levels of Chinese government and how does it impact Chinese MNE OFDI? These are just a few questions we propose for further investigation.

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