CHINA'S EMERGING ROLE AS A GLOBAL SOURCE OF FDI

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China's position as the world's second largest recipient of foreign direct investment (FDI) has been well documented. However, it is less well known that China has recently become an important supplier of global FDI. This briefing describes what is known about the magnitude and composition of China's outward foreign direct investment (OFDI). Official data show that China's OFDI is large (relative to that of most countries), growing, and is mostly comprised of investments directed towards the financial sectors of Hong Kong, the Cayman Islands, the British Virgin Islands, and Luxembourg. Since much of China's OFDI is eventually redirected back to China and other markets, it is difficult to isolate the magnitude and composition of its true outbound investment. Firm-level data provide clearer insight. That data suggests that Chinese OFDI may be higher than what has been reported, and that its investments have mostly been directed towards the building of new facilities in primary commodity sectors (e.g.,oil, coal, metals) in Asia, Latin America & the Caribbean, and Africa. The findings are relevant to the United States, since China's OFDI –most of which is conducted by state-owned enterprises– is likely to add competitive pressure to U.S.-based multinational firms operating in similar markets.

China's Outward FDI Trends

China is supplying a growing share of the world's OFDI. Official data show that during 1990-2007, China accounted for about 1% of global OFDI flows each year. However, China's rapid growth since the global financial crisis, at a time when other countries began curtailing their OFDI, has meant that its supply of global investment has grown in absolute and relative terms (Figures 1 & 2). By 2010, official statistics show that China accounted for 5% of global OFDI flows, and is currently the fifth largest global supplier. China's global OFDI flows are likely to be even higher, since China's Ministry of Commerce (MOFCOM) only publishes officially authorized OFDI. According to an OECD study of its member countries, reciprocal receipts of Chinese OFDI flows were about 40% higher than what MOFCOM reported.

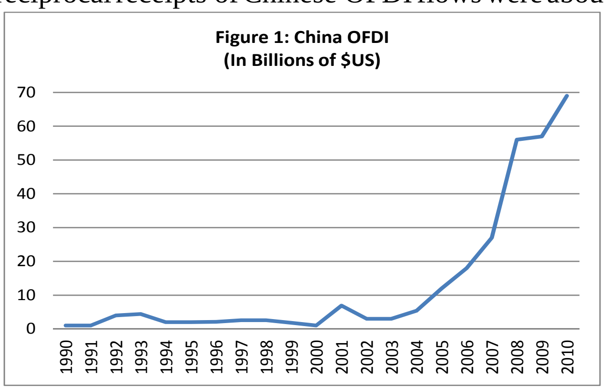

Figure 1: China OFDI (In Billions of $US)

Source: China's Ministry of Commerce (MOFCOM) and UNCTAD

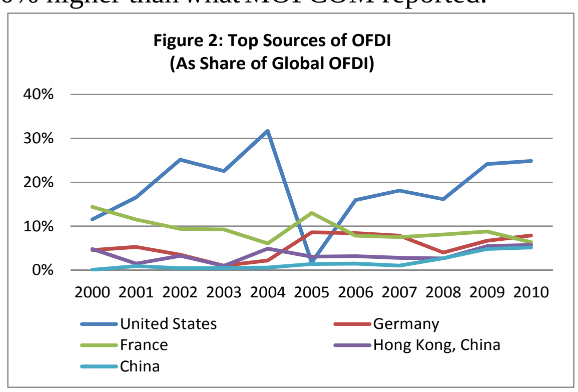

Figure 2: Top Sources of OFDI (As Share of Global OFDI)

Source:UNCTAD

Chinese data show that the majority of China's OFDI was initially sent to Asia and Latin America & the Caribbean (Figure 3), and was concentrated in the leasing/commercial and banking/insurance sectors (Figure 4). Hong Kong and the Cayman/British Virgin Islands account for about 75% of China's OFDI.

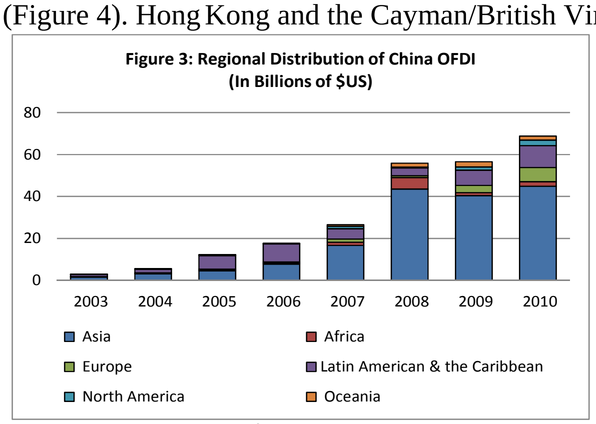

Figure 3: Regional Distribution of China OFDI (In Billions of $US)

Source: China's Ministry of Commerce (MOFCOM)

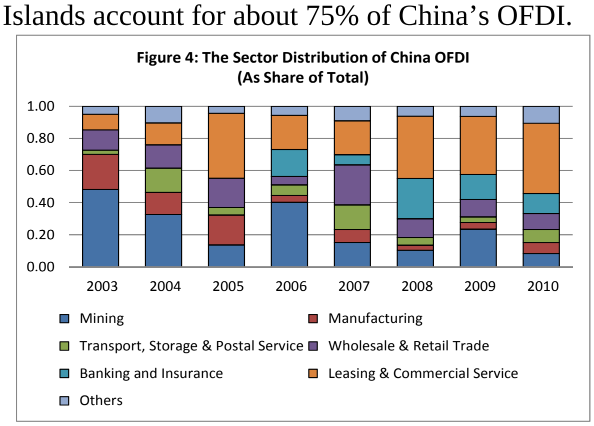

Figure 4: The Sector Distribution of China OFDI (As Share of Total)

Source: China's Ministry of Commerce (MOFCOM)

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Data Limitations: Much of China's OFDI is initially sent to Hong Kong, the Cayman Islands, the British Virgin Islands, and Luxembourg, in large part because of their favorable tax and regulatory environments. Since many of these investments are eventually sent back to China in the form of repatriated profits and funds, or are simply redirected to other markets in the form of greenfield and/or merger and acquisition investment, it is difficult to interpret the true final destination of much of China's OFDI.

Firm-level data from private sector sources provide clearer insight into Chinese OFDI patterns, since these data record the source and destination of final investment flows. The aggregated transactions show:

Table 1: Top Country Recipients of China's OFDI, Based on Firm-Level Investment Data
(In Billions of $US, Aggregated Final Flows During 2003-2010)

Asia ($124)				Latin America & Caribbean ($50)				Europe ($46)				Africa ($46)			
Greenfield	**$86**	**M&A**	**$38**	**Greenfield**	**$31**	**M&A**	**$19**	**Greenfield**	**$21**	**M&A**	**$25**	**Greenfield**	**$40**	**M&A**	**$6**
Indonesia	*$14*	*Hong Kong*	*$22*	*Brazil*	*$18*	*Brazil*	*$9*	*Russia*	*$11*	*UK*	*$5*	*Nigeria*	*$11*	*South Africa*	*$5*
Philippines	*$11*	*Singapore*	*$5*	*Cuba*	*$6*	*Cayman Island*	*$3*	*Germany*	*$3*	*Belgium*	*$4*	*Angola*	*$6*	*Mauritius*	*<1*
Vietnam	*$11*	*Kazakhstan*	*$3*	*Peru*	*$5*	*Br.Virgin Island*	*$2*	*Bulgaria*	*$2*	*Russia*	*$4*	*Sudan*	*$3*	*Chad*	*<1*
India	*$10*	*Macau*	*$1*	*Argentina*	*$2*	*Bermuda*	*$1*	*UK*	*$2*	*Norway*	*$3*	*Egypt*	*$3*	*D.R. Congo*	*<1*

Source: Zephyr and FDI Markets Databases

Characteristics of China's Firm-Level OFDI

- **Chinese OFDI appears higher than what has been reported.** In 2003-2010, firm-level data showed that China's OFDI was 27% higher than official data, and thereby closer to OECD estimates.
- **The majority (about 60%) of China's OFDI has been in greenfield investment.** This investment accounts for the construction of new operational facilities from parent companies in foreign markets. Asia, Africa and Latin America & the Caribbean absorbed 83% of China's greenfield OFDI —Brazil, Indonesia, Russia, the Philippines, Nigeria, Vietnam and India were the top country recipients. China's greenfield OFDI was mostly directed to the energy (33%), metals (29%), and auto sectors (8%).
- **Merger and acquisition (M&A) OFDI is also important:** China's M&A OFDI, which mainly measures equity stake transfers exceeding 10%, has mostly gone to Asia, Europe, and the Americas —Hong Kong, Australia, the United States, Canada and Brazil were the top recipients. China's M&A OFDI was mostly directed towards the energy (35%) and metal extracting (28%) sectors.

Factors Driving Growth in China's OFDI

Economic Factors:

- ***Higher returns*:** Chinese investors have limited options. Domestic banks offer low interest rates, the domestic stock markets are highly volatile, and the government restricts overseas portfolio investment. As such, China's underdeveloped capital market can encourage capital outflow. If approved by the Chinese government, OFDI can be an alternative investment option, and international financial centers can be especially attractive investment destinations given their favorable tax and regulatory environments.
- ***Investment-import link:*** It appears that many Chinese companies invest in sectors producing primary commodities (e.g., iron ore, copper, oil, soybeans) to facilitate importation back to China. Demand for these commodities has been fueled by China's growing middle class incomes, property market boom, infrastructure development, and its manufacturing sector's dependence on natural resources.
- ***Market expansion*:** As Chinese companies develop technology and expertise in various sectors (e.g., automobile, communication, alternative energy), they have sought opportunities to expand abroad.

Policies: The Chinese government initiated its "Go Out" policy in 1999, to promote China's direct investment abroad. Since 2003, the Chinese government has facilitated this investment by loosening its associated regulations, relaxing capital controls, and streamlining investment approval procedures.

State-owned enterprises (SOEs): With government support, SOEs appear to have been strong contributors to China's OFDI projects, particularly in primary sectors. Preliminary analysis of firm-level data suggests that over half of the value of China's OFDI between 2003 and 2010 originated from SOEs.

References: OECD's *Investment Policy Reviews: China;* UNCTAD's *World Investment Reports;* MOFCOM; Zephyr; and FDI Markets.