Fall 2013

Advancing Domestic Development through Overseas Investment

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COMPETITIVE SKILLS

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WITH US$84 billion of outward foreign direct investment (OFDI) flows, China became the world's third-largest outward investor in 2012, behind the United States and Japan. This signals impressive progress given that the country ranked only 20th a decade ago, when the 'going global' policy was launched and outflows during 2000–03 averaged US$3 billion. What are the salient features of these flows and why and how is the government helping Chinese firms to invest abroad?

Apart from the speed with which China's OFDI flows have grown, three features are particularly noteworthy.

The single most important feature is undoubtedly that the country's 115 central state-owned enterprises (SOEs) are responsible for the lion's share of OFDI, about 76 per cent of the country's non-financial OFDI stock in 2011. Their historically large size and strong political connections have put these firms into an advantageous position, with private firms only now beginning to catch up. SOEs are more in tune with the country's development strategy (an important criterion to receive special government support for OFDI) and they have better channels, both professional and personal, to shape the country's policy-making around such investment. At the same time, the dominance of SOEs has created concerns in a number of host countries.

Second is the fact that over 70 per cent of China's OFDI flows consist of FDI into tax havens and offshore financial centres (notably Hong Kong). These flows are, in most cases, not productive investments but rather transactions undertaken for such reasons as transshipment into other locations, round-tripping (to enjoy favourable fiscal benefits provided by Chinese local governments) or to benefit from very low or no taxes—or simply the desire for privacy or to park funds for future purposes. Some of these locations also make it possible to obtain easier financing, and they provide strong private property protection—a motive termed 'institutional arbitrage'.

In the case of Hong Kong (which accounts for the bulk of transshipment FDI), helpful are also geographic proximity, a facilitating environment, cultural ties and a favourable bilateral economic arrangement (notably the Mainland and Hong Kong Closer Economic Partnership Arrangement signed in 2003, and enticements for SOEs to locate subsidiaries there to use as a global platform). One implication of this phenomenon is that official data do not allow us to determine the real sectoral and geographic destinations of China's OFDI.

Third, China's firms benefit from an elaborate—even if cumbersome—regulatory environment that encourages OFDI within the framework of the going global policy. A range of promotional measures are available for eligible firms, including various information services, fiscal and financial incentives, investment insurance, bilateral and other investment treaties, and double taxation treaties—all meant to help firms undertake direct investment projects abroad.

Moreover, this help is even greater in areas that the government deems important for the country's development effort, specified in the government's Priority OFDI Projects for Credit Support, Outward Investment Sector Direction Policy, and The Twelfth Five-Year Plan for Economic and Social Development (notably its sub-plans on industrial reform and upgrading, and OFDI). For instance, building a research and development facility in a high-technology industry abroad is perceived as a highly desired OFDI project, and therefore can receive such support as expedited OFDI approval, priority to receive loans from banks, tax rebates (or waivers), and priority regarding information services about investment opportunities, consular services, risk assessment and control, and insurance. Other examples include projects that provide better access to foreign markets and distribution, explore and exploit natural resources, build transportation and infrastructure facilities in both developed and developing countries, and move light manufacturing (like textiles, household appliances) into developing countries.

But why is the government supporting Chinese firms to invest abroad? Two reasons stand out.

First, China's institutional framework for OFDI seeks to help

such investment foster the emergence of globally competitive Chinese firms. This purpose, in turn, is the result of the interplay of two factors.

The first factor is the government's desire to have internationally competitive firms whose portfolio of locational assets provides better access to resources (natural and other resources) and markets and which themselves become a source of corporate competitiveness. For example, as early as 1997 former President Zemin Jiang stressed, in his report for the 15th National Congress of the Communist Party of China, that China should encourage OFDI to make better use of two markets and two types of resources (that is, domestic and international). This desire was reiterated later in many government reports and formulated into a major purpose of 'going global' in the 10th Five-Year Plan on Inward and Outward FDI in 2001. The second factor is the pressure on government from firms that seek to internationalise in response to domestic and international competition. Formal mechanisms through which firms can make themselves heard and exercise pressure on government policies include the National People's Congress and the Chinese People's Political Consultative Conference. For instance, major business elite representatives such as Dongsheng Li (President of TCL) and Shufu Li (President of Zhejiang Geely Group) encouraged the government to liberalise its OFDI review process and provide more resources and information to support OFDI. Deming Chen, Minister of Commerce at that time, responded that China's current approval process so far focused only on the direction and amount of OFDI, but would inevitably become less cumbersome.

Second, China's institutional framework for OFDI especially seeks to encourage investment that can be expected to contribute most to the country's national economic development. It does this by selectively supporting particular industries and activities in their internationalisation through FDI. For the national economy, broadening the scope and geography of investment means more options for economic restructuring and resource allocation optimisation. OFDI thus provides more resources and opportunities for economic growth. In addition, OFDI provides access to tangible and intangible resources directly relevant to China's development effort, beginning with raw materials but also including technology, brand names and others. This development objective is reflected in the fact that, as mentioned above, the government encourages OFDI through various instruments, in particular in industries and activities of special importance for the development effort.

These two objectives—the desire to nurture internationally competitive firms by helping them to establish a portfolio of locational assets and to use OFDI directly to advance the country's development effort—overlap to a large extent, at least for the time being, and they can be expected to be pursued for the foreseeable future. At the same time, in the framework of strengthening more market-supporting institutions in China, reforming the SOE sector and encouraging OFDI by private firms, Chinese firms can be expected to develop further their own firm-specific capabilities that will allow them to be successful in the world FDI market.

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