FDI and China's Economic Development - Review and Prospect

Jacylyn Y.J. Shi
Why China?

FDI and China’s Economic Development – review and prospect

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26 November, 2005
World Trade Institute
Bern, Switzerland
Global FDI Inflows Witnessed sharp increase and fluctuation 1990-2004

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).
Global FDI Inflows 2004

- 2% higher than 2003 ($648 bn)
- Inflows to developing countries surged 40%
- Developed countries FDI inflows dropped 14%
- Developing countries’ share of world total 36%
- Asia and Oceania is top destination of FDI flows among developing regions
China’s FDI Inflows

- 2004, contractual FDI inflows increased 1/3 over 2003, utilized FDI increased 13.3% to $61bn
- 3\textsuperscript{rd} largest FDI stock, after US and UK
- Largest FDI recipient among developing countries since early 1990s
- 50% FDI from HK, TW, Singapore and Japan
- US is China’s 2\textsuperscript{nd} largest investor (10.8% of total FDI inflow in 2000)
Questions for Discussion

- Part I. FDI in China: Recent trends and patterns
  - What made China become the most appealing destination of FDI?
  - What role has FDI played in China’s development?
  - Has China diverted investment from other Asian countries?

- Part II. What is the recent development of China’s outward FDI flow and its implication to world economy?
Part I
FDI in China: Recent Trends and Patterns
Total FDI in China Contracted and Utilized, 1990-2004 ($bn)
External and Internal Factors of China’s Economic Landscape

- **External**
  - International movement of capital
  - Flying geese paradigm

- **Internal**
  - “Exchange technology with market”
  - SOE reform
China’s FDI Policy Development

- **Stage I**: gradual and limited opening; (1979-1985)
- **Stage II**: active promoting through preferential treatment; (1986-1990)
- **Stage III**: promoting FDI in accordance with domestic industrial objectives. (1992-1999)
- **Stage IV**: “Go Global” (2001-2005)
Legal Framework of China’s FDI

- **1979.** *The Law of the PR China on Joint-Ventures using Chinese and Foreign Investment*
- **1983.** *Regulations for the implementation of the Law of the PR China on Joint-Ventures using Chinese and Foreign Investment*
- **1986.** *Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment*
- **1986.** *the Law of the People's Republic of China on Enterprises Operated Exclusively with Foreign Capital*
- **1994.** *Circular on Issues relating to Strengthening the Examination and Approval of Foreign-funded Enterprises*
- **1995.** *The Provisional Guidelines for Foreign Investment Projects*
FDI Control Measures
Four Approval Categories

- Encouraged
- Restricted
- Prohibited
- Permitted
FDI and Trade in China

FIEs % total export
FDI and Trade in China

FIEs % total import
# Top Origins of China’s FDI, 2004

**Ministry of Commerce, PR China**

<table>
<thead>
<tr>
<th>Origin</th>
<th>Amount Invested US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>$19.00 billion</td>
</tr>
<tr>
<td>British Virgin Islands</td>
<td>$6.73 billion</td>
</tr>
<tr>
<td>South Korea</td>
<td>$6.25 billion</td>
</tr>
<tr>
<td>Japan</td>
<td>$5.45 billion</td>
</tr>
<tr>
<td>United States</td>
<td>$3.94 billion</td>
</tr>
<tr>
<td>Taiwan</td>
<td>$3.18 billion</td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>$2.04 billion</td>
</tr>
<tr>
<td>Singapore</td>
<td>$2.01 billion</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>$1.13 billion</td>
</tr>
<tr>
<td>Germany</td>
<td>$1.06 billion</td>
</tr>
</tbody>
</table>
Hong Kong’s Peculiar Position in China’s FDI

• Contractual amount (1991-2000)
  63% -> 28%
• Actual investment
  60% -> 39%
• Springboard - Geographical adjacency
• “flying geese paradigm”
• “Roundtripping” “Recycling” of Capital
US Direct Investment in China, 1990-2004 ($ billions)
Sectoral Distribution of FDI in China

- **1979-1986**: labor-intensive manufacturing and real estate (48.6%)
- **1989-1991**: industry share at 80%
- **From 1990s**: every field of economy
- **By 2000**: industry and services accounted for 60.87% and 37.31% of total investment
- **Manufacturing**:
  - **1980s**: concentrated on traditional labor-intensive
  - **From 1992**: shifting to capital- and tech-intensive
  - **From mid-1990s**: IT industry
Geographical Distribution of FDI in China

- **1979-1980:** 4 SEZs
- **By 2000:** 65% investment concentrated in 4 provinces and one city
- **Eastern region:** 85%
- **Central region:** 1.12% -> 9.17%
- **Western region:** 5.59% -> 3.03%
Modes of FDI in China

- **EJ Vs**: equity joint venture
- **CJ Vs**: cooperative (contractual) joint venture
- **WFOs**: wholly foreign-owned enterprises
- **SH**: foreign share holding enterprise
- **JE**: joint exploration
China – “the factory of the world”

- Accumulated FDI close to $600 bn
- 450 among G500 Fortune Companies
- China produces
  - >50% of world cameras
  - 30% of air conditioners and television
  - 25% of washing machines
  - 20% of refrigerators
  - Expected to produce 20% cars by 2010
Problems with China’s FDI Policy

- Domestic firms have lagged behind
- Regional disparities have increased
## China: shares of exports by domestic companies and foreign affiliates, by group of products, 1996 and 2000

<table>
<thead>
<tr>
<th>Item</th>
<th>Total</th>
<th>Domestic companies</th>
<th>Foreign affiliates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yarns and fabrics</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>4,547</td>
<td>5,900</td>
<td>3,441</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>76</td>
</tr>
<tr>
<td>Toys</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>5,473</td>
<td>8,293</td>
<td>2,979</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>54</td>
</tr>
<tr>
<td>Travel bags</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>2,653</td>
<td>3,767</td>
<td>1,461</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>55</td>
</tr>
<tr>
<td>Electronic circuits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>996</td>
<td>4,105</td>
<td>216</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>22</td>
</tr>
<tr>
<td>Data processing, office machines and related products</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>5,391</td>
<td>16,547</td>
<td>940</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>17</td>
</tr>
<tr>
<td>Mobile phones (transmitter-receiver apparatus)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value</td>
<td>487</td>
<td>2,931</td>
<td>37</td>
</tr>
<tr>
<td>Per cent</td>
<td>100</td>
<td>100</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: UNCTAD, based on China Customs General Administration, 2002.

\(^{a}\)This database consists of the 200 largest companies and the 500 principal exports.
prosperity & poverty
advanced & backward
Uneven population distribution
China in Transition

- 400 million people lifted from poverty between 1978-2000 (World Bank)
- Gap between rural and urban incomes widened alarmingly (Gini coefficient rose from 29 in 1981 to 43 in 2003)
- Regional disparities widened (Shanghai GDP $5,500, Guizhou $400)
Most Attractive global business locations for 2005-2009: responses of experts and TNCs

Responses from experts
1. China (85%)
2. United States (55%)
3. India (42%)
4. Brazil (24%)
5. Russian Federation (21%)
6. United Kingdom (21%)
7. Germany (12%)
8. Poland (9%)
9. Singapore (9%)
10. Ukraine (9%)

Responses from TNCs
1. China (87%)
2. India (51%)
3. United States (51%)
4. Russian Federation (33%)
5. Brazil (20%)
6. Mexico (16%)
7. Germany (13%)
8. United Kingdom (13%)
9. Thailand (11%)
10. Canada (7%)
Most Attractive prospective R&D locations 2005-09 (UNCTAD)
Business perspective on China’s competitiveness as FDI location

- “Brazil is not a good location to compete worldwide. It is a good location to compete in Latin America. The freight charges to import components are very high, so it will be expensive to export to Europe and the US. It will not be competitive in comparison to buying from Malaysia or China.”

- A global Integrator supplier, 2000
Future Competitiveness in FDI

- Cheap labor
- Improved infrastructure
- Enhanced human capital, managers, skilled workforce
- R&D center
- Largest production platform – largest emerging market
- Further Trade liberalization
The Wage Ladder, Selected Economies, 2004 (UNCTAD)
WTO commitments and China’s FDI

- Advertising
- Banking
- Insurance
- Other services: courier, freight forwarding, hotel, restaurant, technical testing & analysis
- Direct selling law
Part II

China’s Outward FDI Flows (ODI)
Examples of Large-scale Chinese acquisition abroad

- **Lenovo + IBM:** $1.75 billion
- **Hier + Maytang:** $1.28 billion
- **Minmetals + Noranda:** CA$7.5 billion
- **SinoChem + Inchon Oil:** $544 million
- **Huaneng Group + OzGen:** $246 million
- **SAIC + Ssanyong Motor:** $500 million

*During the first 11 months of 2004, total 31 overseas M&A deals*
Women in the Xingu River in Brazil, parts of which would be drained if a proposed dam is built to generate power for Chinese-Brazilian projects (New York Time 2005)
Fact Sheet of China’s ODI

- Average FDI outflow = $3bn (1999-2004)
- Total ODI = $36bn
- Sales of Chinese firms operating overseas = $77bn (2002)
- Over 2000 firms operating overseas
- 43% of ODI from large Chinese SOEs (2003)
China’s accumulated outward FDI flows, 1982-2002 (billions of dollars)

Source: UNCTAD, FDI/TNC database.
## Regional Distribution of China’s FDI outflows, 1979-2002

<table>
<thead>
<tr>
<th>Rank*</th>
<th>Region</th>
<th>1979-2002</th>
<th>Number of Projects</th>
<th>Cumulative investment value (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Asia</td>
<td>3 672</td>
<td></td>
<td>5 482</td>
</tr>
<tr>
<td>2</td>
<td>North America</td>
<td>847</td>
<td></td>
<td>1 270</td>
</tr>
<tr>
<td>3</td>
<td>Africa</td>
<td>585</td>
<td></td>
<td>818</td>
</tr>
<tr>
<td>4</td>
<td>Latin America</td>
<td>362</td>
<td></td>
<td>658</td>
</tr>
<tr>
<td>5</td>
<td>Europe</td>
<td>1 194</td>
<td></td>
<td>561</td>
</tr>
<tr>
<td>6</td>
<td>Oceania</td>
<td>300</td>
<td></td>
<td>549</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>6 960</strong></td>
<td></td>
<td><strong>9 340</strong></td>
</tr>
</tbody>
</table>
Sectoral Distribution of China’s ODI

- Information technology, computers and software (33%)
- Distribution, wholesale/retail and mining (20%)
- Manufacturing, trade, trade services and construction
Driving Forces of China’s ODI

- “Go Global” Policy
- Market expansion
- Technology acquisition
- Jump trade barrier
- Energy security
- Transfer excessive productive capacity
- Growing financial strength
China’s global investment in energy sector

- Oil investment in 14 countries
  - Angola, Indonesia, Iran, Kazakhstan, Sudan, Venezuela, Yemen
- CNPC invested $2.7 billion in Sudan
  - Accumulated $5 billion worth of assets
- Sinopec and Petrobras: gas pipeline $1.2b
- In Argentina total $5b in oil exploration
- $100 billion investment in Latin America in the next 10 years
## Motivators for Chinese ODI

<table>
<thead>
<tr>
<th>Investment Motivators</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market expansion</td>
<td>1</td>
</tr>
<tr>
<td>Long-term development strategy</td>
<td>2</td>
</tr>
<tr>
<td>Acquiring technology</td>
<td>3</td>
</tr>
<tr>
<td>Learning Management skills</td>
<td>4</td>
</tr>
<tr>
<td>Avoidance of trade barriers</td>
<td>5</td>
</tr>
<tr>
<td>Usage of foreign preferential investment policies</td>
<td>6</td>
</tr>
<tr>
<td>Cost reduction</td>
<td>7</td>
</tr>
<tr>
<td>Acquisition of productive materials</td>
<td>8</td>
</tr>
<tr>
<td>Transference of excessive production capacity</td>
<td>9</td>
</tr>
</tbody>
</table>
Future ODI intentions of Chinese companies

<table>
<thead>
<tr>
<th>Fields of Future ODI Activities</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading</td>
<td>54.5%</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>18.4%</td>
</tr>
<tr>
<td>Resource extraction, handling or processing</td>
<td>7.0%</td>
</tr>
<tr>
<td>Business services</td>
<td>5.7%</td>
</tr>
<tr>
<td>Technical services</td>
<td>4.9%</td>
</tr>
<tr>
<td>Other</td>
<td>3.3%</td>
</tr>
<tr>
<td>IT products and services</td>
<td>3.3%</td>
</tr>
<tr>
<td>Agriculture or agri-business</td>
<td>2.5%</td>
</tr>
<tr>
<td>Financial services</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

244 of 296 companies (82%)
Obstacles for China’s ODI

**Internal**
- Technology
- Capital
- Human resources
- Corporate governance
- Comprehension of international laws

**External**
- National security, human rights, subsidization
- Absence of international law
Experts’ view on China’s Competitiveness and weakness in ODI

- The strengths of these firms are that “they have very low-cost positions and great value engineers”.

- Their weaknesses. "They are critically short of talent and their management teams spread very thin," "Their products are not unique enough - they need more product innovation. They also need to maintain a strong core business at home."

-- by Paul DiPaola, Managing Director, Bain & Company China
Thank you!

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