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What determines Chinese outward FDI?

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ABSTRACT

Chinese outward foreign direct investment (FDI) has increased substantially in recent years. Though this has generated considerable interest in the motivations and drivers of Chinese investment abroad, there have been few systematic empirical studies of these questions. This paper performs an econometric analysis of the host country determinants of Chinese outward FDI in the period 2003–2006. We find that Chinese outward FDI is attracted to large markets, and to countries with a combination of large natural resources and poor institutions. Disaggregation shows that the former effect is related to OECD countries, whereas the latter interaction effect holds for non-OECD countries.

1. Introduction

Is Chinese outward foreign direct investment (FDI) primarily drawn to poorly governed countries with abundant natural resources? In recent years, the Chinese financial presence globally has increased substantially, in terms of loans provided, investments made, and other types of flows. In particular, there has been a marked rise in outward Chinese foreign direct investment in recent years. This has spurred discussion and analyses of the motivation and implications of an increased Chinese presence, not least in developing economies. On the one hand, increased Chinese investment may be good for host countries, since more companies vie for locations and markets, and potentially expand opportunities for transfer of technology. On the other hand, however, concerns have been voiced that Chinese investment or financial flows more generally have contributed to propping up bad regimes in host countries, and have been conducted with a view to exploiting their natural resources. To borrow a headline from *The Economist*, is China simply "a ravenous dragon" or is there more to Chinese investment than this?[2]

Though Chinese outward FDI has generated considerable interest, concern and controversy, few empirical studies have been conducted to test the motives behind or consequences of the presence of Chinese multinationals in other countries. There is by now a large econometric literature on the host country determinants of FDI in general, which, if anything, suggests that FDI is attracted to countries with good institutions (Globerman & Shapiro, 2002). Since FDI in general is dominated by flows from developed countries, it is an open question whether these results generalize to Chinese outward FDI. Moreover, there is an emerging literature on FDI flows from emerging economies that suggests that these flows may differ from those of developed economies (Filatotchev, Strange, Piesse, & Lien, 2007). Most studies of FDI related to China, have focused on China as a location for FDI from other countries, rather than as a source of FDI. To date there are only three econometric studies of the determinants of Chinese outward FDI that we are aware of, which present mixed results. Buckley et al. (2007) find that Chinese FDI is attracted to countries with bad institutions (high political risk), whereas Cheung and Qian (2008) find no significant effect of institutions. The latter study finds Chinese FDI to be attracted by natural resources, the former gets this result only for later time periods. A third study by Cheng and Ma (2008) does not include institutions nor resources as explanatory variables.

This paper presents new econometric results on the host country determinants of Chinese outward FDI, which significantly improve on previous studies. A main problem with the studies of Buckley et al. (2007) and Cheung and Qian (2008) is that their data on FDI captures approved investment, rather than actual investment.[3] The results are therefore potentially biased, as investment that is publicly approved may be of a character different from investment decisions that are less visible. For instance, non-approved flows may reflect private investment decisions based on different objectives than government approved flows, or public

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[2] The Economist, March 15th 2008, Special report p. 3.

[3] Approved investment numbers also did not include reinvested earnings, leading to serious underestimates of Chinese FDI (Cheng and Ma, 2008). Cai (1999) suggests that only 15–20% of actual financial outflows in the period up to the late-1990s were approved.

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Table 1
Largest 15 host countries of Chinese outward FDI, 2003–2006 flows, current USD mill. and shares.

	2003	2004	2005	2006	Total 2003–2006	Share 2003–2006
Cayman Islands	806.61	1286.13	5162.75	7832.72	15088.21	0.39
Hong Kong, China	1148.98	2628.39	3419.7	6930.96	14128.03	0.37
British Virgin Islands	209.68	385.52	1226.08	538.11	2359.39	0.06
Korea, Republic of	153.92	40.23	588.82	27.32	810.29	0.02
Russian Federation	30.62	77.31	203.33	452.11	763.37	0.02
United States	65.05	119.93	231.82	198.34	615.14	0.02
Australia	30.39	124.95	193.07	87.6	436.01	0.01
Sudan		146.7	91.13	50.79	288.62	0.01
Germany	25.06	27.5	128.74	76.72	258.02	0.01
Algeria	2.47	11.21	84.87	98.93	197.48	0.01
Singapore	-3.21	47.98	20.33	132.15	197.25	0.01
Nigeria	24.4	45.52	53.3	67.79	191.01	0.00
Mongolia	4.43	40.16	52.34	82.39	179.32	0.00
Indonesia	26.8	61.96	11.84	56.94	157.54	0.00
Kazakhstan	2.94	2.31	94.93	46	146.18	0.00
Total (all countries)	2854.64	5498.01	12261.17	17633.97	38247.79	1.00

investment decisions reflecting motives a government may be reluctant to reveal, such as a drive for natural resources, or the exploitation of host countries with poor institutions. This paper uses more recent data on actual Chinese FDI flows, and therefore provides more reliable results on the impact of host country institutions and resources on Chinese investment. Moreover, previous studies have looked at institutions and natural resources in isolation, and not explored whether the two have a joint influence on Chinese FDI. By contrast, this study tests and finds of significant importance an interacted effect of institutions and resources, suggesting that Chinese investment is more attracted to a country with natural resources, the worse the institutional environment of that country. This result holds even when controlling for the stage of resource exploitation of host countries, which suggests that it is not due to China having only poorly governed countries left to invest in as a latecomer in foreign direct investment.

The paper is structured as follows. Section 2 provides a descriptive overview of Chinese FDI flows, and relates this to the existing empirical literature on the topic. Since there are suggestions that Chinese FDI reflects different motives than FDI generally, Section 3 reviews theoretical arguments as to why this may be the case, leading to a set of testable hypotheses relating to the impact of natural resources and institutions. Section 4 then presents the empirical strategy and the data of the paper. Results on the impact of institutions and natural resources on Chinese FDI are presented and discussed in Section 5, which also addresses the robustness of the results. Section 6 concludes the study.

2. Chinese outward FDI: Patterns and evidence

2.1. Descriptive overview of Chinese outward FDI

Outward foreign direct investment from China has increased considerably in recent years, and China is the source of FDI in a great number of host economies. While the open door policy in the late-1970s lead to modest outward FDI, the liberalization associated with Deng Xiaping's tour of South China in 1992, and the Go Global strategy initiated in 1999, lead to boosts in Chinese outward FDI. Outward FDI in recent years has increased substantially (Buckley et al., 2007; Cai, 1999; Cheng & Ma, 2008; Hong & Sun, 2006). While China accounted for 3.3% of total outward investments from developing countries in 1996, its share had risen to 10% in 2006. This makes China the 3rd largest developing country in terms of outward FDI (after Hong Kong and Brazil), up from 7th position in 1996. In global terms, however, China was only the 17th largest country in terms of outward FDI flows in 2006, and small in comparison to the major industrialized economies.[4]

China started publishing outward FDI data consistent with OECD and IMF standards only in 2003 (Cheung & Qian, 2008). According to the data from UNCTAD used in this study, 142 countries received investment from China in the period 2003–2006. Table 1 presents the 15 largest host economies for Chinese FDI, as well as the total flows for the four years for which comprehensive data is available. As the bottom row of the table shows, total FDI from China has increased more than six times in current terms in the period 2003–2006. The far right column shows that the bulk of the investment, more than 80%, goes to offshore financial centres such as the Cayman Islands and the British Virgin Islands, and to Hong Kong. However, a number of other countries receive substantial amounts in absolute terms, this includes both OECD and non-OECD countries.

From a cursory inspection of the largest recipient countries, countries that are tax havens, geographically close to China, that are endowed with natural resources in the form of petroleum, or that represent large markets, appear to attract Chinese investment. A number of the largest host countries to Chinese FDI also have poor institutional records. Sudan, for instance, is among the 7–8 least democratic and most corrupt countries in the world, accordingto 2008 Freedom House and Transparency International indices.[5] Table 2 breaks Chinese FDI into host regions, where the dominant flows are to Latin American and the Caribbean, and to Asia. Again these data reflect tax haven status or geographical vicinity. Interestingly, though receiving a small share of the total, Africa is host to more Chinese FDI than Europe, North America or Oceania.

As for sectoral composition, just over 40% of Chinese outward FDI flows in 2006 were in the mining and petroleum sector. Almost 54% was in various service industries (mainly business services and finance) and only 4% in manufacturing (Cheng & Ma, 2008). Though these proportions fluctuate from year to year, this again would seem to suggest that accessing large markets and natural resources are important aspects of Chinese outward FDI. It is likely that service industry investments gravitate more towards developed countries, and resource investment to developing countries. Unfortunately, currently available data do not permit cross-classification by industry and country, making it difficult to be more precise about sector distribution in individual regions or countries. However, we return to the question of distinctions in

[4] See http://www.unctad.org/sections/dite_dir/docs/wir2008_outflows_en.xls.
[5] See http://www.freedomhouse.org/template.cfm?page=410&year=2008 and http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table.