

Chapter 12

Chinese Outward Foreign Direct Investment: In Search of a New Theory

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ABSTRACT

In past years, China recorded a fast sustainable economic growth with an estimated average GDP growth rate of 9.7% in the period of 1980-2008, turning China into the world's second largest economy. With an export oriented economic model, China is the most attractive developing country for FDI flows, both short and long term. In this regard, China has been able to achieve a foreign exchange reserve of US\$ 2.2 trillion, the world's largest reserve currency. Around 50% of this huge reserve is being applied in American bonds, while the remaining supports Chinese health and social security systems, bank solvability, internationalization of their economy, investment in geostrategic positioning, and making foreign aid available to other developing countries. During the 2008 global crisis, China was able to resist better than other major world economies, benefitting from this downturn to implement policies to reduce its economic imbalances. One of these imbalances is the gap between Chinese FDI and OFDI, which is now progressively narrowing. In the near future, OFDI is expected to be larger than FDI, and in this paper, the authors research whether Chinese OFDI can be explained by existing theories or if a new theory is required.

INTRODUCTION

Due to the Reform and Open Door Policies initiated in 1978, China recorded a fast sustainable economic growth with an estimated average GDP growth rate of 9.8% in the period of 1980-2009,

turning China, in 2009, into the world's second largest economy, just after USA. With an export oriented economic model, highly supported by Foreign Direct Investment (FDI), mostly from developed countries, China is, since 2002, the most attractive developing country for FDI flows, both at short and long terms, becoming not only the world's factory, but also its number one exporter,

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after surpassing Germany in 2009. With the biggest current account surplus balance of US\$ 253.3 billion in 2009, China has been able to achieve a foreign exchange reserve of US\$ 2.3 trillion, the world's largest reserve currency. Around 50% of this huge reserve is being applied in American bonds, while the remaining supports Chinese health and social security systems, Chinese banks' solvability, internationalization of the Chinese economy, investment in geostrategic positioning to guarantee energy independence and foreign aid to other developing countries.

During 2008's global crisis, China was able to resist better than the major world economies, even benefitting from this downturn to implement policies to reduce its economic imbalances. One of these imbalances is the gap between FDI in China and Outward Foreign Direct Investment (OFDI) of China which is now progressively narrowing. In fact, in the near future, OFDI is expected even to be larger than FDI, Davis (2009) refer that "*China OFDI accounts for not much more than 1% of the global total, far below the country's share of the world trade. However, this total is rising fast and the country will eventually become a major source of global FDI.*"

Mostly two types of Chinese OFDI can be distinguished: trade-oriented investment and resource-seeking investment. Governmental backing has been crucial for the resource-seeking investment. Although the Chinese investment is nowadays more oriented to mature economies, its bulk is mainly directed to the other developing countries mainly to Asian countries, Latin America, and now also to African countries.

LITERATURE REVIEW

FDI is presently one of the most important variables of the international business flows. FDI is defined as an investment, involving a long-term relationship and reflects the objective of establish a lasting interest and control by an individual or

organization the foreign direct investor of one country in an enterprise of a foreign country (Foreign Invested Enterprise - FIE). FDI implies that the investor exerts a significant degree of management and control in the FIE. This can be done either by the transfer of capital flows to create a new venture (green field investment) or by the acquisition of equity capital in an enterprise already existing in a foreign country. Reinvested earnings in the FIEs or short or long-terms loans between the foreign direct investor and the FIE is also consider FDI (UNCTAD, 2009).

OECD (2008) benchmarking definition of FDI, adds that the lasting interest implying a long-term relationship and a significant degree of influence, management and control requires at least the direct or indirect ownership of 10% of the voting power. Basically OECD defines FDI as an investment of an entity resident in one country that has acquired, either directly or indirectly at least 10% of the voting power of a corporation or equivalent for an incorporated company resident in another country. The entity that invests abroad can also contribute with other assets either than equity capital, like technology and production knowledge, that although being intangible assets can be evaluated and considered in the capital invested in the venture or can be considered non-equity forms of investment.

Yan (2005) resumes FDI to two types of economic activities the firm's equity based investment, including the purchase of equity shares in foreign firms in foreign countries and the establishment of firms operations and management in foreign countries the equity based production.

International Business (IB) and Marketing theories, consider FDI (new ventures, joint ventures and acquisitions) as one mode of entry into foreign markets, and in fact as the one which reflects the higher degree of commitment to those markets, allowing the higher involvement in the management and control of the ventures. Bradley (2002) refers that FDI in new ventures, joint ventures or acquisitions can only be consider

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