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**THESIS**

**GOING GLOBAL: THE ECONOMIC AND  
GEOPOLITICAL EFFECT OF CHINA'S INCREASING  
OUTWARD FOREIGN DIRECT INVESTMENT**

by

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March 2013

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CHINA'S INCREASING OUTWARD FOREIGN DIRECT INVESTMENT**

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## **ABSTRACT**

Since at least 2002, Beijing has emphasized a policy of “going global” for state-owned enterprises, as well as, privately-owned domestic enterprises, that has led to over \$68 billion of outward foreign direct investment from China. Outward foreign direct investment has been speculated as one possible medium for Beijing to exert soft power or engage in economic diplomacy, yet there is scant analysis on how OFDI has affected the Asia-Pacific regional geopolitical environment. This thesis attempts to bridge this gap in understanding by analyzing the economic effect of Chinese OFDI actions and presenting the historic and current scope of Chinese OFDI, interpreting Chinese OFDI through the lens of economic theory and realist theory, and tracking the changes in the geopolitical environment in the Asia-Pacific region since 2002 on a country-by-country basis. Overall, Chinese OFDI appears to be mostly in line with economic theory and has provided modest benefits to the Chinese economy, but there have been inconsistent and unpredictable shifts in the geopolitical environment in the Asia-Pacific region during China’s “Go Global” campaign.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

ASEAN	Association of South East Asian Nations
BRIC	Brazil, Russia, India, and China
CCP	Chinese Communist Party
CIC	China Investment Corporation
CITIC	China International Trust and Investment Corporation
CMCC	China Metallurgical Construction Company
CNOOC	Chinese National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
DPRK	Democratic People’s Republic of Korea (North Korea)
ECFA	Economic Cooperation Framework Agreement
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
JVE	Joint Venture Enterprises
MCC	China Metallurgical Group Corporation
MNC	Multinational Corporations
MOFCOM	Ministry of Commerce
MOFERT	Ministry of Foreign Economic Relations and Trade
MOFTEC	Ministry of Trade and Economic Cooperation
NDRC	National Development and Reform Commission
NOC	National Oil Companies
OFDI	Outward Foreign Direct Investment
OPEC	Organization of Petroleum Exporting Countries

PIF	Pacific Island Forum
PNOC	Philippine National Oil Company
PRC	People's Republic of China
ROC	Republic of China (Taiwan)
ROK	Republic of Korea (South Korea)
SAFE	State Administration of Foreign Exchange
SCS	South China Sea
SETC	State Economic and Trade Commission
SOE	State-Owned Enterprise
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WIR	World Investment Report
WOS	Wholly-Owned Subsidy

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# I. INTRODUCTION

## A. MAJOR RESEARCH QUESTION

This thesis researches the effect of Chinese outward foreign direct investment (OFDI) on the Chinese economy and on the geopolitical environment. Divided into five parts, the following questions are addressed. First, why do firms, or states as may be in the case of China, invest abroad? Second, how should the historic and current scope of China's OFDI be assessed? Third, how has Chinese OFDI affected the Chinese economy? Fourth, how do leading economic theories on OFDI and the realism theory of international relations account for the rise and increasing importance of Chinese OFDI? And last, what has been the geopolitical effect of Chinese OFDI on stability, security, cooperation, and economic interdependence in Asia, and specifically in the Asia-Pacific region?

## B. IMPORTANCE

Chinese outward foreign direct investment has grown from practically nothing prior to Deng Xiaoping's economic reforms in 1978 to over \$68 billion annually in 2010.<sup>1</sup> Additionally, since at least 2002, Beijing has emphasized a policy of "going global" for state-owned enterprises, as well as for privately-owned domestic enterprises.

The increase in China's OFDI, combined with growing tensions over its territorial claims, military modernization, and apprehension over economic turmoil from the global recession, has sparked fears that China will begin to challenge the current social, economic, and political order. Chinese investments in the Sudan, Myanmar, Pakistan, North Korea, and other states have been perceived by the West as having ulterior motives not limited to establishing a geo-strategic network to further expansionary goals and secure access to hydrocarbon energy resources.<sup>2</sup> Further, significant, high-profile

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<sup>1</sup> Ministry of Commerce, *2010 Statistical Bulletin of China's Outward Foreign Direct Investment*, (Beijing, China: People's Republic of China, 2011), 79.

<sup>2</sup> Juli A. MacDonald, Amy Donahue, and Bethany Danyluk, *Energy Futures in Asia: A Final Report* (McLean, Virginia: Booz-Allen Hamilton, 2004).

acquisitions and mergers in the natural resources sector, such as the unsuccessful bid by the Chinese National Offshore Oil Corporation's (CNOOC) for the now defunct U.S.-based petroleum exporter Unocal in 2005, and the ongoing, but seemingly successful, acquisition of Canadian-based oil and gas producer Nexen by CNOOC, have sparked fears that China's outward expansion by state owned enterprises is part of a larger grand strategy by Beijing. Indeed, the perception in the West of these actions has led to turbulent and possibly deteriorating relations between the China and the United States as seen in statements during U.S. Congressional hearings that China is pursuing a mercantilist strategy against the United States.<sup>3</sup>

Yet, as China's economy and especially the massive amount of foreign reserves held by the Chinese government continue to grow, the possibility of further antagonistic and adversarial relationships increases because of China's increasing OFDI and could threaten to destabilize the region. Thus, a faulty or incomplete understanding of the effects and implications of Chinese OFDI could unnecessarily threaten the stability of the region.

### **C. PROBLEMS AND HYPOTHESE**

While the possibility that Chinese investment abroad could plausibly be part of a larger global strategy, the reaction by the West should not default to this conclusion and, in fact, could be wrong. A great deal of analysis and research has been slanted toward the premise that Chinese OFDI is a potential national security threat while failing to investigate alternative possibilities.

I believe, and this thesis hypothesizes, that the scope of Chinese OFDI will be equally motivated by both economic and strategic, or national security, imperatives. Tied closely together since economic prosperity has been seen a path for the CCP's political legitimacy, investment abroad in both economic and national security fields like petroleum-based natural resources will drive both possible interpretations of Chinese

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<sup>3</sup> Steven Lohr, Andrew Ross Sorkin, and Jad Mouawad, "Unocal Bid Denounced at Hearing," *New York Times*, July 14, 2005.

OFDI. Further, I hypothesize that there will be a moderate growth in the share of Chinese OFDI in the various global geographic regions like South America, Africa, and Europe.

Additionally, this thesis hypothesizes that assessing Chinese OFDI through economic theory and realist lens shows that both lenses do not entirely account for investment actions, but each lens will conform to certain aspects of China's OFDI patterns.

Finally, this thesis hypothesizes that Chinese OFDI's geopolitical effect may serve to stabilize and pacify tensions. The outward investment will compel China to promote stability, and suppress hostile or destabilizing actions in regions where Chinese OFDI has been invested because that would just undermine its ability to generate a return on its investment.

#### **D. LITERATURE REVIEW**

As the main subject and argument of this thesis is to determine the effect of Chinese OFDI on the geopolitical environment, there is a broad range of literature touching different aspects under review. This review first assesses the literature on multinational enterprises in the global economy and OFDI theory. Second, the review assesses the contemporary study of the Chinese economy and the depth of available knowledge specifically on Chinese multinational corporations, OFDI, and the economic effects of OFDI. There follows a survey of international relations theory and how that relates to political economy and other economic activities such as investing abroad. Finally, the review summarizes what analysis is available on the geopolitical security implications of China's rising economic power, and the predictions China's OFDI has on the Asia-Pacific region and the global environment.

John H. Dunning's *Multinational Enterprises and the Global Economy* is, perhaps, one of the seminal publications on OFDI theory and framework. While nearly twenty years have passed since Dunning published the textbook, the analysis provided is still very much current. In it, Dunning conceptualizes his eclectic paradigm as a "general framework for determining the extent and pattern of both foreign-owned productions

undertaken by a country's own enterprises."<sup>4</sup> This paradigm which features a theoretical framework based upon three pillars of foreign market-seeking direct investment, efficiency, or cost reduction,-seeking direct investment, and resource-seeking direct investment is still used in contemporary analysis of determinants of OFDI.<sup>5</sup> One commonly mentioned criticism of Dunning's theory is that it was built upon analysis of OFDI stemming from developed nations and it may not hold as true for OFDI coming from developing nations. Regardless, it is still a very informative and though basis for the theoretical underpinnings of OFDI.

Peter Buckley and Mark Casson provide the second major theory of OFDI with the internalization theory where firms "internalize missing or imperfect external markets" focusing on lowering costs.<sup>6</sup> This second theory is still relevant today and is an excellent microeconomic theoretical basis for analyzing China's OFDI.

Using Dunning's eclectic paradigm and the internalization theory, Buckley et al. developed one of the first empirical tests of the two theories against the recent historical record.<sup>7</sup> Using data provided by the United Nations, the Chinese government, International Monetary Fund, and World Bank, Buckley et al. analyzed Chinese OFDI through 13 different hypotheses. This is an important and useful analysis of Chinese OFDI because previous assessments by Kevin Cai, John Wong, and Sarah Chan, to name a few, relied on comparative and interpretive analysis.<sup>8</sup>

Previously mentioned earlier as primarily relying on comparative, interpretive, and historical analysis, Cai, Wong, and Chan still provide important additions to the

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<sup>4</sup> John H. Dunning, *Multinational Enterprises and the Global Economy* (Wokingham, England: Addison-Wesley Publishing Company, 1993), 76.

<sup>5</sup> See Peter J. Buckley et al., "The Determinants of Chinese Outward Foreign Direct Investment," *Journal of International Business Studies* 38, no. 4 (July 2007): 499–518.

<sup>6</sup> See Peter J. Buckley and Mark Casson, *The Future of the Multinational Enterprise* (New York: Holmes & Meier Publishers, Inc., 1976).

<sup>7</sup> Peter J. Buckley et al., "The Determinants of Chinese Outward Foreign Direct Investment."

<sup>8</sup> See Kevin G. Cai, "Outward Foreign Direct Investment: A Novel Dimension of China's Integration into the Regional and Global Economy," *The China Quarterly* 160 (December 1999): 856–80; John Wong and Sarah Chan, "China's Outward Direct Investment: Expanding Worldwide," *China: An International Journal* 1, no. 2 (September 2003): 273–301.

literature regarding Chinese OFDI. Further, one of the most recent analyses of Chinese OFDI is by Daniel Rosen and Thilo Hanemann who present a very balanced and thorough synthesis of new and emerging trends in the policy and direction of Chinese OFDI in the wake of the global financial crisis.<sup>9</sup> For historical perspective, Michael McDermott and Chun Hua Huang present an early, descriptive account of Chinese OFDI from 1985 to 1992 when outward investment was truly in its infancy.<sup>10</sup> These works are particularly important because some of the most authoritative accounts of the Chinese economy, in general, like Barry Naughton's textbook, *The Chinese Economy*, provided scant attention to the growing importance of OFDI.<sup>11</sup>

There is a growing wealth of literature on Chinese OFDI that analyzes the phenomenon through a firm specific lens. Yongjin Zhang provides deep investigations into China International Trust and Investment Corporation (CITIC), Sinochem, and Shougang, while Alan Rugman assesses the prospects and makes predictions on the future performance of Chinese transnational corporations through an analysis of the largest Chinese MNCs listed in *Fortune* Global 500.<sup>12</sup> Rugman's synthesis of UNCTAD 2004 data is particularly insightful in demonstrating that OFDI stocks from Chinese MNCs comprise only a small portion of overall GDP, and his conclusion that MNCs "from emerging markets are not operating globally," has significant impacts for the prospects of stability if one believes that OFDI is a driver of liberal interconnectedness and stability.

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<sup>9</sup> See Daniel H. Rosen, and Thilo Hanemann, "China's Changing Outbound Foreign Direct Investment Profile: Drivers and Policy Implication," *PIIE Policy Brief* PB 09-14 (Washington, D.C.: Peterson Institute for International Economics, 2012).

<sup>10</sup> See Michael McDermott and Chung Hua Huang, "Industrial State-owned Multi-nationals from China: The Embryonic Years, 1985-1992," *Asia Pacific Business Review* 3, no. 1 (1996): 3-15.

<sup>11</sup> See Barry Naughton, *The Chinese Economy Transitions and Growth* (Cambridge, Massachusetts: MIT Press, 2007), 402-424, section covering foreign investment hardly covers or reviews outward investment, focusing solely on inward investment.

<sup>12</sup> See Yongjin Zhang, *China's Emerging Global Businesses: Political Economy and Institutional Investigations* (New York: Palgrave-MacMillan, 2003); Alan Rugman, "How Global are TNCs from Emerging Markets?" in Karl P Sauvart, ed., *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity* (Cheltenham, UK: Edward Elgar, 2008), 96-7.

Making use of an institutional lens for the review of Chinese OFDI is Hinrich Voss, Peter J. Buckley, and Adam R. Cross's analysis of how governmental policies and decisions have affected OFDI over the past 34 years since the implementation of Deng Xiaoping's "open" policies.<sup>13</sup>

Addressing scholarly critiques that current theories of OFDI and MNC are biased toward MNC and OFDI from developed nations, a few authors have taken to analyzing the current theories from emerging markets. Specifically, works by Karl Sauvant and an entire volume of works edited by Subhash C. Jain, uses the so-called BRIC nations of Brazil, Russia, India, and China to present conclusions as to the nature, performance, and future potential of multi-national corporations and outward investment from these states.<sup>14</sup>

Moving toward the review of the literature pertaining to the effect of economics in terms of international relations, there has been a wide swath of theoretical analysis by numerous authors. Robert Gilpin's *The Political Economy of International Relations* is a standard pallbearer in terms of side-by-side analysis of the tenants of realist (or as he calls it, nationalist) political economy, liberal institutionalism political economy, and Marxist political economy.<sup>15</sup> Supplementing the realist perspective on political economy, Jonathan Kirshner's chapter in Ethan B. Kapstein and Michael Mastanduno's volume on realism and state-strategies in the post-Cold War era attempts to meld traditional beliefs

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<sup>13</sup> See Hinrich Voss, Peter J. Buckley, and Adam R. Cross, "An Assessment of the Effects of Institutional Change on Chinese Outward Direct Investment Activity," in Ilan Alon, Julian Chang, Marc Fetscherin, Christoph Lattemann, and John R. McIntyre, eds. *China Rules: Globalization and Political Transformation* (New York: Palgrave-MacMillan, 2009, PDF e-book), 135–9.

<sup>14</sup> See Karl P. Sauvant, ed., *The Rise of Transnational Corporations from Emerging Markets: Treat or Opportunity* (Northampton, Massachusetts: Edward Elgar Publishing, Inc., 2008); Karl P. Sauvant, "New Sources of FDI: The BRICs, Outward FDI from Brazil, Russia, India and China," *Journal of World Investment & Trade* 6, no. 5 (October 2005): 639–709; Subhash C. Jain, ed. *Emerging Economies and the Transformation of International Business: Brazil, Russia, India, and China (BRICs)* (Northampton, Massachusetts: Edward Elgar Publishing, Inc., 2006).

<sup>15</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton, NJ: Princeton University Press, 1987).

on free trade to support realist positions.<sup>16</sup> Further rounding out the realist theory library is John Mearsheimer's *The Tragedy of Great Power Politics*, Kenneth Waltz's *Theory of International Politics*, and Hans Morgenthau's *Politics Among Nations: The Struggle for Power and Peace*.<sup>17</sup> Finally, Friedrich List presents, perhaps, one of the earliest economic nationalist perspectives in *The National System of Political Economy*.<sup>18</sup>

Segueing toward the conclusion of this literature review is the combination the topics of economy and geopolitical security. Literature surveying this combination of topics usually focuses on regional level assessments of China's economic growth and its effect on the region. For Asia, *China's Rise and the Balance of Influence in Asia* takes together a diverse set of essays produced from different conferences and using a wide range of datasets, not limited to just the World Bank, International Monetary Fund (IMF), and Chinese ministries; the two editors, William W. Keller and Thomas Rawski optimistically blend China's rising economic power with the shifting geo-political environment. As with other surveys of Chinese capital investment inflows and outflows, *China's Rise* gives less attention to outward investment flows from China, however, it does discuss the effect of changing levels of FDI in the Asia Pacific region.<sup>19</sup> Similarly, *China's Economic Growth and the ASEAN* provides a more focused assessment of changing trade, investment, and economic policy by China in primarily the Philippines but does survey the rest of Southeast Asia.<sup>20</sup>

Along with growing analysis of the effect of China's economic growth in Asia, new literature and reports are being made about the effect of China's economic growth in

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<sup>16</sup> Jonathan Kirshner, "The Political Economy of Realism," in Ethan B. Kapstein and Michael Mastanduno, eds., *Unipolar Politics: Realism and State Strategies After the Cold War* (New York: Columbia University Press, 1999), 69–88.

<sup>17</sup> John Mearsheimer, *Tragedy of Great Power Politics* (New York: W. W. Norton & Co. Inc., 2002); Kenneth N. Waltz, *Theory of International Politics* (New York: McGraw-Hill Publishing, 1979); Hans J. Morgenthau, *Politics Among Nation: The Struggle for Power and Peace* 5th ed. (New York: Knopf, 1972).

<sup>18</sup> Frederich List, *The National System of Political Economy*, trans. Sampson S. Lloyd (Kitchener, Ontario, Canada: Batoche Books, 2001, E-book).

<sup>19</sup> William W. Keller, and Thomas Rawski, eds., *China's Rise and the Balance of Influence in Asia* (Pittsburg, PA: University of Pittsburgh Press, 2007).

<sup>20</sup> Ellen H. Palanca, ed., *China's Economic Growth at the ASEAN* (Manila, Philippines: Raintree Publishing, Inc., 2001).

Africa and Latin America. For Africa, the Sino-Sudan relationship and investment has received numerous amounts of scrutiny, and most other Sino-African analysis have focused China's relationship with regimes having dubious human rights records, resource extraction, and consequences for the region.<sup>21</sup> For the Latin American region, using a wide range of data sets, Barbara Kotschwar, Theodore H. Moran, and Julia Muir provide a comprehensive and extremely current analysis of Chinese investment in the Latin American natural resource sectors.<sup>22</sup> Further reviewing Chinese involvement in Latin America is the volume edited by Riordan Roett and Guadalupe Paz, *China's Expansion into the Western Hemisphere: Implication for Latin America and the United States*.<sup>23</sup> Roett and Paz assess the effects of China investments in Latin America, paying particular attention to lessons from Chinese investment in Southeast Asia and Africa, and the impact and possible complications of the United State-Latin America relationship. These and other regional perspectives are insightful because they provided a contextual basis for reviewing China's rise especially regarding outward direct investment and so-called economic statecraft, commercial diplomacy, and the political economy of Chinese international relations.

## **E. METHODS AND SOURCES**

As the goal of this thesis is analyze the effect of Chinese outward foreign direct investment (OFDI) on the Chinese economy and on the geopolitical environment, the methodology to do so corresponds basically to a comparative study of the statistical analyses of Chinese OFDI in the Asian region, utilizing not only historical studies and

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<sup>21</sup> See Denis M. Tull, "China's Engagement in Africa: Scope, Significance and Consequences" *The Journal of Modern African Studies* 44, no. 3 (September 2006): 459–79; Luke Anthony Patey, "Oil Companies and Armed Conflict in Sudan," *Third World Quarterly* 28, no. 5 (2007): 997–1016; Stephanie Kleine-Ahlbrandt and Andrew Small, "China's New Dictatorship Diplomacy: Is Beijing Parting with Pariahs?" *Foreign Affairs* 87, no. 1 (January-February 2008): 38–56; George T. Yu, "China's African Policy: South-South Unity and Cooperation," in Lowell Dittmer, and George T. Yu, eds., *China, the Developing World, and the New Global Dynamic* (Boulder, CO: Lynne Rienner Publishers, Inc., 2010), 129–56.

<sup>22</sup> See Barbara Kotschwar, Theodore H. Moran, and Julia Muir, "Chinese Investment in Latin American Resources: The Good, the Bad, and the Ugly," *PIIE Working Paper Series* WP 12–3 (Washington, D.C.: Peterson Institute for International Economics, 2012).

<sup>23</sup> Riordan Roett and Guadalupe Paz, *China's Expansion into the Western Hemisphere: Implication for Latin America and the United States* (Washington, D.C.: The Brookings Institute, 2008, PDF e-book).

case studies but other comparative studies of the Chinese economy, OFDI, diplomacy, international relations, and regional security.

Further, a number of statistical data sets regarding Chinese OFDI not mentioned in the literature review are used in this thesis. The United Nations Conference on Trade and Development (UNCTAD) presents annually its World Investment Report (WIR). The latest report was published for the 2012 annum presents a comprehensive regional, nation-specific, type, and sectorial views of global movements of foreign direct investment along with other direct investment statistics.<sup>24</sup> Secondly, the People's Republic of China's (PRC) Ministry of Commerce's (MOFCOM) "2010 Statistical Bulletin of China's Outward Foreign Direct Investment" which lists flows and stock of OFDI from China by region and country, as well as, providing limited contextual comparisons to other major economies engaged in OFDI.<sup>25</sup> Finally, Derek Scissors and the Heritage Foundation provide a running tracker of large Chinese investments overseas by investor, sector, subsector, value, or price, and targeted company.<sup>26</sup>

## **F. THESIS OVERVIEW**

This thesis is organized into five chapters. The first chapter presents the major research questions, the importance of the research questions, problems with the current conventional understanding and widespread implications of Chinese OFDI, proposes a tentative hypothesis that Chinese OFDI serves to stabilize and pacify the Asia-Pacific region, presents a review of the current pertinent literature on the topic, and details the methods and sources of found in the thesis.

The second chapter presents the historical background and context of Chinese OFDI and, in doing so, answer the first three major research questions. By reviewing and analyze the historical pattern of Chinese OFDI and incorporating the latest statistical

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<sup>24</sup> See United Nations Conference on Trade and Development, *World Investment Report 2012* (New York: United Nations, 2012).

<sup>25</sup> PRC MOFCOM, *2010 Statistical Bulletin*.

<sup>26</sup> See Derek Scissors, "China Global Investment Tracker: 2012" *Heritage Foundation*, last modified July 9, 2012, accessed August 15, 2012, <http://www.heritage.org/research/reports/2012/01/china-global-investment-tracker-2012>.

bulletin on Chinese OFDI from the Chinese Ministry of Commerce, this chapter presents how Chinese OFDI has expanded since the beginning the mid-1970s, analyzes the determinants and drivers, demonstrates what and how governmental policies promoted, directed, and suppressed OFDI, and assess the effect on the Chinese economy domestically.

The third chapter analyzes the patterns of Chinese OFDI through the perspective of the realist theory of international relations in addition to analyzing OFDI through a lens of sound business practices to evaluate if Chinese OFDI could be a motivated squarely through normal corporate motivations. The fourth chapter assesses the geopolitical effects of Chinese OFDI in the Asia-Pacific region, specifically with Japan, on the Korean Peninsula, and in the South China Sea area. A final, fifth chapter briefly presents the conclusion of the thesis.

## II. HISTORICAL CONTEXT AND BACKGROUND OF CHINESE OFDI

Chinese outward foreign direct investment (OFDI) has grown from practically nothing prior to Deng Xiaoping's economic reforms in 1978 to over \$68 billion annually in 2010, yet it is only very recently beginning to be studied.<sup>27</sup> Indeed, one of the foremost textbooks on the Chinese economy, Barry Naughton's *The Chinese Economy: Transitions and Growth*, barely alludes to this growing facet in his analysis of Chinese economic development.<sup>28</sup> This chapter presents the historical context and background of Chinese OFDI and answers the first three major research questions of this thesis: why have Chinese firms invested abroad, how should the historical and current scope of China's OFDI be assessed, and what has been the effect of Chinese OFDI on the Chinese economy? Overall, this chapter finds that the scope of Chinese OFDI has expanded greatly, but not overwhelmingly or threateningly, and, although the pattern appears inconsistent with international norms, Chinese OFDI is driven increasingly more by economic factors than governmental direction to individual firms. On a macro-level, government policies and institutional changes have demonstrated a significant ability to promote or suppress overall OFDI levels, which contributes to the understanding of determinants of Chinese OFDI. Finally, the benefit of Chinese OFDI on the Chinese economy has been mixed, thus far.

This chapter addresses the major research questions in chronological order bound roughly by three major policy initiatives. The first period is approximately from the time of Deng Xiaoping's economic reforms to about a year prior to the 14th Chinese Communist Party (CCP) congress in 1992. The second period extends from the 14th CCP congress to the announcement of the *zouchuqu* "Go Global" policy at the turn of the century, and the third period is from *zouchuqu* to present. A vignette on OFDI during the Asian financial crisis in 1997 to 1998 is presented, as well.

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<sup>27</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 79.

<sup>28</sup> Naughton, *The Chinese Economy*, 402–24.

## A. OFDI: PRIOR TO THE 14TH PARTY CONGRESS

This section details China's outward foreign direct investment for the time period just prior to 1978 to about a year prior to the 14th CCP Congress in 1992. The year 1978 saw the launch of the "reform and opening" economic policy initiatives led by Deng Xiaoping, and much of the academic focus on economic reform has signaled this date as a fundamental turning point in China's economy. This is particularly true for domestic reforms, yet even prior to 1978, the Chinese leadership was becoming increasingly interested in initiating investment overseas. With the shift of United Nation (UN) membership from the Republic of China (ROC) in Taiwan to the People's Republic of China (PRC) in Beijing in 1971, the central government in Beijing began to focus on outward investment. The leadership particularly focused on multinational corporations by pressing for the publication of a Chinese version of a 1973 UN study titled *Multinational Corporations in World Development* even before Mao died.<sup>29</sup> Prior to 1978, however, there was hardly any real investment by Chinese firms overseas, in part due to the overall policies and institutions of the Chinese economy and political leadership.<sup>30</sup>

Moving into the late 1970s, Beijing began to explicitly promote overseas investment in various policy documents.<sup>31</sup> To be sure, many of the policy directives of the time were internally and domestically focused, but there were clear signs of a shift in the attitude of the Chinese Communist Party's (CCP) leadership regarding OFDI. Yongjin Zhang, a professor at the University of Bristol, has produced evidence of a State Council document from August 13, 1979 where the formation and support of Chinese overseas investments was one of the top thirteen priorities of economic reform.<sup>32</sup>

The firms and corporations initially allowed to invest abroad were only state-owned enterprises (SOE) that were administrated under the Ministry of Foreign Economic Relations and Trade (MOFERT) and "provincial and municipal international

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<sup>29</sup> Zhang, *China's Emerging Global Businesses*, 50–1.

<sup>30</sup> Voss et al., "Effects of Institutional Change on Chinese OFDI," 145; Zhang, *China's Emerging Global Businesses*, 21.

<sup>31</sup> Zhang, *China's Emerging Global Businesses*, 48.

<sup>32</sup> *Ibid.*, 54.

economic and technological cooperation enterprises” that were operated under the State Economic and Trade Commission (SETC). Applications for overseas investment were submitted to the State Council, which was the only authorizing body for investment overseas.<sup>33</sup> The State Council’s policy priority during this period was to maintain or increase foreign reserves while ensuring that any outward investment would not cause the loss of financial reserves. This priority was reflected in the limited number of projects that were ever actually approved, and the relatively low, \$950,000 average value of each international investment.<sup>34</sup> Figure 1 presents graphically the total value of outward investments by year approved by the State Council during this period. These initial policies and regulations provide the first evidence to support this chapter’s argument that Chinese governmental policy could either significantly promote or suppress investment and it is clearly seen in Figure 1 with the increases in OFDI following official policy changes.

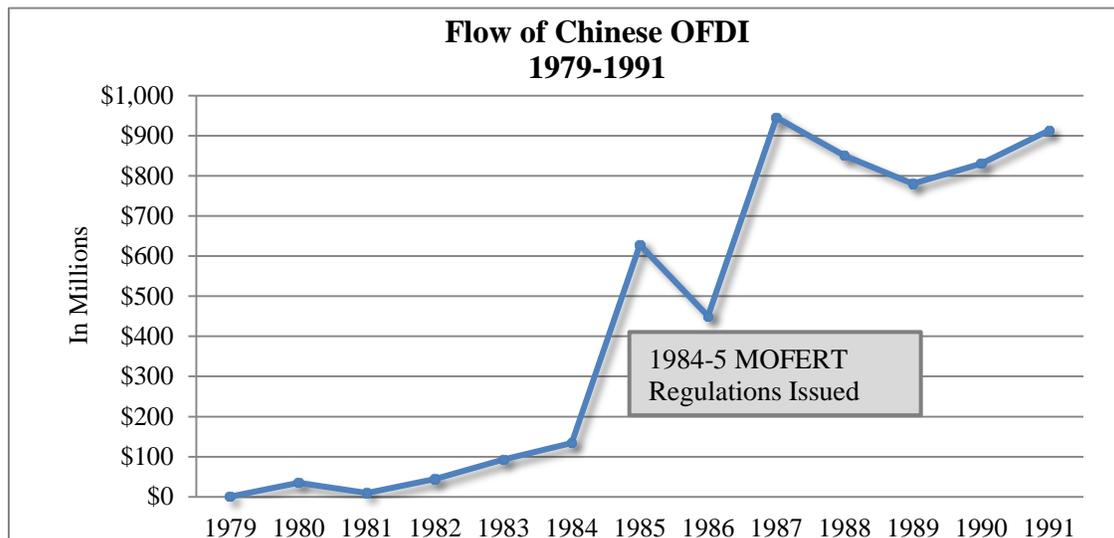


Figure 1. Flow of Chinese OFDI, 1979–1991 (From: Cai, “Outward Foreign Direct Investment,” 860).

<sup>33</sup> Peter J. Buckley, Adam R. Cross, Hui Tan, Liu Xin, and Hinrich Voss, “Historic and Emergent Trends in Chinese Outward Direct Investment,” *Management International Review* 48, no. 6 (2008): 723, for previous two sentences.

<sup>34</sup> Wong and Chan. “China’s Outward Direct Investment,” 280; Voss et al., “Effects of Institutional Change on Chinese OFDI,” 146; Buckley et al., “Historic and Emergent Trends,” 723.

The geographic distribution of outward direct investment during the late-1970s and 1980s was heavily focused on investments in Hong Kong and Macao.<sup>35</sup> Part of the investment might have occurred as a result of “round tripping,” where financial capital was moved to these locations only to be re-invested in mainland China to capitalize on favorable tax and financial policies aimed at attracting inbound FDI. Figure 2 presents a graphical representation of the geographic distribution of OFDI during this period.

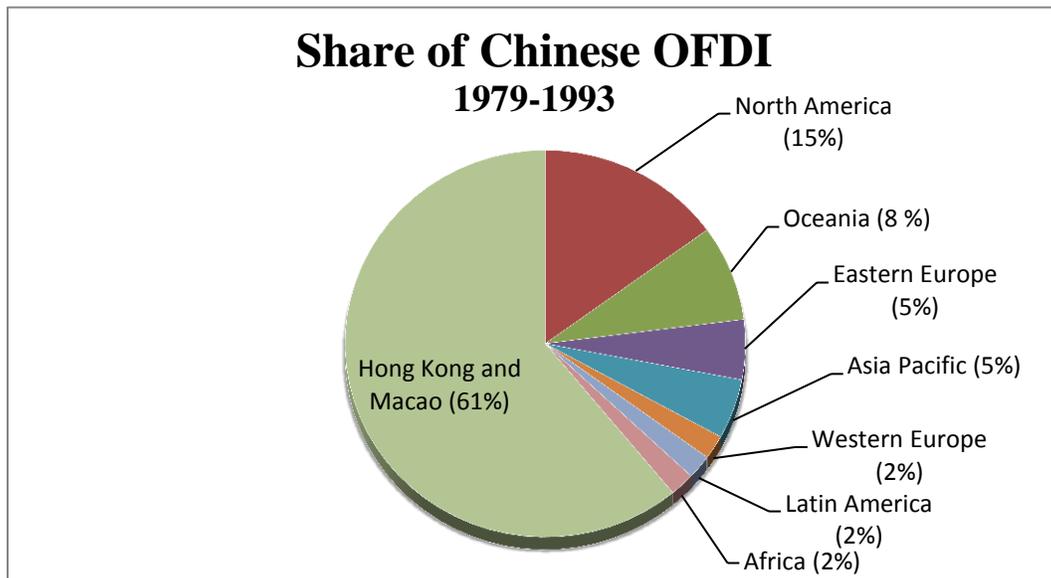


Figure 2. Share of Chinese OFDI, 1979–1993 (From: UNCTAD, *World Investment Report 1995*, 57).

A second characteristic of the early overseas investments, particularly in the late-1970s and early-1980s, was that the investments appear to have been more politically motivated rather than commercially or economically motivated. Kevin Cai notes that political influence in the approval of investments was “particularly evident in China’s heavy investment in Hong Kong and, to a lesser extent, in some strategically and/or politically important Third World countries.”<sup>36</sup> This characteristic of intense governmental direction regarding OFDI establishes a basis for the evolution of governmental direction to firms on the determination and motivation of investments.

<sup>35</sup> UNCTAD, *World Investment Report 1995*, 57; Cai, “Outward Foreign Direct Investment,” 864.

<sup>36</sup> Cai, “Outward Foreign Direct Investment,” 859.

The projects and investments that were encouraged by the central government were to gain access to natural resources that were not abundant in mainland China, to tap into new technology through investment overseas, to open up new export markets for Chinese businesses, and to acquire managerial competency through engagement with Western corporations and other more sophisticated businesses.<sup>37</sup>

Success in fulfilling the policy directive of gaining technology is apparent with the example of Shougang's acquisition of Mesta International (or Mesta Engineering), where the Shougang (Capital Iron and Steel) was able to gain "access to state-of-the-art metallurgical design technologies."<sup>38</sup> Peter Nolan believes that this early example of Chinese globalization gave Shougang a technological edge building up the firm's ability to continuously cast steel to meet not only domestic demand, but also international demand.<sup>39</sup> Capitalizing on the need to gain access to an expanding pool of natural resources were Chinese investments in the Portland aluminum smelter in Victoria, Australia and the Mount Channar iron ore mine in west Australia. These investments were particularly successful, notably, because the cost of iron ore from west Australia was one-fortieth the cost of iron ore produced in China and allowed for the acquisition of sophisticated smelting technology not available in China.<sup>40</sup> These early investment actions demonstrate that OFDI by Chinese firms credibly supported economic growth by providing necessary natural resources that were scarce domestically and increased the technological ability of firms in extracting natural resources both international and domestically.

In the mid-1980s, the central government issued further institutional regulations pertaining to overseas investment that provide the second set of evidence to support this paper's argument that the government had a significant ability to promote OFDI. MOFERT issued three important documents during this period: "MOFERT Circular

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<sup>37</sup> Voss et al., "Effects of Institutional Change on Chinese OFDI," 146.

<sup>38</sup> McDermott and Huang, "Industrial State-owned Multi-nationals from China," 11, the exact name of the acquired firm changes depending on certain publications (Wong and Chen call the firm Masta).

<sup>39</sup> Peter Nolan, *China and the Global Economy* (London: Palgrave, 2001), 73.

<sup>40</sup> Mark Yaolin Wang, "The Motivations behind China's Government-Initiated Industrial Investments Overseas," *Pacific Affairs* 75, no. 2 (Summer 2002): 200-1.

concerning the Approval Authorities and Principles for Opening Non-Trade Joint Venture Overseas as well as in Hong Kong and Macao” (19 May 1984), “Provisional Regulations Governing the Control and Approval Procedures for Opening Non-Trade Enterprises Overseas” (July 1985), and “MOFERT Circular on the Approval Procedures for International Economic and Technical Cooperation Corporation to Set Up Overseas Subsidiaries” (July 1985). One of the most important changes stemming from the new institutional regulations was that any enterprise, regardless of ownership, could begin investing abroad if it had the financial resources and technical ability to do so. A second important institutional change brought on by these new regulations was the delegation of approval authority of investments overseas. As mentioned before, previously the State Council was the sole approving authority. In 1985, MOFERT was granted the authority to approve investments up to \$10 million in value. Further delegated by MOFERT was approval authority of projects valued below \$1 million to the provincial and municipal governments.<sup>41</sup> The effect of these institutional changes are apparent from the significant increase in OFDI after 1984, as indicated in Figure 1, when overseas investments increased almost tenfold in both monetary value and number of projects approved.<sup>42</sup>

## **B. CHINESE OFDI INTO THE 1990S**

In the 1990s, the central government began to take more steps to promote and encourage the institutional environment for outward investment. In 1991, with State Council Document No. 13 of 1991, the State Council further delegated approval authority for overseas investment up to \$30 million to MOFERT. Additionally, Beijing reduced export tariffs on capital used by Chinese firms abroad, pressed for, and awarded preferential loans to Chinese corporations to move physical capital, and crafted simpler administrative procedures.<sup>43</sup> Similarly, in 1995, SAFE revised the regulations for approval of overseas investments for provincial and municipal technological and economic cooperation enterprises. Fourteen provincial and municipal level SAFE offices

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<sup>41</sup> Zhang, *China's Emerging Global Businesses*, 56–9.

<sup>42</sup> Buckley et al., “Historic and Emergent Trends,” 723.

<sup>43</sup> Zhang, *China's Emerging Global Businesses*, 58–9, 73.

could approve projects up to \$3 million in value.<sup>44</sup> A final institutional change that occurred in 1992 was the shift from the People's Bank of China regulating foreign investments of Chinese banks to having the newly instituted China Banking Regulatory Commission approve outward investment by Chinese financial institutions, which continues to present.<sup>45</sup>

Becoming more particularistic in some ways, the central government began utilizing firm specific loans that favored, sometimes unfairly, certain firms over others engaged in similar operations overseas.<sup>46</sup> Equally, if the firm was engaged in industries or operations the central government deemed to be strategically important, the firm would likely receive even more favorable loans, and tax breaks which continues to present day, especially in the capital intensive natural resource sector.<sup>47</sup> These particularistic policies, which created soft budgetary constraints and moral hazards through essentially free money, have been interpreted by some as reasons why the Ministry of Trade and Economic Cooperation (MOFTEC) increased scrutiny and restrictions on overseas investments in the latter half of the 1990s (MOFERT was renamed MOFTEC in 1993).<sup>48</sup>

Further pressing for the liberalization of outward investment in the 1990s were policy directives from the CCP's foremost leaders. On the heels of Deng Xiaoping's 1992 southern tour, CCP General Secretary, and later President of China, Jiang Zemin gave a speech where he listed ten priorities for economic reform. Number two on that list was that China "should encourage enterprises to expand their investments abroad and their transnational operations."<sup>49</sup> These statements made outward investment explicitly part of

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<sup>44</sup> Hinrich Voss, Peter J. Buckley, and Adam R. Cross, "Thirty Years of Chinese Outward Foreign Direct Investment" (working paper, University of Leeds, England, 2011), 13.

<sup>45</sup> Voss et al., "Effects of Institutional Change on Chinese OFDI," 141.

<sup>46</sup> Zhang, *China's Emerging Global Businesses*, 58–61.

<sup>47</sup> Voss et al., "Effects of Institutional Change on Chinese OFDI," 149.

<sup>48</sup> Wong and Chan, "China's Outward Direct Investment," 281.

<sup>49</sup> Jiang Zemin, "Full Text of Jiang Zemin's Report at 14th Party Congress," *Beijing Review*, updated March 29, 2011, accessed August 25, 2012, [http://www.bjreview.com.cn/document/txt/2011-03/29/content\\_363504\\_5.htm](http://www.bjreview.com.cn/document/txt/2011-03/29/content_363504_5.htm).

China's economic development plan and were echoed by various different institutions within China like the State Council's Research Office.<sup>50</sup> The unequivocal proclamations in support of overseas investment by the CCP's senior leadership are most likely significant factors in changing the perceived anti-OFDI opinions held by lower-level governmental personnel who, in turn, improved the commercial environment and inclination of businessmen to apply for investment abroad.<sup>51</sup>

Similarly, not only did the central government press for overseas investment, but so did provincial, municipal and other local officials. Numerous conferences and seminars between local and provincial government officials, senior management of the largest transnational firms in China, and prominent economists established dialogues of cooperation. Such close coordination is reflected in the broad number of Chinese provinces that had relatively equal outward investments.<sup>52</sup> The previous four paragraphs have presented the third set of evidence to support the argument that the Chinese government has a significant ability to promote OFDI. Beijing's ability to promote OFDI will be complemented in the vignette on the effect of the Asian Financial Crisis where it will be demonstrated that Beijing had an equally strong ability to suppress overseas investment independent of the international environment.

Chinese overseas investment during this period was much less concentrated geographically. At the beginning of the 1990s, the majority of overseas Chinese investments were in the relatively few developed economies. At the end of the 1990s, the majority of China's overseas investments were scattered across the developing economies. This transition is presented graphically in Figure 3. Buckley et al. provide three estimations of why this transition occurred. First, Chinese firms' "home country embeddedness" led them to conduct business in locations that firms from developed countries would not otherwise invest. Second, soft budget constraints particular to Chinese SOEs and easy access to excess capital from state lending made investments in

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<sup>50</sup> Zhang, *China's Emerging Global Businesses*, 69.

<sup>51</sup> Eunsuk Hong and Laixiang Sun, "Dynamics of Internationalization and Outward Investment: Chinese Corporations' Strategies," *The China Quarterly* 187 (September 2006): 620.

<sup>52</sup> Zhang, *China's Emerging Global Businesses*, 68.

politically unstable and economically less developed regions not as undesirable as Western nations might have perceived them to be. And third, there were changes in bilateral trade status, tariff reduction policies, and political motivations between Beijing and certain developing economies.<sup>53</sup> Currently, however, the share of Chinese OFDI by economy has shifted dramatically back to developed countries not because investment patterns have changed *per se*, but because certain OFDI recipients, specifically Hong Kong, Singapore, and South Korea, have been reclassified as “developed economies;” with this shift the preponderance of Chinese OFDI is now in developed economies.<sup>54</sup>

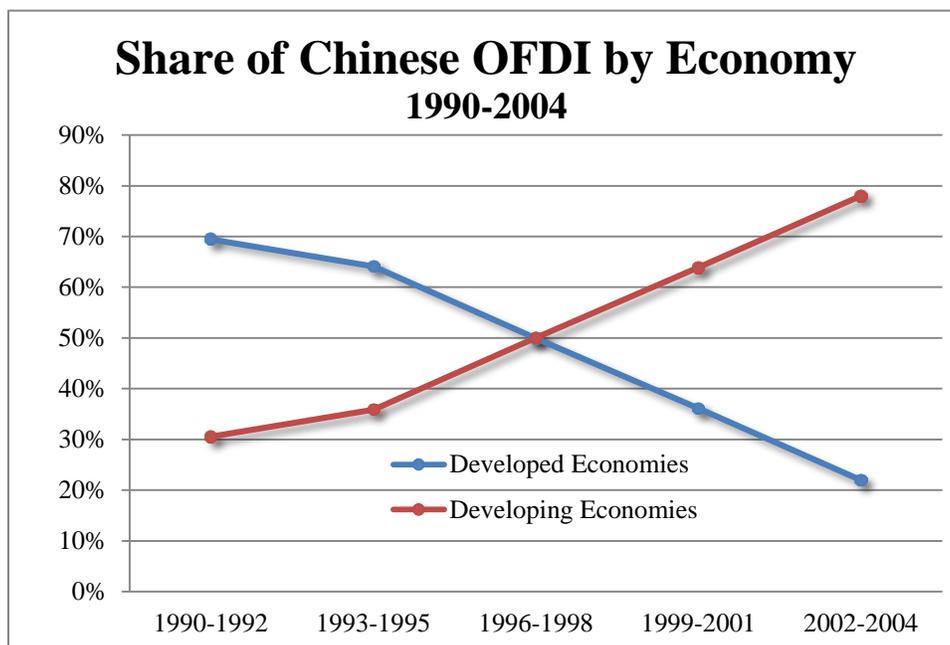


Figure 3. Share of Chinese OFDI by Economy, 1990–2004 (From: Buckley et al., “Historic and Emergent Trends in Chinese Outward,” 726–7).

In addition to the shifting geographic distribution of Chinese OFDI in the 1990s, another equally important shift occurred. The vehicle for investment shifted from predominantly joint venture enterprises (JVE) with foreign firms to wholly-owned

<sup>53</sup> Buckley et al., “Historic and Emergent Trends,” 730; Wang, “The Motivations behind China’s Government-Initiated Industrial Investments Overseas,” 197.

<sup>54</sup> See MSCI Developed Markets Indices ([http://www.msci.com/products/indices/country\\_and\\_regional/dm/](http://www.msci.com/products/indices/country_and_regional/dm/)) for a list of developed markets.

subsidies (WOS) without another foreign firm supporting.<sup>55</sup> Buckley et al. provided three reasons to explain this shift, but a close review of each explanation make them appear less insightful than they originally were. The first reason given is the increasing efficiency of management of enterprises going abroad. This would seem to conflict with the increasing concerns about capital flight from China, which have been estimated as significantly increasing throughout the 1990s.<sup>56</sup> Further, the fact that only one-third of Chinese investments abroad generated a profit would suggest that the firms did not materially improve their management ability.<sup>57</sup> The second reason given is the greater volume of funds available to invest abroad, especially after the initiation of China's "Go Global" policy (which will be discussed below). Again, this would seem to conflict with evidence of tightening of approval and scrutiny by the central government in the mid-1990s, which will be discussed in the vignette on the Asian financial crisis, and empirically because the transition from JVE to WOS had, largely, occurred before the first mention of "Go Global" in 1999. The third explanation given is "the growth in international market entry by acquisition," yet no information is presented to show whether this is accurate or why this would apply to Chinese firms. Ultimately, it is Buckley's own theory on internalization of imperfect markets that might best explain that Chinese firms shifted from predominantly JVE to WOS because it helped in total profit maximization.<sup>58</sup> Whatever the reason, it is important to note that the shift in preferred vehicles for investment did occur.

In 1990s, there was also a shift in the reasons for Chinese firms to invest abroad. Motivations shifted from being exclusively governmentally directed to much more in line with both governmental desires *and* market factors, such as supply and demand and profit maximization. The following four paragraphs highlight the shift in motivations from solely government direction to complementary commercial motivations and support this

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<sup>55</sup> Buckley et al., "Historic and Emergent Trends," 734–5

<sup>56</sup> Zhang, *China's Emerging Global Businesses*, 38–9.

<sup>57</sup> Wong and Chan, "China's Outward Direct Investment," 277.

<sup>58</sup> Buckley and Casson, *The Future of the Multinational Enterprise*, 32, 36–7; Buckley et al., "Historic and Emergent Trends," 734–5.

chapter's argument that Chinese motivations are becoming much more in line with commercial and economic factors rather than the governmentally or politically motivated factors.

The most often cited motivation is to expand or maintain access to markets.<sup>59</sup> One facet of this motivation is to limit the effect of trade barriers set up by foreign governments on the import of Chinese-made goods. A textile manufacturer, for example, purposely set up a factory in Mauritius to explicitly circumvent European and U.S. tariffs on textile imports from China.<sup>60</sup>

A second commonly cited motivation was to maintain access to natural resources like mining, and fisheries.<sup>61</sup> For example, one significant natural resource acquisition during the early 1990s included Capital Iron & Steel's \$120 million investment in Peru's Hierros Mining operations.<sup>62</sup> Similarly, as China became a net importer of oil and gas in 1993, the Chinese national oil companies began to greatly expand overseas with operations in nearly every major petroleum export market.<sup>63</sup>

Thirdly, gaining access to technology and management techniques was still emphasized as a motivation for Chinese OFDI.<sup>64</sup> This was regularly the case with investments in Hong Kong-based firms due to the unique conservatorship of the area by the British government.

A seldom mentioned motivation for Chinese corporations to set up operations abroad in the 1990s is that, in some instances, Chinese products commanded a lower

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<sup>59</sup> Cai, "Outward Foreign Direct Investment," 867; Wong and Chan, "China's Outward Direct Investment," 284; Hong and Sun, "Dynamics of Internationalization," 622–4.

<sup>60</sup> Choo-Sin Tseng and Simon K.M. Mak, "Strategy and Motivation for PRC Outward Direct Investment with Particular Reference to Enterprises from the Pearl River Delta," in Stewart MacPherson, and Joseph Y.S. Cheng, eds., *Economic and Social Development in South China* (Cheltenham, UK: Edward Elgar, 1996), 154.

<sup>61</sup> Cai, "Outward Foreign Direct Investment," 868; Wong and Chan, "China's Outward Direct Investment," 285; Hong and Sun, "Dynamics of Internationalization," 620–1.

<sup>62</sup> Hong and Sun, "Dynamics of Internationalization," 621.

<sup>63</sup> Cai, "Outward Foreign Direct Investment," 868–9.

<sup>64</sup> *Ibid.*, 869–70; Wong and Chan, "China's Outward Direct Investment," 285; Hong and Sun, "Dynamics of Internationalization," 622–3.

price in foreign markets, so if a Chinese firm produced a product in another nation, the price the product could be sold at was greater. This was seen, for example, in decisions by a Chinese thermos manufacturer and a Chinese battery producer to move their production operations abroad.<sup>65</sup>

### C. CHINESE OFDI AND THE 1997–8 ASIAN FINANCIAL CRISIS

Consistently in the contemporary literature on Chinese OFDI during the 1990s are accounts of the impact of the Asian financial crisis. Hinrich Voss et al. write: “In reaction to [the Asian Financial Crisis], MOFCOM tightened the approval procedure and enforced better screening and monitoring of each outward investment project.”<sup>66</sup> Wong and Chan, oft referenced, write: “Following the Asian financial crisis, measures to clamp down on smuggling and illicit capital flight were implemented.”<sup>67</sup>

Yet, Wong and Chan’s source concerning Beijing’s perceptions and measures to clamp down on reckless investments that contributed to capital flight was published *before* the crisis occurred. Indeed, in another source used by Wong and Chan, Chinese fears of capital flight were documented in 1994 at a high level conference led by a vice minister in the Ministry of Finance to determine how to prevent capital flight.<sup>68</sup> Further, the State Council in 1993 issued a circular addressing the subject of capital flight and the need for better management to prevent it.<sup>69</sup> These concerns and institutional changes are reflected in the significant drop in outward Chinese OFDI seen in Figure 4 much prior to the Asian financial crisis. Similarly, as Yongjin Zhang notes, Chinese OFDI actually rose during the crisis and only began to fall once the crisis had abated.<sup>70</sup> The empirical evidence thus leads to a conclusion that the Asian financial crisis only had a marginal, if

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<sup>65</sup> Rosalina P. Tan, “Direct Foreign Investment Flows to and From China,” in Palanca, *China’s Economic Growth at the ASEAN*, 212

<sup>66</sup> Voss et al., “Thirty Years of Chinese OFDI,” 13.

<sup>67</sup> Wong and Chan, “China’s Outward Direct Investment,” 281.

<sup>68</sup> David Wall, “Outflows of Capital from China,” *OECD Development Center Technical Paper* no. 123 (Paris: Organization for Economic Co-operation and Development March, 1997), 41.

<sup>69</sup> Chih-shian Liou, “Bureaucratic Politics and Overseas Investment by Chinese State-owned Oil Companies: Illusory Champions,” *Asian Survey* 49, no. 4 (2009): 674–5.

<sup>70</sup> Zhang, *China’s Emerging Global Businesses*, 100–1.

any, effect on Chinese OFDI and that institutional changes by the central government popularly linked to the crisis actually occurred prior. Secondly, it demonstrates, through the mid-1990s institutional and regulatory changes, that the central government could suppress OFDI.

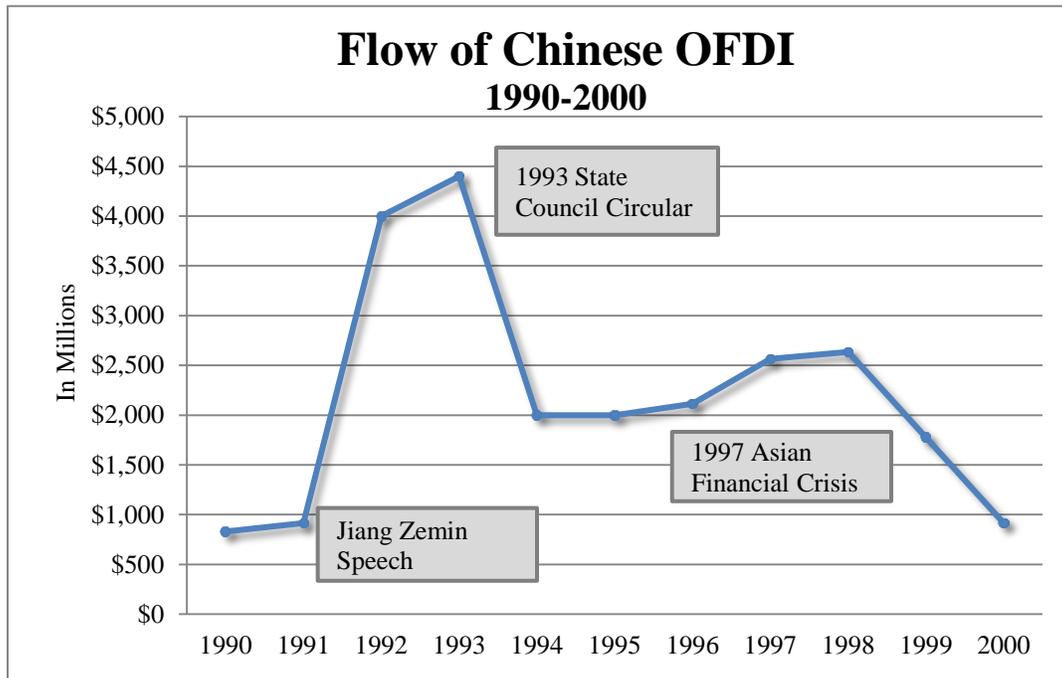


Figure 4. Flow of Chinese OFDI, 1990–2000 (From: Wong and Chan, “China’s Outward Direct Investment,” 273).

The one temporary institutional measure implemented during the crisis, a ban on provincial and local SAFE offices from approving outward investment, was only limited to small investments under \$3 million in value and could be conceived of as aimed at stopping investments aimed at circumventing foreign exchange control by siphoning money off into Hong Kong and Macao. Further, those same investments could be made, and circumstantial evidence points to the fact that many were approved by higher authority.<sup>71</sup>

<sup>71</sup> Voss et al., “Effects of Institutional Change on Chinese OFDI,” 150–1.

## D. “GO GLOBAL” AND BEYOND

### 1. Government Policy: Promoting OFDI

Towards the end of the 1990s, perhaps, the single most important institutional change in Chinese OFDI policy occurred as leading government officials called for “going global.” The policy was explicitly confirmed and codified in the five-year plan that commenced in 2001.<sup>72</sup>

The “Go Global” initiative, in addition to World Trade Organization accession by China in 2001, was supported by a host of additional, seemingly ad hoc, policies to spur increased overseas investment. The primary and most significant changes will be listed here. The approval process was further decentralized completely to subnational government authorities, with the exception of investments in seven sensitive economies such as Taiwan, Japan, the United States, and Iraq, to name a few, that still required national-level approval. Requests to invest abroad were no longer required to produce documentation of viability of the investment. Rather, the Chinese government simply stressed the need for an understanding of market economics and that management needed to be capable of dealing with overseas investments. Firms were allowed to maintain capital in foreign currencies, raise international capital, and reinvest earnings gained in foreign currency abroad without repatriating their earnings first. Security deposits on investments abroad were no longer required. Local SAFE branches were given wide latitude in approval of foreign capital investments and the review and regulatory burden was eased.<sup>73</sup>

Another important institutional change was the issuance of guidance regarding preferred, target countries for Chinese firms by the National Development and Reform Commission, first in 2004 and since updated.<sup>74</sup> This document is important because of perceptions of governmental direction in natural resource acquisition and perceptions of

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<sup>72</sup> Ibid., 151.

<sup>73</sup> Ibid., 151–3.

<sup>74</sup> Philip C. Saunders, “China’s Global Activism: Strategy, Drivers, and Tools,” *Institute for National Strategic Studies Occasional Paper 4* (Washington, D.C.: National Defense University Press, June 2006), 13.

possible mercantilist policies. However, while it is a list of “target” countries (which comprise nearly a third of all UN-member nations), firms are not bound to the list and often make investment in countries not on the list. This institutional change and the lack of total compliance by Chinese firms with the guidance reflect also the further shift of Chinese motivations for OFDI away from governmental direction and towards commercial economic factors.

Third, an institutional change that has only very recently emerged is the use of Chinese OFDI as an alternative vehicle for investment of China’s substantial financial reserves.<sup>75</sup> This is seen with the establishment of the China Investment Corporation (CIC), which is Beijing’s sovereign wealth fund and controls nearly \$500 billion in assets. However, it is important to note the limit and scope of the CIC as it relates to OFDI. All of the top five portfolio holdings of the CIC and its subsidiaries are based in China.<sup>76</sup> As for overseas investment assets, Daniel Rosen and Thilo Hanemann remark, “In reality, these state entities usually take minor stakes, and only in a very few cases do the stakes exceed the 10 percent threshold needed to qualify as FDI. In short, it is China’s firms that generate the country’s outbound FDI action.”<sup>77</sup>

To conclude this chapter’s argument that governmental policy has the ability to significantly influence either the promotion or suppression of OFDI, the monumental spike in OFDI since the “Go Global” policy is but the *fifth* episode demonstrating the government ability promote or suppress the growth of OFDI. In 1978, 1984–5, 1992, 1993–4, and again in with “Go Global” call, government policy demonstrated an uncanny ability to influence the growth of OFDI on a macro-level.

## **2. The Geographic and Sectoral Distribution of Chinese OFDI**

The geographic distribution of OFDI in the 2000s has been one of the most controversial topics about the Chinese economy due to the perception that China is

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<sup>75</sup> Rosen and Hanemann, *China’s Changing Outbound Foreign Direct Investment Profile*, 2.

<sup>76</sup> China Investment Corporation, *Annual Report 2011* (Beijing, China, China Investment Corporation, 2011), 29.

<sup>77</sup> Rosen and Hanemann, *China’s Changing Outbound Foreign Direct Investment Profile*, 5.

casting its financial net across all corners of the globe. These perceptions are not entirely true, but complications from the Ministry of Commerce (MOFCOM), SAFE, and other Chinese ministries' statistical reporting of OFDI do not help. For instance, only the initial destination of Chinese OFDI is reported, leaving the ultimate destination unclear.<sup>78</sup> How large of a problem is this? Considering that over 55 percent of Chinese OFDI goes through Hong Kong and *another 20 percent* flows to other destinations considered to be tax havens and financial clearinghouses, like the British Virgin Islands, Cayman Islands, and, recently, Luxembourg, the problems are considerable. A second complication of Chinese reporting comes from a unique categorization of regions. For instance, the "Asia" region in the MOFCOM 2010 "Statistical Bulletin on China's Outward Foreign Direct Investment" stretches from Cyprus in the Mediterranean Sea to eastern shores of Indonesia.<sup>79</sup> (In 2003, MOFTEC was reorganized into MOFCOM and, additionally, a number of Chinese agencies were subsumed under it.)

There are, however, keen insights that can be gleaned from a rough appraisal of the annual flows of OFDI geographically. Africa, largely considered to be a prime location for Chinese OFDI and a focal point for the belief that China is attempting to "buy up" the world's natural resources, has, but for one year in 2008, maintained a consistent four to six percent share of Chinese OFDI flows by value since the onset of the "Go Global" policy. By contrast, the less often mentioned Latin American region has seen a much more sustained flow of OFDI, having an average annual investment share of about 26 percent of total Chinese OFDI throughout the 2000s. More recently, Europe has become a prime destination for Chinese OFDI, receiving the third largest amount of OFDI stock, behind Asia and Latin America.<sup>80</sup> Figures 5 and 6 present graphically these statistics.

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<sup>78</sup> Ibid., 4.

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

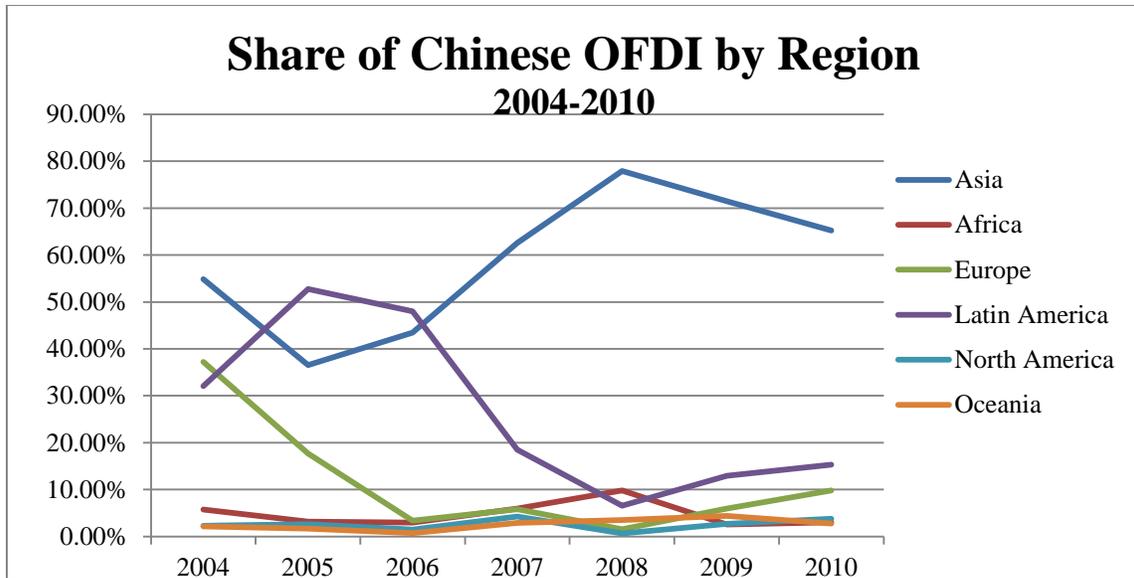


Figure 5. Share of Chinese OFDI by Region, 2004–2010 (From: PRC MOFCOM, 2010 *Statistical Bulletin*, 83–88).

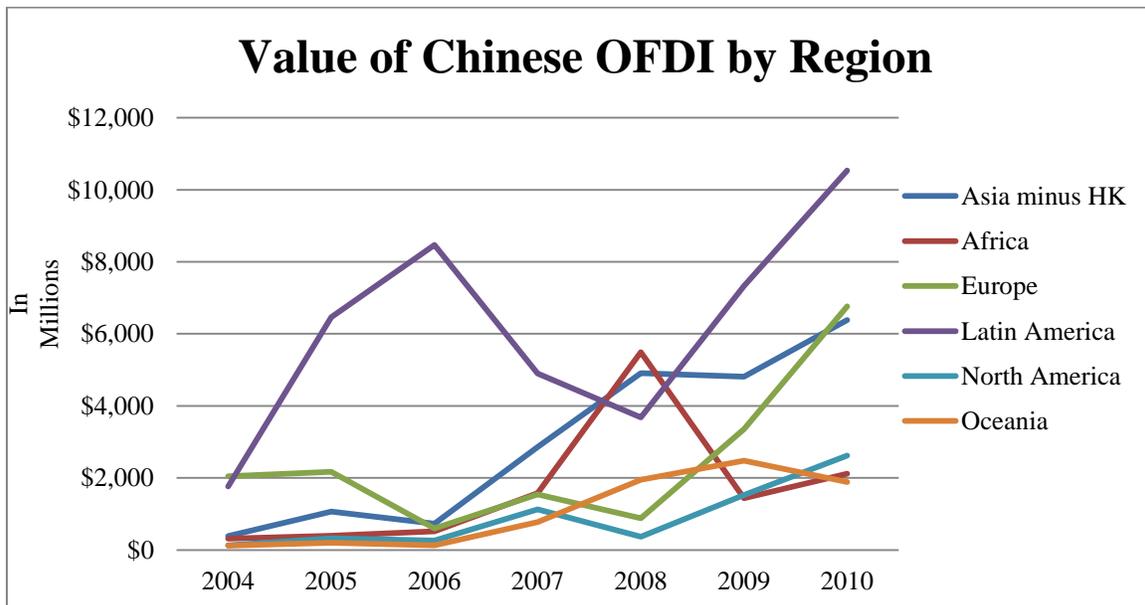


Figure 6. Value of Chinese OFDI by Region Excluding Hong Kong, 2004–2010 (From: PRC MOFCOM, 2010 *Statistical Bulletin*, 83–88).

The geographical distribution data, however, can be manipulated to give alternative results. If the number of firms invested in particular regions is used as the metric instead of using total value of investment, the outcomes change. One long running

survey of Chinese firms conducted jointly by three IGOs, including the U.N. Commission on Trade and Development, found, using this previously mentioned method, that Asia is still the dominate region of investment, but ranking a close second, third and fourth were North America, Europe, and Africa.<sup>81</sup> Figure 7 presents graphically these statistics. These alternative statistical presentations can lead to the alternative perceptions of China OFDI activities.

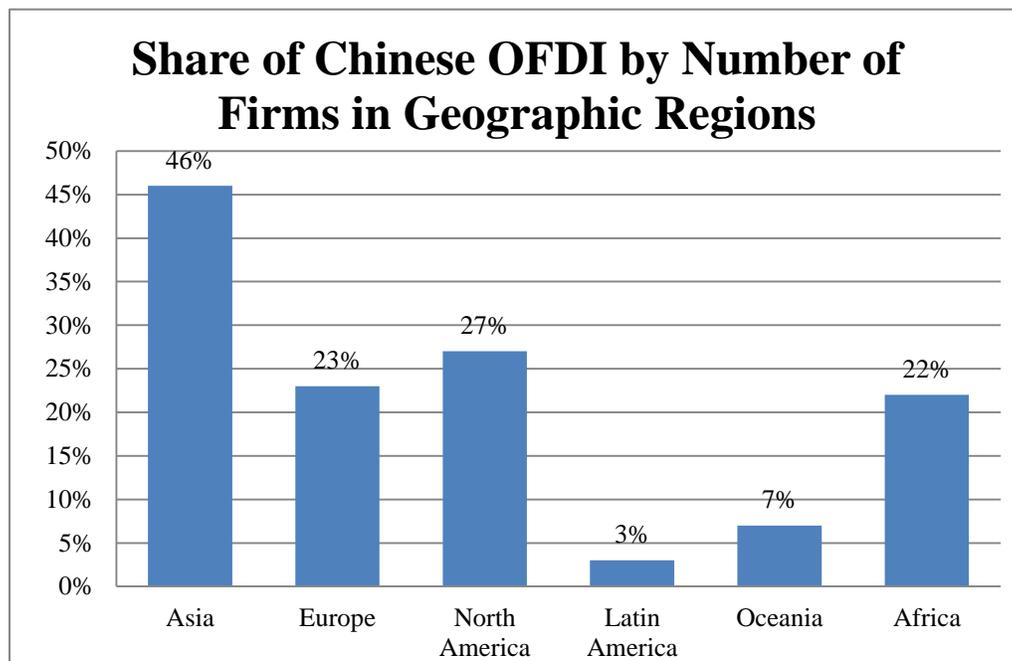


Figure 7. Share of Chinese OFDI by Number of Firms in Geographic Regions (From: China Council for Promotion of International Trade et al., *China Goes Global*, 4).

Official MOFCOM statistics on the sectoral distribution of Chinese OFDI suffer from similar deficiencies as those on geographic distribution. The MOFCOM sectoral numbers are not aligned to industry standards and do not reflect the final industry invested in.<sup>82</sup> Using Derek Scissor’s global tracker of Chinese investments from 2005 to

<sup>81</sup> China Council for Promotion of International Trade, the United Nations Conference on Trade and Development, and the Asia Pacific Foundation of Canada, *China Goes Global 2011: Survey of Outward Direct Investment Intentions of Chinese Companies* (Vancouver, B.C.: Asia Pacific Foundation of Canada April 2011), 4.

<sup>82</sup> Rosen and Hanemann, *China’s Changing Outbound Foreign Direct Investment Profile*, 4.

present, a sketch of the sectoral distribution can be made and is presented in Figure 8. Energy production and metal mining, smelting, and processing are the two largest sectors. Unfortunately, investments under \$100 million in value are not typically captured in Scissor’s tracker and this could significantly alter the number given that the average value of Chinese overseas investments, by stock, is approximately \$20 million.<sup>83</sup> However, you measure it, the sectoral distribution of Chinese OFDI does not compare with the global trends, and, in the words of Rosen and Hanemann, “is not consistent with international norms.”<sup>84</sup>

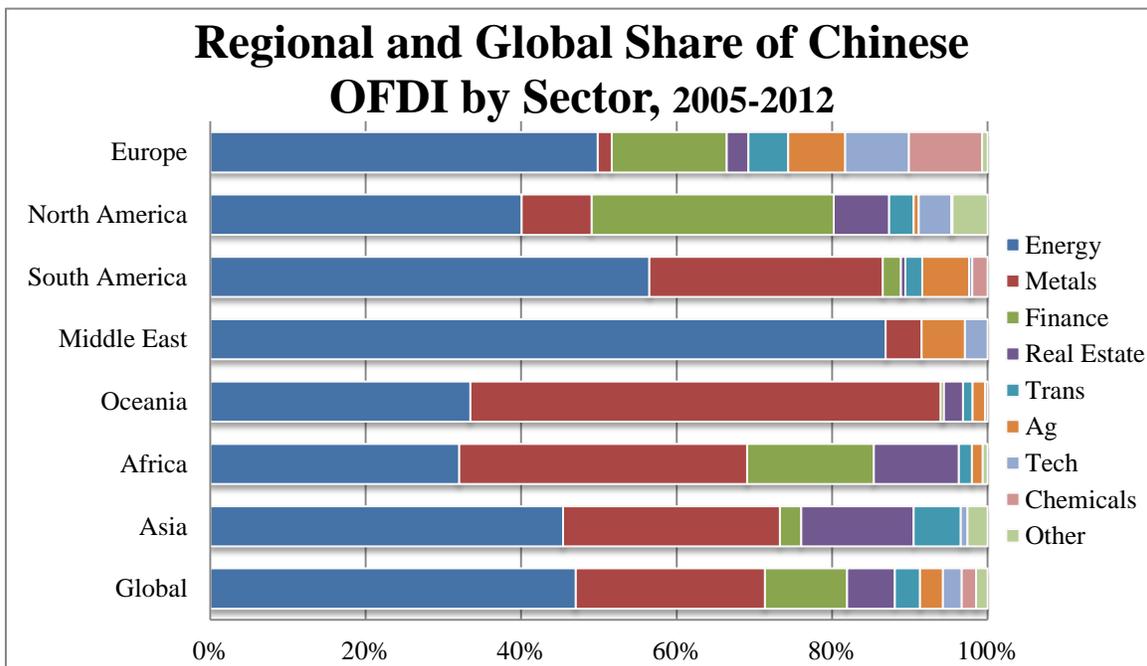


Figure 8. Region and Global Share of OFDI by Sector (From: Derek Scissors, “China Global Investment Tracker,” last modified 19 July 2012).

Again, as mentioned in the geographic distribution section, the statistics can be manipulated, so to speak. Using the survey of Chinese firms mentioned earlier that utilizes number of firms invested in sectors as opposed to total value, the manufacturing

<sup>83</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 79, statement that there are 16,000 enterprises abroad with a combined value of \$317.21 billion.

<sup>84</sup> Rosen and Hanemann, *China’s Changing Outbound Foreign Direct Investment Profile*, 2.

sector becomes the leading category, followed by a close second, third and fourth ranking of mining, wholesale/retail, and agriculture.<sup>85</sup> Figure 9 presents these results graphically.

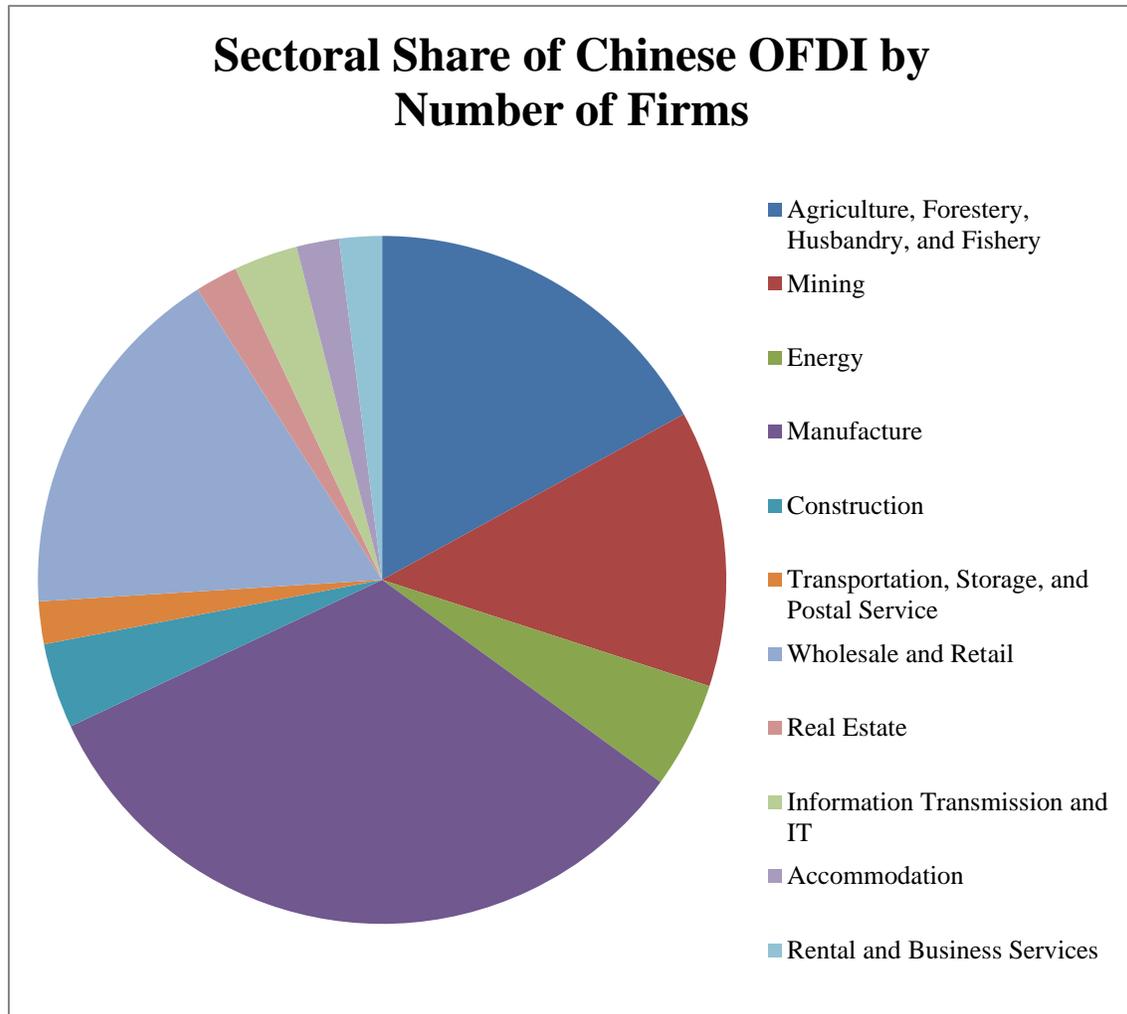


Figure 9. Sectoral Share of Chinese OFDI by Number of Firms (From: China Council for Promotion of International Trade et al., *China Goes Global*, 6).

The previously mentioned sectoral and geographic distribution may seem to be impressive and expansive, and there is no doubt that since 1978 that China's OFDI has expanded greatly. In a global context, however, it has only barely increased compared with other economies expanding at only a slightly faster pace. Chinese OFDI outflows from 2000 to 2007 accounted, on average, for less than one percent of the total global

<sup>85</sup> China Council for Promotion of International Trade et al., *China Goes Global 2011*, 6.

OFDI outflows and China's outflow was less than that of Russia who China is consistently grouped with under the BRIC rubric.<sup>86</sup>

In terms of sheer volume of OFDI stock, China is far below other nations. China has only the 15th highest OFDI stock and just passed Russia by \$3 million in 2011. Comparatively, the United States, which is characteristically number one on the list of OFDI stock, has more OFDI stock than all of the developing economies, including China, *combined*, and accounts for over a fifth of the entire global share of OFDI. China, in 2011, by UNCTAD standards, accounted for less than two percent of the entire global share of OFDI stock.<sup>87</sup> Rosen and Hanemann produced a striking statistic of per capita OFDI stock for selective economies: in 2009, China's per capita OFDI stock was at approximately at \$70 per person; India's was \$25; UAE's was \$6,100; the United States was \$9,300; Germany came in with a whopping \$15,000 of OFDI stock per capita!<sup>88</sup> In this light, total Chinese OFDI stock is growing, but it is not nearly at the levels of other economies, developed and developing.

The sectoral distribution, especially the emphasis on the natural resources, is also not so striking in the global context. Chinese firms do have an investment pattern that is not consistent internationally, but, even with China's impressive investment into the energy sector, roughly 90 percent of the global oil reserves are owned by other national oil companies and are not for sale.<sup>89</sup> Further, under Buckley and Casson's theoretical internationalization framework, the partially internalization of certain markets, especially ones involving strategically and economically important natural resources like petroleum and energy reserves, is actually the most economically efficient method to reduce the high costs of total internalization of markets but capitalize on the benefits of internalization. In effect, China is creating the ability to maintain a more stable market, not only in China but worldwide, because it can balance the external market with a separate internal market and because it is becoming one of the primary global consumers

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<sup>86</sup> Rosen and Hanemann, *China's Changing Outbound Foreign Direct Investment Profile*, 6.

<sup>87</sup> UNCTAD, *World Investment Report 2011*, Web Table 4.

<sup>88</sup> Rosen and Hanemann, *China's Changing Outbound Foreign Direct Investment Profile*, 6–7.

<sup>89</sup> Peter Nolan, *Is China Buying the World?* (Cambridge, UK: Polity Press, 2012), 138.

of natural resources.<sup>90</sup> In that light, China's OFDI, especially in natural resources, makes a lot of economic and commercial sense and Beijing's approach appears less mercantilist. Finally, there are just some sectors, like commercial aircraft manufacturing, that are so dominated by a small number of established firms, in which it is going to be extremely difficult for a Chinese firm to capture *any* amount of market share in the near to medium term, let alone a significant amount of market share.<sup>91</sup>

To wrap up this chapter's argument that Chinese OFDI has expanded greatly but not overwhelmingly, when the geographic and sectoral distribution of Chinese OFDI is viewed through a contextual lens that takes into consideration the global environment, Chinese OFDI does not appear to be as dominant, dramatic, or as threatening as it can popularly be perceived.

### **3. Current Determinants of Chinese OFDI**

The determinants to invest abroad by Chinese firms since the inception of the "Go Global" policy have remained relatively consistent with those in the prior decade. These determinants are: to expand or maintain access to markets; to gain or maintain access to natural resources; and to gain access to technology and management techniques. A new determinant that has arisen in the 2000s is the desire to gain what are termed "strategic assets," which will be discussed below. Secondly, the general trend of less government dictation of corporate plans and policy in favor of following market forces has become even more apparent. Finally, with better quality data on Chinese OFDI from various sources, new models based on empirical mathematical regression are producing new results that differ from conventional understanding of Chinese OFDI motivations. This subsection will discuss three topics pertaining to OFDI determinants: acquisition of strategic assets; government policy that is even more hands off in terms of direction OFDI; and new mathematical models that are challenging conventional wisdom on Chinese motivations.

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<sup>90</sup> For the theoretical framework see Buckley and Casson, *The Future of the Multinational Enterprise*, 38–42.

<sup>91</sup> Nolan, *Is China Buying the World?*, 119–126.

Firstly, “strategic assets” are not assets that have geopolitical, military, or security related disposition. Rather, they are “strategic” in a commercial sense, such as brands and name recognition that carry clout and instant appeal. Contemporary examples are Apple, Google, BMW, Mercedes, Trek bicycles, etc. Previously, Chinese firms in general failed to craft instantly recognizable marketable and sustainable brands indigenously.<sup>92</sup> Recently, Chinese firms have begun to acquire some internationally recognizable brands. Examples are Lenovo acquisition of IBM’s laptop subsidiary, Haier’s purchase of Thomson TV and its failed bid for Maytag, Geely’s purchase of Volvo Cars, among others. Thus, far, however, China has been less than successful in translating purchases of brands into strategic assets that have international appeal. Alan Rugmen, in a scathing critique, notes that all of the Chinese firms in the *Fortune 500* list of largest corporations have 95 percent of their sales in China, and the strategic assets purchased have been distressed, technologically inferior, and, basically, obsolescent brands.<sup>93</sup> These keen insights support this paper’s argument that the Chinese OFDI expansion out pacing or making dramatic gains on the international community, and Chinese OFDI is driven by commercial motivations because strategic asset purchases, in and of themselves, are consistent with John Dunning’s conventional theory on internationalization.<sup>94</sup>

The second shift in determinants of Chinese firms since the “Go Global” policy was announced is that has become quite clear that motivations of Chinese companies have become almost entirely detached for governmental policy. The government defers managerial decisions and investment choices to the business firms, and it only has a significant hand, if that, in very large high profile investments. Rosen and Hanemann quip, “The image of agents from the Politburo commanding state enterprises to ‘go buy the world’ is largely fictitious.”<sup>95</sup> Similarly, the long running survey of Chinese corporate

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<sup>92</sup> Wong and Chan, “China’s Outward Direct Investment,” 294.

<sup>93</sup> Rugman, “How Global are TNCs from Emerging Markets?” 96–7.

<sup>94</sup> Dunning, *Multinational Enterprises and the Global Economy*, 76–78.

<sup>95</sup> Rosen and Hanemann, *China’s Changing Outbound Foreign Direct Investment Profile*, 11.

executives lists overseas market potential as being more and more dominant in motivating firms to invest or go abroad.<sup>96</sup>

Interestingly, perceptions are growing that some of China's largest firms are beginning to actually influence the central government now. This is especially true in the conduct of some of China's most "strategically" important state-owned firms: the national oil companies (NOCs). High profile petroleum operations in the Sudan pitted two of the four national oil companies against each other, leading Sinopec to partner with a Malaysian oil company to undercut a Chinese National Petroleum Corporation (CNPC) bid by over \$60 million. Sinopec not only followed market principles but bucked the "guidance" from the central government, leading the central government to modify its diplomatic positions with other governments.<sup>97</sup>

The final discussion on Chinese OFDI determinants is in terms of new mathematical models that empirically test motivations for investment. Commonly tested hypotheses are the natural resource-seeking hypothesis and market-seeking hypothesis.<sup>98</sup> Consistently, empirical mathematical regression has found that natural resources are *not* a primary motivation for Chinese OFDI, and that the farther away from China an investment location is, the less likely Chinese firms will actually invest in that location.<sup>99</sup> The only motivational hypothesis that withstands the tyranny of statistics is the motivation to expand the number of markets Chinese products are available in. While these models produce interesting and provocative results, they must be regarded with some skepticism, however, because many of the data relied upon only use the initial location of OFDI, which is extremely slanted towards Hong Kong.

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<sup>96</sup> China Council for Promotion of International Trade et al., *China Goes Global 2011*, 8.

<sup>97</sup> Chih-shian Liou, "Bureaucratic Politics," 670–90.

<sup>98</sup> K. C. Fung, Alicia Garcia-Herrero, and Alan Siu, "A Comparative Empirical Examination of Outward Foreign Direct Investment from Four Asian Economies: People's Republic of China; Japan; Republic of Korea; and Taipei, China," *Asian Development Review* 26, no. 2 (2009): 86–101; Buckley et al., "The Determinants of Chinese Outward Foreign Direct Investment," 499–518.

<sup>99</sup> *Ibid.*

#### 4. The Effect of Chinese OFDI on the Chinese Economy

The effect of Chinese OFDI on the Chinese economy at home is inherently hard to quantify. The economy has benefited in some ways and in other ways it still has yet to realize any benefit, and there have been few negative effects.

The institutional policies discussed above have had a substantial effect on the overall outward investment pattern of Chinese firms and on the Chinese economy. Undoubtedly, investments in the natural resource sectors have secured the requisite resource inputs required to maintain economic growth in China.

Further, the investments have created a global infrastructure for the integration of China into the global economic system by modernizing the logistics system and building international connections and offices abroad.<sup>100</sup> Chinese infrastructure investments in the developing world have been in wide array of different activities like roads, ports, stadiums, and hospitals, that have, more often than not, been complete on time and on budget, and have, in Peter Nolan's words, "made important contributions to [Chinese] economic development."<sup>101</sup>

While these investments in infrastructure abroad have increased the ability of Chinese firms to operate in the international community, there has been some criticism that Chinese investments toward certain regions and countries have neglected or damaged the local populations through exploitive work practices, especially in Africa.<sup>102</sup> These perceptions can have a negative effect on Chinese economy due to the fact that it leads some people to boycott Chinese products and cause diplomatic issues.

The management skills and abilities of Chinese firms to manage global operations have not significantly benefited and are still a liability for the overall effectiveness of

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<sup>100</sup> Rosen and Hanemann, *China's Changing Outbound Foreign Direct Investment Profile*, 7–10.

<sup>101</sup> Nolan, *Is China Buying the World?*, 72–4.

<sup>102</sup> Mutuna Chanda "China in Zambia: Jobs or exploitation?" *BBC News*, 12 December 2010, <http://www.bbc.co.uk/news/world-africa-11898960>; Ching Kwan Lee, "Raw Encounters: Chinese Managers, African Workers and the Politics of Casualization in Africa's Chinese Enclaves," *The China Quarterly* 199 (September 2009): 647–66.

China's OFDI on the economy at large.<sup>103</sup> The current inefficiency of Chinese management provides grounds for some optimism that Chinese OFDI still has untapped potential to benefit the Chinese economy because only the most efficient and adept firms are able to prosper internationally and that will eventually translate into the domestic economy.<sup>104</sup> In this light, the Chinese economy is just now beginning to benefit from increases in management and corporate know-how from OFDI, and the next 15 to 20 years will be the test to see whether Chinese firms can apply what they have learned thus far from their international experience to the domestic economy.

The Chinese economy has not benefited from strategic assets acquisitions, thus far. Chinese firms have yet to establish recognizable international brands like the Koreans have with Hyundai and Samsung or the Japanese with Sony, Toyota, and Honda. This is not to say that Chinese will not do so; it is just that thus far, the "go global" policy has not produced a strategic asset that is unequivocally associated with China.

## **E. CHAPTER CONCLUSION**

Chinese OFDI will continue to be a politically and economically important topic in the years to come. Based upon UNCTAD and contemporary reporting, the next statistical bulletin on OFDI from China released by the MOFCOM will almost undoubtedly show a greater flow of FDI from China. This chapter has presented the historical context and background of Chinese OFDI and answers the first three major research questions of this thesis: why have Chinese firms invested abroad, how the historical and current scope of China's OFDI should be assessed, and what the effect of Chinese OFDI on the Chinese economy has. Overall, the scope of Chinese OFDI has expanded greatly, but not overwhelmingly or threateningly, and, although the pattern is inconsistent with international norms, Chinese OFDI is driven increasingly more by economic and commercial factors than governmental direction to individual firms. On a macro-level, government policies and institutional changes have demonstrated a

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<sup>103</sup> Rosen and Hanemann, *China's Changing Outbound Foreign Direct Investment Profile*, 7–10.

<sup>104</sup> Alan Rugman, "How Global are TNCs from Emerging Markets?" 104–5.

significant ability promote or suppress OFDI. Finally, the benefit of Chinese OFDI on the Chinese economy has been mixed, thus far.

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### III. THEORETICAL INTERPRETATIONS OF CHINESE OFDI

In the literature on contemporary China, there are growing schisms between scholars who believe China is engaging in a vast grand strategy to achieve potentially nefarious goals or rival the current global, political, economic, or security framework and those who see a pragmatic China trying to incorporate itself in existing frameworks and find its place within the global order. Underlying these two arguments are theoretical beliefs that are imposed on interpretation of China's actions. This chapter attempts to interpret Chinese OFDI systematically through the theoretical underpinnings that guide current discourses. Economic theory on foreign investment created by Peter Buckley, Mark Casson, and John Dunning is presented first, followed by an analysis of Chinese OFDI through these lenses. Following the economic lens, an analysis of Chinese OFDI through the realist lens, or realist international theory, is presented. Each lens has areas of convergence and divergence in interpreting Chinese OFDI, with the economic lens appearing better suited to interpret Chinese OFDI than the realist lens.

#### A. THE ECONOMIC LENSES

Chinese OFDI can be assessed through the leading economic theories regarding overseas investment. The two theories that will be used to assess Chinese OFDI through an economic lens are the internalization theory developed by Peter Buckley and Mark Casson, and John Dunning's eclectic paradigm.<sup>105</sup> The first subsection section briefly sketches these two theories, and the second subsection assesses how closely the facts of Chinese OFDI match the two theories.

##### 1. Buckley and Casson's Internalization Theory

Buckley and Casson's internalization theory was developed to account for failures of the conventional theory of production where profit maximization and perfectly competitive markets are assumed. Internalization theory breaks with conventional theory

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<sup>105</sup> Buckley and Casson, *The Future of the Multinational Enterprise*; Dunning, *Multinational Enterprises and the Global Economy*, 76–80.

in assuming that markets are not always perfect (because if the market was perfect, it could not be improved upon) and that firms internalized these market imperfections by “bringing under common ownership and control the activities which are linked by the market.”<sup>106</sup> The fact that this internalization occurs across national boundaries creates so-called multinational enterprises and stimulates outward investment.

The theory identifies five market imperfections that compel firms to internalize markets. First, complex, integrated operations linked to the market may require a significant lapse of time to complete, but insufficient futures market exists to coordinate. Second, profit maximization might require unfeasible discriminatory pricing in the external market. Third, excessive concentration of market power to one side creates an unstable bargaining position. Fourth, unequal knowledge exists between the buying and seller. And fifth, governments may implement *ad valorem* tariffs and other restrictions like non-trade barriers in the international marketplace. Buckley and Casson identify certain markets that have a higher concentration of these imperfections, and firms in those markets have stronger incentives to internalize: the market for knowledge (which includes research and development) since it is time consuming, without a futures market, a natural monopoly, and is difficult to price; and the market for perishable agriculture, capital intensive manufacturing process, and raw materials that are geographically concentrated.<sup>107</sup>

While there are numerous benefits to internalization, firms will also have to bear certain costs in the process: possibly higher resource costs because a single external market is now divided up into smaller, more numerous internal markets within a firm (this can be offset by only partial internalization of external market); communication costs stemming from greater centralized control, especially over longer distances; market fragmentation, which can make overhead costs increase; and greater costs to ensure internal accuracy of information that external markets theoretically regulate automatically. A final cost of internalization is political interference against foreign firms

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<sup>106</sup> Buckley and Casson, *The Future of the Multinational Enterprise*, 33.

<sup>107</sup> *Ibid.*, 37–41.

and governmental “patronage to indigenous producers” and the threat of nationalization of industries. Finally, internalization also requires proficient and credible ability to oversee diverse activities that possibly could be taking place all over the world.<sup>108</sup>

The confluence of these costs, benefits, governmental factors, suitability of the industry leads to the “interplay” of four factors: industry-specific factors, regional-specific factors, nation-specific factors, and firm-specific factors. Industry-specific factors are the “nature of product, structure of external market, and relation of optimal scales of activities.”<sup>109</sup> Region-specific factors are the geographic separation in terms of not only distance but also psychic “social” perceptions. Nation-specific factors are the political environment of the nations involved. Finally, the firm-specific factor is the ability of the firm to be able to organize and execute multinational operations.<sup>110</sup>

## **2. Dunning’s Eclectic Paradigm**

John Dunning, professor emeritus at Rutgers University and Reading University in the United Kingdom, developed his eclectic paradigm of multinational enterprises and investment as “a general framework for determining the extent and patten of both foreign-owned production undertaken by a county’s own enterprises and also that of domestic production owned by foreign enterprises.”<sup>111</sup> In this sense, Dunning’s paradigm presents a structure that firms can use to capitalize on specific advantages in the multinational arena to be successful. Building on the Heckscher-Ohlin-Samuelson trade theory and explicitly incorporating previous theories, Dunning identifies three specific advantages that contribute to a firm investing abroad: ownership-specific advantages, location-specific advantages, and internalization-specific advantages. These three advantages are where the paradigm receives it oft used label of “OLI model.”

Ownership-specific advantages are developed out of traditional industrial organization theory. They include property rights and intangible assets advantages like

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<sup>108</sup> Ibid., 41–4, “patronage to indigenous producers” (ibid., 43).

<sup>109</sup> Ibid., 44.

<sup>110</sup> Ibid., 44–5.

<sup>111</sup> Dunning, *Multinational Enterprises and the Global Economy*, 76.

product innovations, resources of the firm, and organization of work. Similarly, minimization of transaction costs through common ownership within organization complements the ownership-specific advantages listed above. Applied to common international production determinants, like natural resources seeking, market seeking, and strategic asset seeking, ownership-specific advantages contribute capital, technology, economies of scale, management efficiency, and synergy of effort.<sup>112</sup>

Location-specific advantages, in Dunning's words, "include not only Ricardian type endowments, but also the cultural, legal, political, and institutional environment."<sup>113</sup> In essence, the physical and institutional host and home country environment can contribute to the reasons and the patterns of investment overseas. Such political and institutional factors include artificial barriers or conduits like *ad valorem* taxes, free trade policies, and non-trade barriers. Similarly, the physical environment influences location specific advantages through potential communication cost of transportation (especially seen with international canals, straits, and waterways like the Panama Canal and the Strait of Malacca), in addition to, the presence, distribution, and concentration of natural resources in a particular location. Location advantages, when applied to common international invest determinants like natural resources seeking, market seeking, and strategic asset seeking, include: acquiring possession of natural resource concentrated real estate, direct access to new markets, and utilization of transportation and communication facilities.<sup>114</sup>

The final specific advantage Dunning identifies in his eclectic paradigm is internalization advantages. This advantage includes the market imperfections identified earlier by Buckley and Casson and other imperfections identified by international economists like Stephen Hymer to aid in maximizing profit and minimizing cost through the "circumvention or exploitation of market failure."<sup>115</sup> Most of the imperfections have already been mentioned in the earlier section on internalization theory, but Dunning

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<sup>112</sup> Ibid., 80–4.

<sup>113</sup> Ibid., 77.

<sup>114</sup> Ibid., 80–4.

<sup>115</sup> Ibid., 81.

includes such “anti-competitive” practices as predatory pricing, cross-subsidization, and monopolization of market outlets as reasons of why firms choose to invest abroad. In terms of international production determinants, like natural resources seeking, market seeking, and strategic asset seeking, internalization advantages convey the ability to ensure stability of supplies, reduce transaction uncertainty, improve competitive advantage and mitigate risk.<sup>116</sup>

### 3. Analysis

Using these theoretical lenses, Chinese OFDI can be interpreted in line with standing economic theory. This subsection links Chinese OFDI actions with the tenets of the previous two theories to see how Chinese OFDI may align.

The five market imperfections noted by Buckley and Casson in their internalization theory provide the first point of comparison. The first market imperfection noted, integrated operations linked to the market may require significant lapse of time to complete but insufficient futures market to coordinate, is only partially valid. Tied closely to natural resource extraction, many natural resources that are commonly targeted by Chinese investment like hydrocarbons and metals have robust and competitive futures markets located in major economic centers like New York, London, and, even, Shanghai.<sup>117</sup>

The second market imperfection—profit maximization requiring unfeasible discriminatory pricing—can be seen as a rational action by Chinese firms, especially state-owned enterprises and corresponds to some actions by Chinese firms. This can be applied correctly to factors regarding the retail price of gasoline and products that have governmentally-set prices. Because the NDRC sets the retail price of certain commodities artificially low, internalization of certain natural resource markets can help NOCs maximize profit (or inhibit mounting losses) and falls in line with Buckley and Casson’s theory. Chinese NOCs internalize international production of energy resources, sell some

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<sup>116</sup> Ibid., 80–4.

<sup>117</sup> See Ben Baris, “Hong Kong Uses London Metal Exchange to Spearhead Expansion,” *Institutional Investor*, 24 July 2012, for evidence of futures markets available to Chinese firms.

of the product on the international market at a higher price than the domestically set price, and help minimize losses accrued through the retailing of artificially low priced petroleum products in China.

Third, the market imperfection listed in internalization theory—excessive concentration of market power to one side creating an unstable bargaining position—holds very true in China’s case. Again, chiefly seen in the natural resource sector, the Organization of Petroleum Exporting Countries (OPEC) has been described as a cartel with an excessive concentration of market power that leads to a preferable bargaining position, and attempts by China to expand its control over petroleum resources through OFDI is in line with Buckley and Casson’s internalization theory.<sup>118</sup> While there is debate as to how much OPEC exhibits cartel behavior, it is only necessary for the impression to exist to create an impetus for firms to act to limit any potential unfavorable bargaining position. Chinese OFDI appears to fall in line with the third reason Buckley and Casson give for why firms would invest abroad.

The fourth market imperfection listed by Buckley and Casson—unequal knowledge between the buying and seller—has limited utility in explaining China’s OFDI surge. This imperfection is probably best served for reasons why there is an increase in FDI *into* China due to the perception about the reliability, consistency, quality, and efficacy of Chinese firms, especially in manufacturing and production.

Finally, the fifth market imperfection that compels the internalization of a market—governmental implementation of *ad valorem* tariffs and other restrictions—is extremely relevant in terms of Chinese OFDI actions. In Chapter II, this thesis documented Chinese investment into certain African and SE Asian nations explicitly to circumvent European Union and U.S. import taxes placed on certain manufactured goods. Similarly, in September 2009, the United States imposed exacting 35 percent import tariffs on Chinese tires signaling that tariffs on Chinese products are still a common

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<sup>118</sup> See introduction of Raymond Li, “The Role of OPEC in the World Oil Market,” *International Journal of Business and Economics* 9, no. 1 (2010): 83, for a common description of OPEC.

occurrence and give further credence to Chinese OFDI actions to thwart crippling sanctions and other barriers.<sup>119</sup>

Moving to the assessment of Chinese OFDI through Dunning's eclectic paradigm, many similarities and connections, too, can be drawn. From the ownership-specific advantages perspective, China's substantial OFDI into natural resources that were extensively documented in Chapter II thesis falls in line with the eclectic paradigm, as it provides access to markets, and negotiating strength. Further, the privileged access by firms to strategic resources gives them an advantage against their competitors. With regard to the manufacturing and strategic assets investments by Chinese firms, ownership advantages have been seen in the access to management and organizational skills and the burgeoning focus on the ability to generate and gain brand loyalty. Overall, in terms of assessing Chinese OFDI specific actions with regard ownership-specific advantages, there are many parallels.

The second part of Dunning's eclectic paradigm—location-specific advantages—is only partially evident in Chinese OFDI actions. In terms of market seeking international investment, material and labor costs are usually not a motivating factor which is listed one of the primary impetuses for location-specific investments.<sup>120</sup> Within the natural resources sector, however, the parallels between location specific-advantages and Chinese OFDI are clear: limited domestic supply of certain resources compels international investment where the resources are abundant. Overall, Chinese OFDI only partially matches the location-specific advantages of Dunning's eclectic paradigm.

The final portion of Dunning's eclectic paradigm—internalization-specific advantages—has been detailed extensively in the first part of this section's analysis.

To conclude, Chinese OFDI patterns seem fairly consistent with economic theory regarding international investment. Chinese OFDI is consistent with three of the five reasons Buckley and Casson put forward as to why a firm would want to internalize

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<sup>119</sup> See Gary Clyde Hufbauer and Sean Lowry, "U.S. Tire Tariffs: Saving Few Jobs at High Cost," *PIIE Policy Brief 12-9* (Peterson Institute for International Economics, April 2012), for description and effects of U.S. tariffs on Chinese tires.

<sup>120</sup> Dunning, *Multinational Enterprises and the Global Economy*, 84.

international production. Similarly, Chinese OFDI is mostly consistent with Dunning's eclectic paradigm of ownership-specific, location-specific, and internalization-specific advantages for international investment.

## **B. THE REALIST LENS**

Consistently in contemporary literature, Chinese economic activity has been interpreted as facet of a realist grand strategy.<sup>121</sup> This section analyzes Chinese OFDI through the realist lens to see how much Chinese OFDI activity reflects realist theory. As in the previous section on economic theory, a contemporary understanding of realist theory is presented, followed by an analysis of Chinese OFDI through the theory.

### **1. Realist Economic Theory**

Realist theory is essentially all about the struggle for and achievement of relative power.<sup>122</sup> To a realist, the world is made up of rational, unitary state actors that compete in a zero-sum, anarchic world. The realist great power struggle varies between two major subdivisions of realism: defensive, or structural, realists; and offensive realists. For the adherents of the defensive school, like Kenneth Waltz, the world is tenuously balanced between each nation-state's martial capabilities which cancel each other advantage out.<sup>123</sup> Offensive realists, guided by their founder John Mearsheimer, see it differently. Great powers actively compete against each other until one nation-state gains supreme hegemony, either regionally or globally.<sup>124</sup> In both sub-schools, national interests and security are superior to all others interests.

Realist theory translates into political economy though the adaptation of neomercantilist policies that accept the principles of liberal trade and economic theories while placing limits on the range of goods traded and imposition of tariff and

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<sup>121</sup> See Aaron L. Friedberg, "'Going Out': China's Pursuit of Natural Resources and Implications for the PRC's Grand Strategy," *NBR Analysis* 17, no. 3 (September 2006): 17.

<sup>122</sup> Jack Snyder, "One World, Rival Theories," *Foreign Policy* 145 (November/December 2004): 55.

<sup>123</sup> Waltz, *Theory of International Politics*.

<sup>124</sup> Mearsheimer, *Tragedy of Great Power Politics*.

protectionist measures to protect certain aspects of the national economy.<sup>125</sup> Indeed, the foremost advocate of economic nationalism and neomercantilism, the German Friedrich List, who famously said “*The power of producing wealth* is therefore infinitely more important than the wealth itself” accepted many of the tenets of Adam Smith ideas but crafted them to suit the fomentation of national power.<sup>126</sup> Similarly, Jacob Viner, a Canadian economist who significantly influenced the development of economic nationalism, said “wealth is an absolute essential means to power, whether for security or for aggression.”<sup>127</sup>

Fundamentally, the role of the state is to promote the production of wealth to serve the national security interests of the state and all other considerations are inferior.<sup>128</sup> Should conflict or differences arise between domestic economic considerations and international security, the state will, according to realist political economic theory, intervene and arbitrate in favor of national security.<sup>129</sup> Additionally, international relations will shape economic patterns through both limiting production of national security related items to domestic, or allied, economic centers and the use of economic means to gain political leverage. Seen in Nazi Germany’s use of asymmetric trading relationships which built leverage over smaller states, this method of shaping international relations through economic means can also be used to gain influence with “overly generous concessions.” Economic growth is associated with conflict and war through a fundamental shift in the balance of relative power among nations.<sup>130</sup> To limit and inhibit any shifts in relative power, especially as capital becomes increasingly

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<sup>125</sup> Kirshner, “The Political Economy of Realism,” 70–71.

<sup>126</sup> List, *The Nationalist System of Political Economy*, 135, quoted in Kirshner, “Political Economy of Realism,” 71

<sup>127</sup> Jacob Viner, *The Long View and the Short: Studies in Economic Theory and Policy* (New York: Free Press, 1958), 286, quoted in Gilpin, *The PE of IR*, 32.

<sup>128</sup> Gilpin, *The PE of IR*, 33.

<sup>129</sup> Kirshner, “Political Economy of Realism,” 73.

<sup>130</sup> *Ibid.*, 75–79, “overly generous concessions” (*ibid.*, 79).

invested abroad, states will enact taxation policies, trade barriers, and other measures that favor their increase in relative power.<sup>131</sup>

In summation, if a state is engaged in a form of economic nationalism based upon realist theory, the state should have a significant and pervasive influence in their international economic affairs, instigate economic policies oriented toward maintaining and gaining national security *vis-à-vis* potential threats, use economic means to gain influence, engage in economically protectionist practices, and intervene in economic matters.

## 2. Analysis

Chinese OFDI interpreted through a realist lens produces mixed results. There are both instances of convergence *and* divergence with the theoretical framework laid out in the previous section. This subsection will highlight instances where Chinese OFDI appears inconsistent with a realist interpretation and where Chinese OFDI falls in line with realist theory.

Beginning with the inconsistencies, China's emphasis on acquiring "strategic assets" or internationally recognized brands that have worldwide appeal is not consistent with realist theory. Realist theory expects that a state will "shape their policies in light of [the consideration for war]."<sup>132</sup> As mentioned in earlier chapters of this thesis, China has begun to make investments and purchases of some internationally recognizable brands like Lenovo's acquisition of IBM's laptop subsidiary, Haier's purchase of Thomson TV and the failed bid for Maytag, and Geely's purchase of Volvo Cars. While it was also argued that these investments has thus far been less than successful, it is immaterial as long as Chinese firms continue to make direct and substantial efforts to acquire international brands because it indicates a willingness to engage in international commerce which would be negatively affected by war. The Chinese emphasis on a investing in strategic assets and brands indicates that Chinese policy wants to maintain a stable economic environment with other nations and goes against realist predictions.

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<sup>131</sup> Gilpin, *The PE of IR*, 262.

<sup>132</sup> Kirshner, "Political Economy of Realism,"72.

The second inconsistency with Chinese policy comes from what most analysts would say is a prime example of Chinese state invention and direction of OFDI. As mentioned in Chapter II, the NDRC, in coordination with MOFCOM, periodically issues a list of nations and industries Chinese firms should invest in.<sup>133</sup> Yet, even as the central government issues this direction, Chinese firms feel no obligation to follow it. Principally, one country that is often nefariously connected to potential Chinese attempts at instituting a new world order, Iran, is *not* on the list, and Chinese firms still engage in Iranian investment even though the central government implicitly tells them not to. In fact, the catalog of “preferred” states is more than a third of the world’s nation-states with 23 Asian nations, 15 African, 11 European, 11 nations in the Western Hemisphere, and 5 states in Oceania.<sup>134</sup> The disparate and expansive number of nations and industries listed demonstrates that what is speciously described as firm, specific, and direct guidance is really broad, general advice that most, if not all, nations disseminate to domestic firms. Phillip Saunders characterizes these and other policy actions by China regarding foreign investment as “modest compared with U.S., European Union, and Japanese programs.”<sup>135</sup>

Additionally, while the Chinese government maintains a requirement to receive governmental approval for overseas investment, the approval process has been decentralized away from the central government toward the provincial governments.<sup>136</sup> Overall, the central government’s direction is broad and modest with the exception of investment in sensitive economies like Taiwan and control has shifted more toward the provincial level. Further, as mentioned in Chapter II, most firms are driven by profit maximization rather than so-called strategic objectives by the state.

A final instance where Chinese OFDI is inconsistent with a realist lens is the strategically important NOCs, which buck government direction in coordinating

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<sup>133</sup> Voss et al., “Effects of Institutional Change on Chinese ODI,” 153.

<sup>134</sup> David Zweig, “The Rise of a New ‘Trading Nation,’” in Dittmer Yu, eds., *China, The Developing World, and New Global Dynamic*, 40–41.

<sup>135</sup> Saunders, “China’s Global Activism: Strategy, Drivers, and Tools,” 2.

<sup>136</sup> Voss et al., “Effects of Institutional Change on Chinese ODI,” 153.

investment with foreign firms and undercutting other Chinese state owned enterprises.<sup>137</sup> If the central government were going to intervene in any foreign investment issue with strategic implications, it would be in the petroleum sector. Current research supports the conclusion that the trend is moving away for central government intervention toward the commercial and business interests of the individual firm.

There are, however, some instances where Chinese OFDI and, specifically, government policy pertaining to OFDI, reflect a realist interpretation of Chinese OFDI. Falling under the old Soviet model of official appointments of prominent cadre to leadership positions, China's nomenklatura system selects and appoints the heads of state-owned enterprises.<sup>138</sup> Since the last nomenklatura system reform in 1998, the Central Committee has maintained direct control of leadership appointments in 44 non-financial SOEs, the Party Central Large-scale Enterprise Work Committee directly appoints the leadership for another 120 non-financial SOEs, and the Party Central Finance Work Committee maintains control over the appointment of 40 more financial SOEs. In addition, provincial, municipal, and other local party organs control company personnel appointments for an estimated 600 to 700 smaller SOEs.<sup>139</sup>

Similarly, the CCP has been able to exert some type of influence in private firms. A recently released investigative report on Chinese telecommunications companies Huawei and ZTE indicates that the CCP maintains, for undisclosed reasons, internal party branches even though these firms are privately owned.<sup>140</sup>

Secondly, the central government has demonstrated an ability to directly intervene in OFDI to limit or inhibit potential losses of economic power. Mentioned in Chapter II, the State Council issued a circular in 1993 addressing the subject of capital flight and the

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<sup>137</sup> Chih-shian Liou, "Bureaucratic Politics," 670–690.

<sup>138</sup> See John Burns, "China's Nomenklatura System," *Problems of Communism* 36, no. 5 (September–October 1987): 36–51, for a general description of the system.

<sup>139</sup> Hon S. Chan, "Cadre Personnel Management in China: The Nomenklatura System, 1990–1998," *The China Quarterly* 179 (September, 2004): 708–9.

<sup>140</sup> Mike Rodgers and Dutch Ruppertsberger, *Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE* (Washington, D.C.: U.S. House of Representatives Permanent Select Committee on Intelligence, 8 October, 2012), 22, 40

need for better management to prevent it.<sup>141</sup> This central government intervention in economic matters resulted in the significant drop in outward Chinese OFDI and is consistent with a realist interpretation of government policy on Chinese OFDI where the government would intervene to prevent a loss of relative power.

Finally, the realist lens appears to be converging with Chinese OFDI and central government policy concerning Chinese-Taiwan economic relations. As will be discussed in the next chapter on the geopolitical effect of Chinese OFDI, the central government has acted in a manner consistent with Jonathan Kirchner's description of realist political economy, specifically the development of asymmetric economic relationships to increase political leverage through expenditures of wealth shaped along political lines.<sup>142</sup> Seen currently under the new relationship being developed under the Economic Cooperation Framework Agreement (ECFA), China is sacrificing, or, at least, delaying any economic gains for increased economic cooperation potentially aimed at gaining political leverage over the island. This will be further discussed in Chapter IV.

### **C. CHAPTER CONCLUSION**

This chapter analyzed Chinese OFDI through economic lenses and a realist lens. Buckley and Casson's internalization theory and John Dunning's eclectic paradigm were presented to understand the theoretical reasons why firms would chose to invest abroad. These theoretical assumptions were used to assess Chinese OFDI actions and the result was a general convergence with both theories with a few exceptions. Following the economic lenses, realist international relations theory and how it relates to political economy was presented as an alternative theory for the interpretation of Chinese OFDI. Both defensive realist theory and offensive realist theory was presented and applied to Chinese OFDI. While there were areas of similarity between realist theory and governmental actions regarding Chinese OFDI, there were equally as many inconsistencies with realist theory. These mixed results underlie the fundamental requirement to assess each foreign investment from China individually; while the vast

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<sup>141</sup> Chih-shian Liou, "Bureaucratic Politics," 674–5.

<sup>142</sup> Kirshner, "Political Economy of Realism," 77.

majority of Chinese OFDI appears to correlate with sound economic fundamentals, there is always the possible lone outlier investment that is initiated for reasons other than profit maximization and generation of wealth. Overall, Chinese OFDI appears to be mostly consistent with economic theory and only marginally consistent with realist theory.

#### IV. THE GEOPOLITICAL EFFECT OF CHINESE OFDI ON THE ASIA-PACIFIC REGION

Chinese OFDI has grown from practically nothing prior to Deng Xiaoping's economic reforms in 1978 to over \$68 billion annually in 2010, yet it is only very recently beginning to be studied.<sup>143</sup> Similarly, since 2002, China has advocated a policy of "Going Global" for domestic firms to invest abroad. The increase in China's OFDI, combined with growing tensions over its territorial claims, military modernization, and apprehension over economic turmoil from the global recession, has sparked fears that China will begin to challenge the current social, economic, and political order. Some in the West believe that China's OFDI is part of a mercantilist strategy against the United States, or the "Go Global" policy is part of Chinese grand strategy, a so called "charm offensive," to advance political influence and gobble up the world resources through growing economic power.<sup>144</sup> Others see Chinese OFDI through a slightly less threatening perspective and as guided more by economic policy and commercial factors.<sup>145</sup>

This chapter attempts to answer the fifth major research question by analyzing what effect Chinese OFDI has had on the Asia-Pacific region. Utilizing a country-by-country basis (with the exception of the South Pacific region, which is analyzed in whole), this chapter correlates Chinese OFDI in each country since 2002 with the geopolitical dynamic between Beijing and the countries studied. The countries and regions studied, in the order that they are presented, are: North Korea, South Korea, South Pacific, the Philippines, Indonesia, Japan, and Taiwan. Overall, the results are mixed. OFDI appears to be helping China gain influence in Taiwan and some parts of the South Pacific. It is causing conflict with the Philippines and correlating to rise and fall of public opinion regarding China in South Korea. It is having negligible effect in swaying Indonesia Beijing's way, but it correlates with increased cooperation between the two

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<sup>143</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 79.

<sup>144</sup> David Shambaugh "China Engages Asia: Reshaping the Regional Order," *International Security* 29, no. 3 (Winter 2004/2005): 64–7; Steven Lohr, Andrew Ross Sorkin, and Jad Mouawad, "Unocal Bid Denounced at Hearing," *New York Times*, July 14, 2005; Friedberg, "Going Out," 17.

<sup>145</sup> Saunders, "China's Global Activism: Strategy, Drivers, and Tools," 1–2.

countries. It is having an inconclusive effect in Japan (if not slightly negative); and, in North Korea, Beijing actually appears to be becoming more influenced by Pyongyang rather than the other way around.

Before presenting the case studies, a description of the methodology is presented. The format of each case study is to present the dynamics of Chinese OFDI during the period studied (typically from 2002), then present how the relationship with the China has changed, and conclude with what, if any, inferences can be made to the effect of Chinese OFDI between the two countries. During some of the case studies, commonly held beliefs as to goals China has are mentioned, but, more often than not, these beliefs are presented to *contrast* actual findings of the correlative effect between the OFDI and bilateral relations. Similarly, this is chapter's intention is to be a correlative study and make no pretense that OFDI is a *causal* factor. There are numerous competing and significant factors that push and pull nations in the region and assuming that OFDI is dominant would be tenuous. With this being said, the intention of this chapter is to analytically present the effect of the changing levels of OFDI into the region and see how it correlates with China's relationship in those countries.

#### **A. NORTH KOREA**

Investment in North Korea has generally been a difficult and unwanted process by most nations, but China has been the largest nation, other than South Korea, to invest in the country. Since 2003, Chinese investment has averaged \$15.3 million, but it has swung widely from year to year, with investment peaking in 2008 at over \$41 million only to be followed by a low of less than \$6 million the next year. The total stock of Chinese investment in North Korea, however, has increased over tenfold from 2004 to 2010, growing from just over \$21 million to greater than \$240 million.<sup>146</sup>

The reported volume of investment, along with perceptions of close Sino-North Korean cooperation and the inherent stagnation of Pyongyang's economy, has led many

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<sup>146</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 82, 88.

to believe that China possesses significant influence over North Korea.<sup>147</sup> Part of this assumption is found in asymmetric interdependence theory. Some scholars believe that one of the primary motivators for Chinese investment in North Korea is to strengthen Beijing's political influence within the regime, as well as to get Pyongyang to embrace economic reforms.<sup>148</sup>

However, a casual observation of the relationship between Beijing and Pyongyang would indicate that increased investment by China in North Korea has not had any appreciable effect on influencing the regime towards China's interests. Significantly, Jaewoo Choo remarks, "Beijing's lack of prior knowledge about the military exercises may be *ipso facto* a manifestation of its persistent denial of political leverage over the years."<sup>149</sup> Indeed, with increasing investment in the regime, Beijing was unable to prevent the testing of a nuclear bomb in 2006 and was only given 20 minutes of advance notice.<sup>150</sup> This inability to restrain the regime has not been an isolated incident as North Korea has engaged in continuous provocative events with the transition from Kim Jong-Il to his son Kim Jong-Un with the 2010 sinking of the South Korean corvette *Cheonan*, artillery bombardment of Yeonpyeong Island, and the failed test fire of a missile in 2012.<sup>151</sup> This consistent string of military provocations by North Korea, which Beijing had largely denounced until recently, indicates clearly that Beijing has gained little political influence over Pyongyang despite increases in Chinese OFDI.

Secondly, Chinese investment has done little to move North Korea towards economic reforms. The Chinese have attempted to use OFDI to move economic reforms through a number of different avenues, and they all have seemed to fail. Ironically, the North Koreans have canceled many projects, notably at the Musan iron mines, because

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<sup>147</sup> Jaewoo Choo, "Mirroring North Korea's Growing Economic Dependence on China: Political Ramifications," *Asian Survey* 48, no. 2 (March–April 2008): 343.

<sup>148</sup> Jae Cheol Kim, "The Political Economy of Chinese Investment in North Korea," *Asian Survey* 46, no. 6 (November–December 2006): 905–7.

<sup>149</sup> Choo, "Mirroring North Korea's Growing Economic Dependence on China," 344.

<sup>150</sup> Stephanie Kleine-Ahlbrandt and Andrew Smal I, "China's New Dictatorship Diplomacy: Is Beijing Parting with Pariahs?" *Foreign Affairs* 87, no. 1 (January–February 2008): 44–5.

<sup>151</sup> John Sudworth, "North Korean Artillery Hits South Korean Island," *British Broadcasting Channel*, 23 November 2010, <http://www.bbc.co.uk/news/world-asia-pacific-11818005>.

the preponderance of funding for joint ventures into natural resource extraction has come from the Chinese; in effect, the substantial amounts of Chinese OFDI into the DPRK has pushed Pyongyang away from reforms and progress.<sup>152</sup> Even more recently, it appears Chinese investment and economic reforms have only been welcome as long as they do not impinge upon Pyongyang's security goals.<sup>153</sup>

In conclusion, the casual effect of Chinese investment into North Korea has not seemed to influence North Korea much. Indeed, North Korea has seemed to backslide from a previous high point, during the so-called "Sunshine Policy" period with South Korea at the turn of the century. Conversely, Chinese OFDI may have contributed to a "wag the dog" outcome where it has influenced China's policy toward North Korea more than the investment has influenced North Korean policy toward China as China seems to be slightly more conciliatory towards Pyongyang. Bates Gill's assessment of Beijing's recently policy toward North Korea highlights the increasing diplomatic exchanges between the two countries, more accommodating language in the wake of Pyongyang's military provocations against Seoul, and the growing economic linkages between the two nations.<sup>154</sup> While it might be a tenuous argument that Chinese OFDI has made Beijing's foreign policy more in line with the Pyongyang's perspective, a casual observance might lead to this conclusion and should not be discounted.

## **B. SOUTH KOREA**

The effect of Chinese OFDI on South Korea is, perhaps, one of the clearest examples of the effect OFDI can have on public opinion. The range of total annual investment into South Korea reaches both the low and high extremes in nearly every country China has invested in (except for countries seen as tax havens or money shelters) and, in concert, public and political opinion of China by South Koreans have mimicked

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<sup>152</sup> Kim, "The Political Economy of Chinese Investment in North Korea," 915.

<sup>153</sup> Benjamin Kang Lim, "Exclusive: North Korean Leader Seeks Trip to China for Economic Help," *Reuters*, August 24, 2012, <http://www.reuters.com/article/2012/08/24/us-korea-north-china-idUSBRE87N06R20120824>.

<sup>154</sup> Bates Gill, "China's North Korea Policy: Assessing Interests and Influences," *USIP Special Report* 283 (Washington, D.C.: United States Institute of Peace, July 2011):1-5.

those swings in OFDI flows. While public and political opinion might be influencing OFDI rather than OFDI influencing opinion, the correlation should not be spurned needlessly. This section briefly sketches the effect of Chinese OFDI as it pertains to the Sino-South Korean relationship.

Annual flows of Chinese OFDI into South Korea have risen higher than almost every country except for notable money shelters and tax havens like Hong Kong, Cayman Islands, and Luxembourg. Annual flows have also recorded the largest *negative* change since comprehensive statistics began being published by the Chinese Ministry of Commerce. In 2005, Chinese OFDI reached its peak inflow of over \$550 million after a steady buildup of positive flows for years 2003 and 2004. The following year in 2006, the flow precipitously dropped to under \$25 million and averaged a comparatively paltry \$100 million from 2006 to 2009. Most recently, in 2010, the annual Chinese OFDI flow was an astonishing *negative* \$721.68 million!<sup>155</sup>

The effect of Chinese OFDI might have affected the South Korean's public opinion of China. As the flows of Chinese OFDI rose in the early part of the 21<sup>st</sup> century, public opinion of the Chinese was on the rise with growing preference among South Koreans that China might be a better strategic ally.<sup>156</sup> In the second half of the decade, however, when Chinese OFDI dropped off substantially and then fell into the negative, favorable opinion of China began to wane and increase for the United States.<sup>157</sup> The degree of change in favorability has not been as extreme as the flows of OFDI and such significant events as China's failure to condemn the North Korean attack on the South Korean corvette *Cheonan* and its shelling of Yeonpyeong Island probably factored in recent polling. The shift in public opinion, however, started well before those events lending some credibility to the correlation.

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<sup>155</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 82, 88.

<sup>156</sup> Jae Ho Chung, *Between Ally and Partner: Korea–China Relations and the United States* (New York: Columbia University Press, 2006): 96–8.

<sup>157</sup> Chung Min Lee, "Coping with Giants: South Korea's Responses to China's and India's Rise," in Ashley J. Tellis, Travis Tanner, and Jessica Keough, eds., *Strategic Asia 2011–12: Asia Responds to its Rising Powers, China and India* (Seattle, WA: National Bureau of Asian Affairs, 2011, PDF e-book): 173–5.

Secondly, the wild swings in OFDI have a loose connection with the ROK presidential cycle. The 2005 spike in Chinese OFDI might have been connected to the election of the purportedly pro-Beijing Roh Moo-hyun in 2003 and deepening economic ties.<sup>158</sup> Similarly, the mass exodus of Chinese capital in 2010 might be been tied to the more pro-United States election of Roh's successor, Lee Myung-bak, the belief that Sino-South Korean relations have soured, and a more confrontational North-South security environment.<sup>159</sup> These plausible conclusions, however, might reflect less OFDI's effect on the ROK and more the environment's effect on OFDI, but the correlation is should still be acknowledged.

Overall, the effect of Chinese OFDI appears to present a clear correlation of Chinese OFDI influencing public opinion, and, perhaps a little less so, influencing political opinion both positively and negatively. The flow of capital investments has varied a considerable degree since Beijing has emphasized its policy of "Going Global." The ebb and flow of public perception of China in South Korea has mirrored the pattern of Chinese investments, but significant security-related events also probably factored in determining the favorability of China. Additionally, the security and political environment might be determining the levels of OFDI rather than the other way around. In the end, however, the results are intriguing and should not be discounted.

### **C. SOUTH PACIFIC**

Chinese OFDI into the South Pacific region coincides considerably with Beijing's "Going Global" initiative. Further, the pattern of investments appears to follow in the wake of rebuilt diplomatic connections, rather than investments influencing the formation of diplomatic connections. Secondly, the investments only have had a mixed effect in obtaining seemingly preferential diplomatic and strategic goals like isolating Taiwan.

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<sup>158</sup> Dick K. Nanto, and Emma Chanlett-Avery, "The Rise of China and Its Effect on Taiwan, Japan, and South Korea: U.S. Policy Choices," *CRS Report for Congress* RL32882 (Washington, D.C.: Library of Congress, January 13, 2006): 24–5.

<sup>159</sup> Chung-in Moon "South Korea in 2009: From Setbacks to Reversal," *Asian Survey* 50, no. 1 (January–February 2010): 56–64.

This section sketches the corollary between Chinese OFDI in the South Pacific island region and Beijing's diplomatic relationship.

Chinese investments in the region have followed increased interaction by Beijing with the Pacific Island Forum (PIF), an international governmental organization grouping 16 states from Oceania, Micronesia, and parts of Melanesia. Specifically, Beijing has focused their investment activities with eight PIF nations that do not recognize Taiwan as either the legitimate government of China or an autonomous nation. These nations are: the Cook Islands, Federated States of Micronesia, Fiji (which has since been suspended from the PIF), Niue, Papua New Guinea, Samoa, Tonga, and Vanuatu).<sup>160</sup>

Investments made by Chinese firms in the region include the Shanghai Deep Sea Fisheries investment to build ten commercial fishing boats, fish processing and packing facilities, and other industries facilities related to deep sea fishing. The investment has been facilitated by the drafting of memorandums of understanding to provide exclusive fishing rights to the Chinese within certain portions of each respective nation's economic exclusive zones. A second notable investment is China Metallurgical Construction Company's (CMCC) pledge of over \$600 million into nickel and cobalt mines and exclusive rights to 85 percent of production for the next 40 years.<sup>161</sup> This investment, in addition to investments in solar, wind, and natural gas energy resources, has led some to believe that these investments are attempts by China to break longstanding western influence in the region.

The results from the investments have been mixed. The speculated goal of trying to isolate Taiwan through economic diplomacy has yielded mixed results from OFDI initiatives.<sup>162</sup> Beijing withheld investment in the Pacific Island Trade Office until the PIF secretariat headquarters was moved to a nation that did not recognize Taiwan as the legitimate government of China.<sup>163</sup> Taiwan has pushed for recognition within the PIF,

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<sup>160</sup> Tamara Renee Shie, "Rising Chinese Influence in the South Pacific: Beijing's 'Island Fever,'" *Asian Survey* 47, no. 2 (March–April 2007): 309–10.

<sup>161</sup> *Ibid.*, 311–3.

<sup>162</sup> Saunders, "China's Global Activism: Strategy, Drivers, and Tools," 9.

<sup>163</sup> Shie, "Beijing's Island Fever," 319.

but Beijing has applied pressure to the Forum to keep Taipei excluded.<sup>164</sup> Certain nations, however, have been increasingly concerned with Chinese encroachment; Kiribati flip-flopped its recognition to Taiwan after Chinese meddling in a national election and China's failure to deliver on investments in the region connected to passport and visa requirement relaxation.<sup>165</sup> Nauru also switched back and forth between recognizing the PRC and Taiwan since 2002.<sup>166</sup>

Chinese investment and economic revitalization in the region, however, has led some South Pacific politicians to advocate breaking longstanding, historical ties to Australia and New Zealand and align themselves more with China. Similarly, because in many international governmental organizations, it is "one country, one vote," Chinese OFDI appears to have served to garner a much more sympathetic voting bloc from South Pacific island nations in the United Nations, World Health Organization, International Maritime Organization, International Labor Organization, and World Trade Organization. Indeed, Shie notes that since the PIF members have "some of the highest representation per capita in international organizations," dollar diplomacy is the least expensive in the South Pacific region.<sup>167</sup>

To conclude this section on the South Pacific, the casual effect of the increased OFDI in the region is mixed. Taiwan is about as isolated as it was when Chinese investment in the region increased exponentially, but China has most likely gained a few useful votes within international organizations, in addition, to critical access to natural resources rights that include mining, and fishing. Thus, the effect of the OFDI has gained some influence, lost some influence, gained some resources, and the overall assessment and outcome is mixed.

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<sup>164</sup> "Taiwan calls on Pacific Forum to allow it to be a proper Dialogue Partner," *Radio New Zealand International*, 25 August, 2008, <http://www.rnzi.com/pages/news.php?op=read&id=41647>.

<sup>165</sup> Shie, "Beijing's Island Fever," 316.

<sup>166</sup> Joy Su, "Nauru switches its allegiance back to Taiwan from China," *Taipei Times*, May 15, 2005, <http://www.taipeitimes.com/News/front/archives/2005/05/15/2003254718>.

<sup>167</sup> *Ibid.*, 318–21.

## D. THE PHILIPPINES

The Sino-Philippines relationship has been in the spotlight recently with incidents between the two nations surrounding territorial disputes in the South China Sea. These events have, coincided with a surge in investment from China in the Philippines. Overall, the increased Chinese OFDI into the Philippines has a very strong negative correlation with the geopolitical stability between the two nations. This section sketches the extent of Chinese investment in the Philippines and the correlation with geopolitical stability.

Prior to the “Going Global” initiative, Chinese investment in the Philippines had historically been very limited with less than 30 investments recorded between 1978 and the mid-1990s.<sup>168</sup> Further, after Beijing began to emphasize its policy of “Going Global” in 2002, investment, Chinese investment into the Philippines did not increase dramatically. From 2002 to 2007, China’s total OFDI stock in the Philippines increased by a scant \$35 million. Chinese investment only became significant after 2010 when the flow of investments surged in excess of \$240 million and the overall stock nearly tripled.<sup>169</sup>

One of the most heralded Chinese investments was a joint venture between CNOOC and the Philippine National Oil Company (PNOC) to jointly explore oil and gas fields in the South China Sea. A letter of intent was signed by both sides in 2003, but, both investment and cooperation has yet to begin.<sup>170</sup> Similarly, China Metallurgical Group Corporation (MCC) completed a deal valued at over \$1 billion in 2008 to begin smelting copper from the Philippines, the cost of which most likely will be spread out over numerous years.<sup>171</sup> Finally, the China-ASEAN Free Trade Agreement that was

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<sup>168</sup> Tan, “Direct Foreign Investment Flows to and From China,” in Palanca, *China’s Economic Growth at the ASEAN*, 212.

<sup>169</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 82, 88.

<sup>170</sup> Zou Keyuan, “Prospects for Joint Development in the South China Sea,” in John Wong, Zou Keyuan, and Zeng Huaqun, eds., *China-ASEAN Relations: Economic and Legal Dimensions* (Hackensack, NJ: World Scientific Publishing, 2004), 256.

<sup>171</sup> Derek Scissors, “China Global Investment Tracker,”; Reuters, “China’s MCC eyeing copper smelter in Philippines,” November 27, 2008, <http://www.abs-cbnnews.com/business/11/27/08/chinas-mcc-eyeing-copper-smelter-philippines>.

signed in 2002 came into effect in 2010 and has increased Chinese investment in the Philippines.<sup>172</sup>

With the increase in Chinese investment into the Philippines, however, bilateral tension between Beijing and Manila has soured significantly over a territorial dispute primarily concerned with a small island in the South China Sea named Scarborough Shoals.<sup>173</sup> Indeed, prior to the spike in OFDI, Beijing and Manila regularly held engagements between various ministers. The 2006 and 2008 PRC White Papers on National Defense list multiple engagements between the Chinese and Philippine military officials. Yet after economic investment increased, high level diplomatic exchanges between the two nations have declined. Recently, during a conspicuous tour through the ASEAN region, PRC Foreign Minister Yang Jiechi passed over a visit to Manila while visiting Jakarta, Brunei, and Myanmar.<sup>174</sup>

The correlation of a spike in Chinese OFDI coinciding with a deterioration in bilateral relations between Beijing and Manila has historical precedence. In 1994, numerous Chinese government-backed business delegations visited Manila pressing for the initiation of investments “in the areas of port developments, cement production, and appliance manufacturing.”<sup>175</sup> Shortly thereafter in 1995, Chinese and Philippine military forces squared off over Mischief Reef.<sup>176</sup>

Overall, there is an unmistakable negative correlation with Chinese OFDI into the Philippines. During the early part of the 2000s, the two nation’s relations were rather amicable and cooperative. In 2010, however, once overall investment rapidly increased, relations soured quickly. This mirrored a set of similar circumstances some fifteen years

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<sup>172</sup> Alice D. Ba “China and ASEAN: Renavigating Relations for a 21st-century Asia,” *Asian Survey* 43, no. 4 (July–August 2003): 638.

<sup>173</sup> Jane Perlez, “Dispute Between China and Philippines Over Island Becomes More Heated,” *New York Times*, May 10, 2012.

<sup>174</sup> Li Xiaokun and Zhou Wa, “China Daily: China To Boost Southeast Asian Ties,” *China Daily Online*, 10 August 2012.

<sup>175</sup> Tan, “Direct Foreign Investment Flows to and From China,” in Palanca, *China’s Economic Growth at the ASEAN*, 212.

<sup>176</sup> Ross Marlay, “China, the Philippines, and the Spratly Islands,” *Asian Affairs* 23, no. 4 (Winter 1997): 200–4.

earlier in 1995 with the Mischief Reef confrontation. While the Mischief Reef incident subsided, Chinese OFDI maintained; perhaps so too the Scarborough Shoals incident will subsided and Chinese OFDI will continue, however, only time will tell.

## **E. INDONESIA**

Consistently, Indonesia has been a top recipient of Chinese OFDI. It has been speculated that Chinese investment into Indonesia has been to influence Jakarta to side with Beijing in rising territory disputes in the South China Sea (SCS) because Jakarta does not claim a significant portion of the contested body of water. Overall, however, the use of OFDI to influence Indonesia has been mixed. Additionally, Chinese OFDI seems to have contributed to building a perception that China's rise will be amicable. This section will review Chinese investment into Indonesia, and assess the effect on geopolitical relations.

Since the beginning of China's "Going Global" policy was officially announced, China has maintained a consistent and relatively high investment in to Indonesia, when compared to other ASEAN nations (other than Singapore). Since 2009, the total value of OFDI flows has begun to plateau around the \$200 million per year.<sup>177</sup> This plateau might be temporary as current reporting has indicated numerous investments, and mergers and acquisitions of metal, mining, and energy concerns in Indonesia by Chinese corporations.<sup>178</sup> In any case, China's OFDI stock in Indonesia remains significantly higher than the any other ASEAN nation, with the exception of Singapore.

Over the same period of time, China and Indonesia have become close strategic partners. Signed in 2004, the Comprehensive Strategic Partnership between Beijing and Jakarta was the only pact signed between any ASEAN country and China until the 2008 Sino-Vietnam strategic partnership.<sup>179</sup> Military cooperation between the two has

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<sup>177</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 82, 88.

<sup>178</sup> Derek Scissors, "China Global Investment Tracker."

<sup>179</sup> Evan S. Medeiros, *China's International Behavior: Activism, Opportunism, and Diversification* (Santa Monica, CA: RAND Publications, 2009): 84

increased in addition to cultural exchanges.<sup>180</sup> These concrete signs of close cooperation correlate almost directly to the rise in OFDI stock, and indicate that Indonesians perceive China not a competitor, nor threat.

The high levels of OFDI, however, appear unable to significantly influence Indonesia to side with China on territorial disputes in the SCS or other matters in the international arena. During a recent ASEAN summit in Phnom Penh, Indonesia was seen as a primary arbitrator of an agreement that would have weakened China's territorial claim while aligning the ASEAN members against Chinese claims.<sup>181</sup> Similarly, at the first East Asian Summit in 2005, Jakarta reportedly bemoaned the exclusion of a U.S. representative.<sup>182</sup> Further still, after PRC Foreign Minister Yang Jiechi met with Indonesia officials in Jakarta recently, Beijing mollified their position on the ASEAN Code of Conduct in the SCS committing to move forward on the code consensually, something that Jakarta had been pressing.<sup>183</sup> Overall, it appears that Chinese OFDI can only go so far to influence Indonesia's position on the SCS and within multilateral organizations.

To conclude this section, Indonesia has consistently been a primary recipient of Chinese OFDI when compared to other ASEAN nations (excluding Singapore). The high level of OFDI has correlated with increased diplomatic, cultural, military, and economic linkages between Jakarta and Beijing. OFDI appears, however, to have been met by an inability by Beijing to politically influence Jakarta.

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<sup>180</sup> "Indonesian Vice-President Meets Chinese Religion Delegation – Xinhua," *BBC Monitoring Asia Pacific - Political Supplied by BBC Worldwide Monitoring*, July 23, 2010; "Indonesia Hikes Defence Budget," *BBC Monitoring Asia Pacific - Political Supplied by BBC Worldwide Monitoring*, August 24, 2012.

<sup>181</sup> Jane Perlez, "Asian Leaders at Regional Meeting Fail to Resolve Disputes Over South China Sea," *New York Times*, 12 July 2012.

<sup>182</sup> Jorn Dosch, "China and Southeast Asia: A New Regional Order in the Making?" in Dittmer and George, *China, the Developing World, and the New Global Dynamic*, 75.

<sup>183</sup> "Chinese FM Stresses Joint Effort with ASEAN to Maintain Peace in South China Sea," *Xinhua*, August 11, 2012.

## F. JAPAN

The Sino-Japanese relationship has been increasingly strained as of late. Similar to the Philippines case study, the amount of OFDI by the Chinese into Japan has been rather limited until recently. Similar again, deterioration of bilateral relations over territorial disputes coinciding with increased OFDI from China. Overall, however, the corollary of Chinese OFDI into Japan and the geopolitical effect is mostly inconclusive due to structural economic reasons.

While Sino-Japanese trade has soared and China has become Japan's leading trade partner in terms of exports *and* imports, Chinese OFDI into Japan has been rather limited since 2002.<sup>184</sup> From 2003 to 2009, the amount of Chinese OFDI into Japan consistently grew, but the average OFDI from China into Japan was a scant \$39.26 million per year. In 2010, however, Chinese OFDI into Japan jumped nearly ten times to over \$335 million with total stock in excess of \$1 billion.<sup>185</sup> Most of the major investments have been in either real estate, or in the financial sector.

The 2010 surge in Chinese OFDI coincides with a flare-up in the territorial disputes over the Senkaku Islands (or Diaoyudao in Chinese) and the ongoing disputes over how to define the economic exclusive zone around the Okinotorishima Island.<sup>186</sup> Similarly, the slow, but steady growth of Chinese OFDI into Japan has been paralleled by a slow, but steady, growth of anti-Chinese sentiment in Japan, and anti-Japanese sentiment in China.<sup>187</sup>

The correlation between Chinese OFDI into Japan and a divergent Sino-Japanese relationship is complicated, however. On one hand, numerous Japanese businessmen and economists believe Japan's economic performance and prosperity is tied to China's

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<sup>184</sup> "Strategic Asia by the Numbers," in Tellis, et al., *Strategic Asia 2011–12*, 354 (Table 5).

<sup>185</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 82, 88.

<sup>186</sup> Michael J. Green, "Japan, India, and the Strategic Triangle with China," in Tellis, et al., *Strategic Asia 2011–12*, 144–148

<sup>187</sup> Susan Shirk, *China: Fragile Superpower* (New York: Oxford University Press, 2008), 140–5; Tsuneo Akaha, "The Nationalist Discourse in Contemporary Japan: The Role of China and Korea in the Last Decade," *Pacific Focus* 23, no. 2 (August 2008): 164–72.

economy, but, on the other hand, many Japanese have grown increasingly weary of China's economic influence and have pushed for stronger ties with the West.<sup>188</sup> These conflicting perceptions combined with the economic structural reality that FDI accounts for less than one-fifth of one percent of total capital formation in Japan.<sup>189</sup> The extremely limited effect of FDI on capital formation and economic support in Japan make *any* inferences on the effect of Chinese OFDI mostly tenuous.

## G. TAIWAN

The Taiwan case study in this chapter offers, perhaps, the greatest support for Chinese ODFI being linked to stabilization of bilateral relations and garnering of political influence. While Chinese OFDI remained relatively low until recently, it appears to be connected with a better diplomatic relationship. This section sketches the overall correlation between Chinese OFDI into Taiwan and the evolving geopolitical relationship between Beijing and Taipei.

Since the 2002 inception of the "Going Global" policy, OFDI from mainland China barely penetrated Taiwan. From 2005 to 2009, the average total OFDI stock in Taiwan was a less than \$150,000!<sup>190</sup> This low figure can be attributed to two reasons: Taiwan's 1992 "Act Governing Relations between Peoples of the Taiwan Area and China Area" that curtailed investment from China (but much more liberally allowed Taiwanese investment into China), and the Beijing's attempts to foment intense economic isolation after the election of Taiwan's pro-independence Democratic People's Party leader, Chen Shui-bian, in 2000.<sup>191</sup> In 2010, after the Taiwanese election of the more moderate Ma Ying-jeou, Chinese ODFI stock jumped over ten thousand percent to more than \$18

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<sup>188</sup> Evan S. Medeiros, "The New Security Drama In East Asia: The Responses of U.S. Allies and Security Partners to China's Rise," *Naval War College Review* 62, no. 4 (Autumn 2009): 42; Green, "Japan, India, and the Strategic Triangle with China," in Tellis, et al., *Strategic Asia 2011-12*, 146-7.

<sup>189</sup> UNCTAD, *World Investment Report 2012*, Web Table 5.

<sup>190</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 83, 89.

<sup>191</sup> Daniel H. Rosen and Zhi Wang, *The Implications of China-Taiwan Economic Liberalization* (Washington, D.C.: Peterson Institute for International Economics, 2009): 36-7; Yun-han Chu, "Taiwan in 2007: The Waiting Game," *Asian Survey* 48, no. 1 (January/February 2008): 127-8.

million in total value.<sup>192</sup> Based upon recent reporting, investment in 2011 appears to have almost tripled the 2010 figure.<sup>193</sup>

The surge in Chinese investment into Taiwan is undoubtedly linked to completion of the ECFA in 2010. The ECFA, and associated side negotiations, allow for increased commodity trade, service trade, investment, and dispute settlement.<sup>194</sup> The economic impact of ECFA translates significantly into political influence because of Taiwan's low overall FDI stock, and the fact that China could quite easily capture a significant share of total FDI stock in Taiwan. This is especially true given the statistical conclusion that Chinese OFDI is preponderantly invested near China's borders.<sup>195</sup> Indeed, in terms of investments, Taiwan is increasingly dependent on China and the ECFA positively influences investment from China in three significant ways: it removes most mainland prohibitions on investment, political risks from cross-strait relations are mitigated for mainland investors, and joint-ventures are even more attractive because of the substantially deferred investment in Taiwanese businesses.<sup>196</sup>

Not only have economic ties increased due to this agreement, but so have cultural and social ties increased along with the rising OFDI from China. Wealthy mainland Chinese are more regularly providing charitable and philanthropic support to impoverished Taiwanese; Taiwanese residents are establishing romantic and marital bonds across the strait with mainlanders; and educational barriers in both Taiwan and China are being removed.<sup>197</sup>

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<sup>192</sup> PRC MOFCOM, *2010 Statistical Bulletin*, 89.

<sup>193</sup> "Taiwan needs to deregulate Chinese investment," says Merrill Lynch," *China Economic Review - Daily & Industry*, August 13, 2012.

<sup>194</sup> Hung-Mao Tien, and Chen-Yuan Tung "Taiwan in 2010: Mapping for a New Political Landscape and Economic Outlook," *Asian Survey* 51, no. 1 (January/February 2011): 79–82; Ming-Tong Chen, "Taiwan in 2011: Focus on Crucial Presidential Election" *Asian Survey* 52, no. 19 (January/February 2012): 74.

<sup>195</sup> Rosen and Wang, *The Implications of China-Taiwan Economic Liberalization*, 40.

<sup>196</sup> *Ibid.*, 47, 92–3.

<sup>197</sup> Chen, "Taiwan in 2011," 75.

The correlation between the rising OFDI (and economic ties) from the low point in the mid-1990s to the mid- to late-2000s is unmistakable. Taiwan was being increasingly isolated economically and diplomatically, the 1995 Taiwan Strait Crisis rocked the security environment, and Taiwan's leading politicians were under increasing public pressure to declare *de jure* independence from China.<sup>198</sup> Even in the mid-2000s, cross strait relations were increasingly being strained with 2005 anti-succession law.

The shift of Chinese influence coincides directly with increases in economic ties, preponderantly from the Economic Cooperation Framework Agreement that propelled an increase in OFDI. The correlation of Chinese OFDI on Taiwan, then, is very positive. As Taipei continues to become more dependent on China for investment and economic ties, it appears that the trend of Beijing's growing political influence will continue.

## **H. CHAPTER CONCLUSION**

Chinese OFDI will continue to be a politically and economically relevant topic in the years to come. Based upon contemporary reporting, the next statistical bulletin on OFDI from China released by the MOFCOM will almost undoubtedly show a greater FDI flow from China. This chapter answered the fifth major research question by assessing the geopolitical effect OFDI has had on the region through a country-by-country (and one region) analysis. The results have been mixed. OFDI correlates with an increase in Beijing's political influence in Taiwan, and some parts of the South Pacific. OFDI appears to correlate with a deterioration of bilateral relations with the Philippines, while correlating with shifts in public opinion in South Korea. OFDI does not appear to have had any effect swaying Indonesia's political positions, but does correlate with an increase in cooperation. In Japan, the correlation of OFDI on bilateral relations is inconclusive, if not slightly negative. Most interestingly in North Korea, Beijing appears to be actually becoming influenced more by Pyongyang rather than Beijing gaining influence over them.

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<sup>198</sup> Robert S. Ross, "Taiwan's Fading Independence Movement," *Foreign Affairs* 85, no. 2 (March/April 2006): 141-2.

## V. CONCLUSION

This thesis has presented a comprehensive overview of the effect of Chinese outward foreign direct investment on the Chinese economy and on the geopolitical environment. Divided into five major research questions, this thesis researched why Chinese firms invest abroad, how the historic and current scope of China's OFDI should be assessed, how Chinese OFDI has affected the Chinese economy, how the leading economic theories on OFDI and realism could account for the rising emphasis placed on OFDI, and what geopolitical effect Chinese OFDI has had on stability, security, and cooperation in Asia. A summation of the results follows.

Based on the analysis found in Chapter II, Chinese firms currently invest abroad for four main reasons: to expand or maintain access to markets; to maintain access to natural resources like metals, oil, and fisheries; to gain access to technology and management techniques; and to acquire or gain "strategic assets" that have international recognition. There has been some governmental direction for Chinese OFDI, limited to investments made by state-owned enterprises (SOE), but SOEs have demonstrated that they are motivated primarily by economic and commercial factors like profit maximization rather than responding to governmental direction. Overall, Daniel Rosen's and Thilo Hanemann's pithy remark is apropos: "The image of agents from the Politburo commanding state enterprises to 'go buy the world' is largely fictitious."<sup>199</sup> Chinese firms are going abroad almost entirely because of economic and commercial motivations.

The current scope of Chinese OFDI was addressed in Chapter II. Due to differences in methods of accounting for Chinese OFDI by the PRC's Ministry of Commerce (MOFCOM), geographic and sectoral distribution of Chinese OFDI should be assessed through a compendium of sources. This thesis has used the MOFCOM's 2010 "Statistical Bulletin on China's Outward Foreign Direct Investment," numerous editions of United Nation's Conference on Trade and Development's annual World Investment Reports (UNCTAD WIR), long running surveys of Chinese enterprises, secondary

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<sup>199</sup> Rosen and Hanemann, China's Changing Outbound Foreign Direct Investment Profile, 11.

analysis by reputable international economic think tanks such as the Peterson Institute of International Economics, independent ledgers of OFDI actions such as Derek Scissor's *China Global Investment Tracker*, and statistical analysis of Chinese investment activity to develop a thorough and balanced geographic and sectoral understanding of Chinese OFDI. Overall, the preponderance of Chinese investment is in the Asia region and, while the absolute value of investments from China into regions like Latin America, Europe, and Africa are increasing, the total share, or percentage, of total OFDI from China into those same regions, is either maintaining historic levels or actually decreasing.

With regard to the business sectors Chinese OFDI is invested in, Chinese OFDI statistics on sector distribution suffer from similar deficiencies as those on geographic distribution because the MOFCOM sectoral categories are not aligned to industry standards and do not reflect the final industry invested in. Remedying this issue, this thesis has drawn from a range of sources such as the UNCTAD WIRs, secondary analysis, surveys, in addition to MOFCOM statistics. Using these sources, it was found that natural resource-based investment such as mining, petroleum, fisheries and agriculture, manufacturing, and financial and business investment are the leading sectors of Chinese investment. Further, as highlighted in Chapter II, the sectoral distribution of Chinese OFDI is not consistent with international norms but, when view from a contextual lens, the investment pattern mostly is consistent with leading OFDI economic theory given China's disposition in the world economy, and due to numerous barriers to entry.

Inherently hard to quantify, the Chinese economy has benefited in some ways and in other ways it still has yet to realize any benefit, and there have been a few negative effects. The domestic economy has benefitted from access to critical natural resources and creation of necessary infrastructure for global commerce, and Chinese firms have also increased their rapport in the global market, opening avenues of investment and opportunity. The managerial skills of Chinese firms, especially large SOEs that have invested abroad, do not appear to have markedly improved. This maybe a symptom of the need for requisite "dwell time" to realize burgeoning changes within senior leadership and provides for guarded optimism that more benefits of investing abroad are coming.

Finally, Chinese OFDI has not yet acquired brand recognition, or “strategic assets,” which have been a recent focus of investments; in some ways, OFDI into certain international brands have *decreased* the attraction of the brand. Overall, the effect of Chinese OFDI on the Chinese economy has been mixed, if not slightly positive.

Analyzing Chinese OFDI through the lenses of the major economic theories regarding OFDI and the realist theory of international relations has yielded interesting results. Chinese OFDI patterns fall mostly in line with Buckley and Casson’s internalization theory and Dunning’s eclectic paradigm. Conversely, a realist political economy lens developed from theories proposed by Hans Morgenthau, Kenneth Waltz, and John Mearsheimer provided marginal utility since many realist, national power-based predictions do not correlate to Chinese OFDI actions. Overall, economic theory is a much more suitable lens for analyzing OFDI actions than realism.

The final major research goal of this thesis was to document and analyze the observed effect of OFDI from China into specific states and areas in the Asia-Pacific region. The countries and regions studied are: North Korea, South Korea, the South Pacific, the Philippines, Indonesia, Japan, and Taiwan. Using a mix of public polling, secondary analysis, statistical comparison, and political trends, the overall correlation of trends in Chinese investment into particular states and changes in the geopolitical environment is mixed and inconclusive. OFDI correlates with an increase in Beijing’s political influence in Taiwan, and some parts of the South Pacific. OFDI appears to correlate with a deterioration of bilateral relations with the Philippines, while correlating with shifts in public opinion in South Korea. OFDI does not appear to have had any effect swaying Indonesia’s political positions, but does correlate with an increase in cooperation. With respect to Japan, the correlation of OFDI with the course of bilateral relations is inconclusive, if not slightly negative. Most interestingly in North Korea, Beijing appears to be actually becoming influenced more by Pyongyang rather than the other way around.

Finally, this thesis hypothesized that the geopolitical effect of Chinese OFDI would be mostly stabilizing and moderate tensions in the region. This hypothesis has not been fully borne out due to current tensions in China’s relations with Japan and with the

Philippines. However, as in the case of all ideal international relations models, there is still possibility that this hypothesis will be confirmed because of the documented effects of OFDI in Taiwan, Indonesia, and elsewhere. Only time will tell.

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