THE ROLE OF FOREIGN DIRECT INVESTMENT IN SUSTAINING CHINA’S ECONOMIC GROWTH

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Abstract:- In over three decades and a half of spectacular economic growth – starting in 1979 with the launch of reform processes and with the dynamic mutations from an autarchic to a global model – the introduction and implementation of the policies targeting the use and attraction of foreign direct investment (FDI) represented an exceptionally important stage in China’s history of international “openness,” playing an active role in the promotion, support and enhancement of its economic development. The aim of this article is to outline China’s sinuous investment path, from the autarchic pattern followed by the stage of economic openness characterised by the application of the “open doors” policy and up to the rethinking of the development paradigm and the country’s affirmation on the market as a new powerhouse in the global economy. Our research also aims to outline the implications that all these stages had on China’s current position of world leader in terms of inward FDI. As such, by means of comparative, quantitative and qualitative analyses, we will examine the evolution in time and the external impact of policies regarding the attraction of FDI, as well as the strategy aiming at incentivising Chinese outward investment – a relatively recent phenomenon – and the related support measures, in order to identify the country’s current development stage and its position in the global landscape, as well the possible challenges that China might face in the future.

Key-words: China, foreign direct investment, economic growth, inward/ outward FDI

JEL Classification: F21, F43, F62, F63

1. Introduction

The paradigm change and the gradual evolution of the national policies and legislation concerning the inflow of foreign direct investment (FDI), from restrictive to passive attractive and then to approaches that promote active selection and encouragement of FDI inflows, have made foreign investors a primordial driver for China’s economic growth, for its technological and industrial development, and also a beneficial factor for the creation and preservation of a dynamic competitive environment (Chunlai, 2011). As such, if in the beginning, in the starting phase of reform programmes launched in 1979,¹ the main objective of attracting foreign capital was the deficit of local capital and the stimulation of foreign trend in order to speed up transition and economic development, at present, China is seeking increased competitiveness by enabling market access for its main foreign competitors and thus the improvement of the national economic climate (Sussangkarn et. al, 2011).

As a result, due to the continuing progress of reform and economic openness, in conjunction with the huge market potential, the relative low labour cost and the increasingly comprehensive policy encouraging foreign investment applied by the national authorities in recent years, FDI inflows have increased at an accelerated pace, and China is now the first main beneficiary of FDI worldwide (overcoming the U.S. in 2014, ²

¹ After the long period of economic stagnation during Mao Zedong’s ruling, the Chinese planned economy adopted a new development approach based on “reform and openness,” characterised by the attraction of foreign direct investment, in correlation with a strategy that stimulates exports (Economist Intelligence Unit, 2012). The open doors policy was initiated in 1978, once Deng Xiaoping became the country’s leader and was based on a set of measures meant to generate openness to foreign investors and international trade. This policy is considered the “cornerstone” of China’s economic modernisation (Sussangkarn et. al, 2011).
which had held the position up to then)\(^2\) and the second destination of FDI targeting developing countries, after
Hong Kong (UNCTAD, 2015).

Also, if until 2000, due to legislative impediments that aimed at restricting outward direct investment (ODI), China was not in a favourable position in the hierarchy of world investors (Rosen&Hanemann, 2009), upon the beginning of the new millennium, the national authorities started implementing an initiative encouraging local companies to invest outside the country, by adopting a new “going global” strategy\(^3\) (Hong&Sun, 2004). Given China’s unmatched economic performances the recent decades due to the “targeting” of newly designed outward orientation, the Chinese Government saw the necessity of affirming the country’s economic profile at international standards but also of conquering other outlets for local production which would implicitly contribute to acquiring new skills, advanced technology or high-value intangible assets (management and organisational transfer, trademarks, etc.) (Bellabona&Spigarelli, 2007). Furthermore, the launch of this Government initiative also took into account the perspective of reducing the high trade surplus that China constantly registered during the years preceding the launch of the reforms. According to specialists (Palley, 2006; Williamson, 2005), FDI stimulation was able to restore the domestic balance, in the sense that the speeding up of exports as a policy supporting growth, corroborating by a fixed exchange rate and increased control on capital movement, as well as the gradual opening of the national economy contributed to the accumulation of trade surplus and huge foreign currency reserves, which generated pressure on the exchange rate and tensions among the main trade partners (Otani, 2005).

Therefore, this recent policy that encouraged orientation towards foreign markets determined Chinese firms to redirect their multinational activity, because of reasons that are related to obtaining access to new resources and technologies or in order to expand the scope of their competitiveness in the global economic landscape.

The new strategic directions have generated both an unprecedented amplification of China’s outward investment flows\(^4\), but also geographic and sectoral diversification, as now, outward investments are no longer limited to state enterprises but, to an increasing degree, they have extended to the increasingly dynamic private sector (Davies, 2013).

2. Foreign direct investment – a supporting factor for China’s growth

As the literature points out (Davies, 2013), over the recent decades, foreign direct investment has been considered by economic analysts and decision-makers as representing both a fundamental driver for the globalization process, and a “catalyser” of economic growth and development. Capital inflow adds up to the internal resources of the host country and helps cover the investment needs, generates the mobilisation of the national economy and urges it to involve in more productive and competitive activities, thus representing an important vehicle for the transfer of technology and know-how, a vital aspect for raising the technical standard of production, and at the same time a promoter of growth through the creation of new jobs and the expansion of the knowledge pool existing in the host economy through the qualification of workers, the acquiring and dissemination of skills, as well as through the introduction of alternative management and organisational architecture practices.

At historical scale these theories have been fed into and additionally confirmed by the experience of the recent financial crises\(^5\) which illustrated and proved the risks and increased uncertainty associated with portfolio investment, emphasizing the importance of FDI as an alternative flow of capital. Thus, in the present economic landscape, foreign direct investment is one of the most wanted “products” of the global economy (Braunstein&Epstein, 2002) and a permanent challenge for the authorities and decision-

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\(^2\) As we will show in the analysis conducted in this article, in 2003, China again overcame the US and held for a year the first position among FDI beneficiaries worldwide.

\(^3\) Although the Going Global Strategy was initially referred to in a document of the Chinese State Department launched in 1999, which presented a set of measures aimed at encouraging Chinese companies (in particular those owned by the state) to invest on the foreign market and engage in assembly and processing activities outside the country’s border, it was adopted only in 2000, based on the Programme for the development of the national and social economy, an integral part of the 10th five-year (Freeman, 2007).

\(^4\) At present, China is third worldwide among countries that export capital (after the U.S. and Hong Kong), therefore being second in the top of investments generated by developing countries (UNCTAD, 2015).

\(^5\) Note: here, we refer not only to the latest financial crisis that shook world economy (the Great Recession), but we are also taking into account the Asian Crisis, as well as the one that occurred in Latin America.
making bodies at national level which make constant efforts in order to attract and diversify the sources of foreign financing.

In this context, given the evolution of China’s policy concerning FDI, which is an attentively supervised and managed experiment, an attempt to use foreign capital to stimulate at the same time both a growth strategy based on exports, and a way of substituting imports, the analysis of the dynamics of the inflow of investments in China may be representative for understanding the investment mutations that occurred in the global economy as a whole.

If 35 years ago, before the trade and investment liberalization reforms were launched, China was practicing an inefficient economic policy that was keeping the country in a state of economic stagnation and relatively isolated from the global economy, since it opened to international trade and foreign capital, in 1979, it became one of the economies with the fastest growth, the second largest economy of the world (after the U.S.), and the first international destination for FDI flows, also acquiring the title of “the world’s factory” and that of main holder of foreign currency reserves (Morrison, 2014).

Although since the very launch of the programmes of openness to the “outside world,” the national authorities have started seeing the promotion of exports as a key-component of the economic growth strategy and foreign investments as a means of development and facilitation of this outward orientation, due to ideological considerations, but also due to a certain precaution caused by the lack of experience in the field (Wei, 2003), China opted for a gradual liberalization of the foreign investors’ access on the national market.

Therefore, as regards the adoption of the policies aimed at attracting FDI, China decided on a moderate and gradual approach, which sought to minimise risks and was based on regional pilot-projects that, once successfully implemented, were to be extended at national level. According to Chinese economic analysts (Jing & Song, 2003), the preparation of the related legislation, followed by the necessary reform of the institutional infrastructure and, implicitly, the specific policy adopted for the regional openness to FDI represents a particularly complex and laborious process, consisting of four successive stages.

2.1 The limited openness stage (1979-1986)

After Deng Xiaoping took over the reins of the economic policy at the end of the 1970s, China decided to start a national modernisation and economic development process, by increasing the volume of its trade with other countries. In order to achieve this, one of the main directions proposed by the former Chinese leader was attracting foreign investment and the establishment of foreign partnership companies, a direction that was leading to the capture of advanced technology, know-how and management skills, increased access to foreign markets and, implicitly, the promotion of exports.

Therefore, this early age of outward openness was an experimental stage in which, in order to achieve rapid industrialization, the government issued new regulations that allowed the establishment of joint ventures with a majority held by state companies.

Later on, as far as FDI was concerned, the Government gave total control to authorities of Guandong and Fujian provinces where four special economic zones (SEZ) were created and where the establishment of joint ventures was (temporarily) limited to export-oriented activities. The main purposes for the creation of SEZs were the development of controlled experimental enclaves in China’s coastal area which would attract and exploit foreign capital, representing at the same time a “window” towards the outside world.

All these unprecedented incentives with an explicit role of enabling the absorption of FDI, correlated with China’s comparative advantage consisting in the abundance and low cost of work force, generated the rapid growth of the experimental regions – which became leaders of Chinese exports – and were genuinely successful from the very beginning. However, the Government noted that foreign investments were predominantly directed towards the light industry sectors and to sectors using low technology, and therefore extended its objective towards attracting high-end technology (including for hardware and software), but also towards

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6 In terms of nominal GDP (measured at current prices in US dollars) the U.S. is the largest economy of the world reaching USD 17.41 trillion, approximately 22.44 percent of the gross world product, while China ranks second with USD 10.36 trillion in 2014 (World Bank Data, 2015).

7 The promulgation in 1979 of the Law on the establishment of joint ventures is considered the “cornerstone” of China’s openness programme in the specific FDI field. Later on, an ample legislative package was adopted with regard to the registration of companies, the organisation of work, the accounting system, exchange rate, etc.
extending the “investment policy laboratory”\(^8\) to the south-eastern coastal region where, because of its location, the investments could have relationships with Hong Kong, Macao and Taiwan. Consequently, in 1984 the Government announced additional decentralisation of decision-making authority with regard to the investment policy for 14 other port cities that were to be opened to the inflow of foreign capital, gaining also autonomy for the creation of the FDI legislative framework. Initially created in order to remedy the deficiencies found at SEZ level, they later became technological and economic development zones (TEDZ), inside which investments were given preferential treatment and import facilities.

Although in this first stage of the change foreign investment grew constantly, reaching a total volume of around USD 8 billion according to national statistics – Table 1 – [or USD 7 billion (Graph 1), according to the statistical data provided by UNCTAD\(^9\) - UNCTADStat, 2015], because restrictions were maintained with regard to market access or relating to the equipment procurement or the exchange rate, together with other organisational barrier,\(^10\) the annual average growth remained at a relatively low level at this stage, reaching around USD 1 billion USD.

Table 1: Direct foreign investment inflow in China 1979-2013 (in USD bn.)

<table>
<thead>
<tr>
<th>Year/period</th>
<th>Contracted FDI value</th>
<th>Actually used FDI value</th>
<th>Year</th>
<th>Contracted FDI value</th>
<th>Actually used FDI value</th>
<th>Year</th>
<th>Contracted FDI value</th>
<th>Actually used FDI value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-1984*</td>
<td>9.8</td>
<td>4.1</td>
<td>1991</td>
<td>11.9</td>
<td>4.4</td>
<td>2001</td>
<td>62.4</td>
<td>46.9</td>
</tr>
<tr>
<td>1992</td>
<td></td>
<td></td>
<td>1993</td>
<td>111.4</td>
<td>27.6</td>
<td>2002</td>
<td>69.2</td>
<td>52.7</td>
</tr>
<tr>
<td>1994</td>
<td>82.7</td>
<td>33.8</td>
<td>2003</td>
<td>82.8</td>
<td>53.5</td>
<td>2004</td>
<td>115.0</td>
<td>60.6</td>
</tr>
<tr>
<td>1985</td>
<td>6.3</td>
<td>1.9</td>
<td>1995</td>
<td>91.3</td>
<td>37.5</td>
<td>2005</td>
<td>153.5</td>
<td>60.3</td>
</tr>
<tr>
<td>1986</td>
<td>3.3</td>
<td>2.2</td>
<td>1996</td>
<td>73.3</td>
<td>41.7</td>
<td>2006</td>
<td>189.0</td>
<td>63.0</td>
</tr>
<tr>
<td>1987</td>
<td>3.7</td>
<td>2.3</td>
<td>1997</td>
<td>51.0</td>
<td>45.3</td>
<td>2007</td>
<td>193.7</td>
<td>74.8</td>
</tr>
<tr>
<td>1988</td>
<td>5.3</td>
<td>3.2</td>
<td>1998</td>
<td>52.1</td>
<td>45.5</td>
<td>2008</td>
<td>...</td>
<td>92.4</td>
</tr>
<tr>
<td>1989</td>
<td>5.6</td>
<td>3.4</td>
<td>1999</td>
<td>41.2</td>
<td>40.3</td>
<td>2009</td>
<td>...</td>
<td>90.0</td>
</tr>
<tr>
<td>1990</td>
<td>6.6</td>
<td>3.5</td>
<td>2000</td>
<td>62.4</td>
<td>40.7</td>
<td>2010</td>
<td>...</td>
<td>105.7</td>
</tr>
<tr>
<td>2011</td>
<td>...</td>
<td></td>
<td>2012</td>
<td>...</td>
<td>116.0</td>
<td>2013</td>
<td>227.8</td>
<td>117.6</td>
</tr>
<tr>
<td>2014</td>
<td>...</td>
<td></td>
<td>2015</td>
<td>...</td>
<td>119.6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: * For the period 1979-1984, the statistical data provided by the National Bureau of Statistics of China are not broken-down by years, but cumulated for the entire reference period;

Graph 1: FDI inflow in China 1985-2012 – UNCTAD data (USD bn.)

\(^8\) The name comes from the fact these were regions created for the testing of investment policies that, if proved successful, were to be implemented in other Chinese regions as well (Ho, 2004).
\(^9\) Generally, the statistical data regarding foreign investment provided by UNCTAD and other international databases are different from those published by the National Bureau of Statistics and the Ministry of Commerce of China, because the latter only include FDI for non-financial companies. For the period we refer to, the UN statistical database does not present the data related to years 1979.
\(^10\) Among others, the legislation required the managers of joint venture companies established to have Chinese nationality (Ho, 2004).
Also, the legislative framework that was still in an incipient phase and the uncertainties generated by the lack of communication with the national authorities, the low level of transport infrastructure development and the scarcity of highly-qualified workforce were factors that were adding to the lack of confidence of foreign investors. Because by mid 1980s the results obtained through the application of reform programmes proved to be below the initial estimations of the national authorities, the Chinese Government decided to initiate a more “aggressive” policy aimed at capturing new inflows of FDI (Zang, 1999).

### 2.2 The stage of the active promotion of foreign direct investment (1987-1991)

This stage was characterised by the extension and/or adjustment of the specific FDI legislation and the opening of more regions to foreign capital. Therefore, in 1986, the state promulgated the *Law on the establishment of 100% foreign-owned companies (100% FOEs)*, which gave companies from other countries the right to open subsidiaries in China, but also the *Order on encouraging foreign investment*, with a particular focus on companies established with 100% foreign capital.

The entry into force of the new regulations eliminated the restrictions regarding the prohibition of foreign companies from exercising full ownership rights and implemented new incentives that also eliminated investor uncertainty. Among the measures adopted, of particular relevance are those that concern the protection and guarantee offered by the state to FOEs with regard to ownership, in the sense that foreign investors legally acquired the right to transfer the profit abroad and the right to dispose of the funds left in the event of a possible liquidation of a company established in China (Fu, 2000). Also, joint ventures were ensured access to utilities for the same tariffs as state-owned enterprises, as well as additional tax relief (if the activity carried out was based on the contribution of advanced technologies), or the possibility to contract low-interest loans.

The newly-created investment context triggered unprecedented historic mutations that paved the way to cross-border processing and generated a complete division of the workforce between China and Hong Kong (Jing&Song, 2003).

Also in this stage, the massive inflow of FDI from Hong Kong, Taiwan and Macao, as well as from other developing countries, helped China gain international confidence regarding the consistence of its investment policy. Nevertheless, it must be mentioned that due to the persistent national limitations on the exchange rate – which hindered the withdrawal of capital by investors in developed countries – it is possible that the inflows from developing countries were overestimated as a result of “round-tripping” (a disguise of local capital investment into foreign investment,\(^{11}\) for the purposes of circumventing certain legislative restrictions or for benefiting from incentives and the privileged treatment reserved to foreign capital. As such,

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\(^{11}\) This phenomenon occurs when foreign investment capital leaves the country and returns in the form of FDI, either in order to circumvent certain restrictions, or to benefit from tax incentives or other privileges granted to foreign investors.
for example, because investments from these latter regions referred to were mainly targeted towards export, they could avoid the exchange rate restrictions.\(^{12}\)

The positive effects of the new regulations adopted by the Chinese Government in the period 1987-1991 are also reflected by the national and international statistics (presented in Table 1 and Graph 1), which illustrate that the FDI inflow actually used by the Chinese economy significantly increased, reaching a total amount of USD 16.8 billion, corresponding to an average annual amount of around USD 4.2 billion (Table 2).

Table 2: Evolution of FDI in China in relation to the stages of the national policy in the field

<table>
<thead>
<tr>
<th>Stage/years</th>
<th>Total FDI value/stage</th>
<th>Average annual increase</th>
<th>Growth pace compared to previous period (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-1986</td>
<td>8.2</td>
<td>1.2</td>
<td>...</td>
</tr>
<tr>
<td>1987-1991</td>
<td>16.8</td>
<td>4.2</td>
<td>51.2</td>
</tr>
<tr>
<td>1992-2000</td>
<td>323.4</td>
<td>36.0</td>
<td>94.8</td>
</tr>
<tr>
<td>2001-2014</td>
<td>1164.8</td>
<td>83.2</td>
<td>72.2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>1513.2</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Drawn up by the author based on statistical data published by the National Bureau of Statistics of China (Statistical Yearbook, different years) and the Chinese Ministry of Commerce (MOFCOM, 2015).

2.3 The stage of FDI policy adjustment and consolidation (1992-2000)

The third stage of China’s investment openness progress started in 1992, when the Chinese leader Deng Xiaoping visited the southern regions and the special economic zones, and aimed at extending the reform and the scope of the “open doors” policy and the promotion of national commitment to the creation of the socialist market economy, which had proved to be a real success in gaining the trust of foreign investment.

In its attempt to redirect capital flows from the eastern part of the country towards the western territories, the government decided to adopt a new strategic approach, proposing a departure from the procedure of granting a certain special treatment in certain regions, to that of applying nationwide policies for attracting foreign investment, with a particular focus on the intensive capital and high-end technology investments (Nicolas, 2008).

Year 1995 saw the publication of the Guidelines of foreign investment projects\(^{13}\) which permitted and encouraged investments dedicated to industries that introduced advanced technologies, increased production quality and increased export capacity, as well as to those oriented towards the use of local resources located in the country’s central and western regions.

The launch of the new programme for the development of the national and social economy, as an integral part of the 9th five-year plan (1996-2000), represented the starting point towards a new approach of local governments which, by applying proactive investment policies would intend to transfer FDI flows from the workforce-intensive processing industry towards the capital-technology-and know-how intensive sector, as well as towards the sector service and from public to private ownership (Chen&Song, 2004).

2.4 The stage subsequent to the accession to World Trade Organisation (WTO): 2001-present

After 15 years of negotiations, China became in 2001 a full-fledged member of the WTO, which has transformed the country into a participant in the multilateral trade arrangements with the other members, but at the same time comprised a series of obligations regarding the national FDI policy, in the sense of a wider

\(^{12}\) According to the data presented by an OEDC report (2008), although a considerable part of FDI inflows in this period in China came from Hong Kong companies, they represented investment from companies registered in the UK. Moreover, certain Chinese enterprises have adopted this policy in order to benefit from the privileged status granted to foreign investors – as such, domestic capital sources exited the country to return later “disguised” as foreign investment and benefit from the preferential policy applied to foreign investment and avoid the immobility of local capital.

\(^{13}\) The Yearbook published in 1995 and then modified in 1997 and 2002 comprised an ample set of rules on the review and approval of FDI projects, by classifying them into three categories: encouraged, restricted and prohibited, clearly determining the limitation of foreign ownership in certain specific fields. Also, by classifying investments into three distinct groups, the catalogue established whether the investment would be permitted or not, what type of tax or other incentives would be applied in case of an approval, as well as the complexity and duration of the approval process.
opening of the market to foreign competitors and the elimination of trade barriers, such as the geographic restrictions that had previously limited the expansion of foreign companies.

As such, joining the WTO had a positive impact on the liberalization of FDI inflow into China, in particular in terms of the national treatment and increased transparency, and was an incentive for the improvement of the country’s competition policies, industrial policies and intellectual property protection measures. The development of the national legislation and policies regarding foreign direct investment rapidly materialised in the systematic evolution of the FDI regulatory and promotion framework, through the establishment of rules or the amendment of existing ones in accordance with the international provisions in force. Also, a particularly important aspect of the accession agreement was the fact that China undertook to further open the service sector to foreign investment (including financial and professional services – consultancy, accounting, etc.).

Beginning in 2001, the Chinese Government started a comprehensive process for the relaxation of restrictions imposed on FDI, through the complete modification of the legislation on the establishment of joint ventures and 100% foreign-owned enterprises.

According to the objectives set out in the 12th Five-year Plan (2011-2015), the future actions to attract FDI will pay particular attention to the technological consolidation, innovation, industrial restructuring and modernisation process, to the financial sector reform and to the development of the service sector, with an increased focus on the promotion and support of economic growth mainly based on internal demand.

All these ample changes in China’s investment policy after joining the WTO proves the complexity and intensity of the action taken at national level both in order to stimulate the inflow of foreign investment, and in order to permanently improve their sectoral orientation and regional distribution and therefore in order to increase the impact of FDI inflows on economic growth.

The creation and preservation of an attractive investment climate, the relatively-efficient public services, the abundance of workforce resources, a huge market characterised by political and macroeconomic stability are only a few of the factors that opened for China the perspective of becoming in a relatively short period of time one of the favourite destinations of FDI inflows worldwide. As such, in this stage of the country’s evolution, the annual volume of inflows of FDI constantly has increased from USD 46 billion in 2001, to USD 119.6 billion in 2014 (Table 1).

Also, in accordance with the international hierarchies based on the foreign investment confidence index, calculated by the American consulting firm A. T. Kearney, in 2014, China was second in the top of foreign investment confidence, only surpassed by the U.S. – which proves that despite the major competition from other favourite destination that are traditionally focused on attracting FDI, the investors opted for the stability and perspectives for sustained growth of the Chinese economy.

3. Position in the global investment landscape – recent developments of FDI inflows in China in the dual statistical analysis

The success of the Chinese policy of attracting and mobilising foreign capital and the country’s increasing attractiveness, reflected by international classification – based on all the arguments showed above – are also confirmed by the statistical data presented in the latest UNCTAD report (2015), which shows that FDI flows received by China in 2014 have increased to around USD 129 billion USD, compared to USD 124

14 So far, the government authorities had considered that intense competition from foreign banks could contribute to the fast-track development of trade loans in the local banking system (Yueh, 2012).

15 These objectives are also found in the 13th Five-year Plan (2016-2020), approved at the end of October 2015 by the Chinese Communist Party.

16 Beginning in 1998, the consulting firm A. T. Kearney computes a FDI Confidence Index, which reflects the opinions and perceptions of the managers of representative transnational companies.

17 It is interesting to note that in the period 2000-2012, China constantly ranked first in this classification, and the fact that it has been recently surpassed by the U.S. (2013) was mainly caused by the increased lack of confidence among investors in the national business environment as a result of the decrease of the growth pace beginning 2012 (A.T. Kearney, 2012).

18 For a uniform and accurate presentation of the data, in the comparative international analysis of this sub-chapter, we have used the statistical data published by the UNCTAD, instead of those drawn up at national level, which are calculated differently.

19 Managing to beat its own record of 2011, the maximum investment level reached by China so far.
billion in 2013 (Graph 1), but also by reference to the annual average value of around USD 77 billion registered during 2000-2011.

Although the progressive growth of FDI inflow volume seen in the period 2000-2008 was interrupted in 2009, as a result of the negative consequences of the international financial and economic crisis (when the value of FDI flows received was reduced to around USD 95 billion, compared to USD 108 billion in 2008), that were seen in the deterioration of the global investment climate and the reduction of investment capacity, China managed to remain on the top position among developing countries reached in 2000 (Davies, 2013), in terms of attraction of FDI. Moreover, during the same period, China managed to rank first in the world top of best placed countries that absorb FDI, as China surpassed the U.S. (Graph 2). This result may be explained on the one hand by the fact that the in the U.S. and the European Union the perception of the crisis phenomenon and the major related risks were present until mid-2012, but in particular by the fact that the Chinese economy maintained a high growth pace even during the global recession (albeit lower than in the previous year), which contributed to the increase of confidence and to the undertaking of the investment decision among the large transnational companies (Morrison, 2014).

**Graph 2: China’s position in the world hierarchy of FDI recipients in 2014**

Note: The world ranking of the main 20 countries that receive FDI comprises both developed, and developing and transition countries;

In 2010, foreign capital inflow in China saw a new spectacular evolution as a result of an annual leap of 17.2%, totalling USD 114.7 billion, followed by an increase by 7.4% in 2011, materialised in a volume value of USD 124 billion, which represents a first historical “peak” so far (as we have mentioned, the same value of investments was also recorded in 2013), which was only exceeded in 2014 (Graph 1).

Although in 2012, for the second time since the onset of the global financial crisis, the investment flow targeting the Chinese market decreased by around 2%, totalling an annual level of USD 121 billion – a moment when a large part of international analysts (Devonshire-Ellis, 2013) launched theories according to which this phenomenon was due to the loss of the comparative advantage given by the processing industry – this proved to be a decline caused by the junction of several circumstantial factors. On the one hand, the decrease was caused by the reduction of inflows from EU countries that are still facing major internal tensions and imbalances, correlated to the increase of the interest of Latin American investors for alternative destinations on the Asian continent. Added to these external causes, internal determinant factors reflect China’s re-orientation in terms of

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20 In 2003, China had even managed to slightly surpass the U.S. with regard to FDI inflows, with a value of USD 53.3 billion, compared to the USD 53.1, of the U.S. (UNCTAD, 2014).

21 Because during the international financial and economic crisis, Chinese inflows of FDI only decreased in 2009 – when the reduction was of 10%, while at global level, the reduction in 2009 was of 32% compared to 2008 (when the contraction had been of 11.5%, UNCTAD, 2012) – specialists have compared this evolution with that during the period of the Asian economic crisis (1997-1998), when the country also managed to keep a relatively stable level of FDI inflows, despite the collapse in the region. For this reason, China gained the name of “paradise of investment risk avoidance” (Davies, 2013).
economic and investment policy, aimed at supporting FDI inflows for high-technology industries and the service sector, and at discouraging those intended for low added value processing sectors.

4. China’s outward direct investment

Although the intensity and sudden emergence of Chinese outward direct investment gave the impression that this is a recent phenomenon, in fact such investments have been present since the early 1980s, but at that time ODI had an insignificant value, it was carried out solely by state-owned enterprises and was focused mainly on Hong Kong (Freeman, 2007).

With the launch of the “going global” government programme in 2002 – a programme whereby the authorities encouraged local enterprises to invest abroad – China rapidly became an important source of investments at international level, and its strategic motivations in this regard evolved progressively from the simple focus on natural resources to the conquest of new outlets for local production, finding new RD&I resources that favour the rapid absorption of high technology and the rapid improvement of competence and skill standards.

This policy was consolidated in 2004, when the National Commission for Reform and Development, together with China ExIm Bank announced measures for the support of outward investments in four specific fields, in connection with the basic necessities of the Chinese economy in full expansion: i) investments for attracting natural resources and raw materials for which the necessary supply is limited; ii) investment in processing sectors that promote export or involve new technologies and equipment; iii) the performance under a foreign partnership of certain R&D projects based on high technologies, management experience and skills; iv) mergers and acquisitions involving the increased international competitiveness of national companies and the extension of production and sale markets.

Consequently, the spectacular economic development that characterised the last decades and the progressive intensification of the Government’s going global policy encouraged an increasing number of Chinese companies to adopt an expansion strategy on new markets both in order to gain access to new resources and in order to increase their domestic competitiveness.

4.1 The implications of economic rebalancing on China’s outward direct investment

Initially, based on the economic growth model applied by the governmental authorities until 2000, the outward direct investment had a limited role, targeting only two strategic development directions (Lardy, 2007):

- first of all, ODI flows represented the instruments used mainly in order for China to be integrated in the global trade system and for the improvement of the national logistic structures, seeking the establishment of Chinese commercial company offices abroad;
- secondly, given the speeding up of the increase of the domestic demand for natural resources and raw matter insufficient at national level – stimulated by the ample urbanisation process, the increased production and internal consumption – the decision-making authorities saw the opportunity of obtaining them from foreign markets.

Because in this first stage of evolution, China’s economic policy was mainly oriented towards increased production and exports, which led to the build-up of massive trade surplus and foreign currency reserves, once the country affirmed itself on the global stage, an alternative development strategy, based on growth adjustment and rebalancing was required.

In order to achieve this, the Chinese Government has been considering the preparation of new measures that would lead to the increase of population income and the stimulation of internal consumption, as well as to the focusing of production on value added sectors – making the transition from quantity to quality.

4.2 China’s current role and investment position at global level

If at the beginning of the new millennium, Chinese outward investment flows had an almost insignificant share in the global total (below 1%), they have grown constantly since 2002 and have had outstanding results even during the economic and financial crises. In 2012 China ranked on the third position in
the top main investment capital sources worldwide (after the U.S. and Japan)\(^{22}\) and on the first position among developing countries. Although this ranking was maintained in 2013, in 2014, although China managed to remain on the third position among world investors (this time after the U.S. and Hong Kong), it became the second main source of investments among developing countries.

**Graph 3: China’s position in the world value ranking of FDI generated in 2014 (USD bn.)**

![Graph 3](image)

Note: The world ranking of the main 20 countries generating FDI comprises developed, developing and transition countries;  

Although as a result of the onset of the global recession, which generated an increase of investor concern with regard to the sustainability of certain regions, as well as powerful internal tensions in the main developed countries, the global foreign direct investment flows suffered serious contractions (around 10.4% in 2008 and 40% in 2009 – UNCTAD, 2014), compared to the level in 2007, China doubled its outward investments in this period, becoming an increasingly important source of capital.

**Graph 4: China’s outward investment flows 2000-2014 (USD bn.)**

![Graph 4](image)


The upward trend of China’s investment activity abroad continued until 2014, when the FDI volume registered a new historic high of USD 116 billion (compared to USD 101 billion in 2013), which corresponds to a share of around 9% of the world total.

\(^{22}\) In 2011, China was fifth after the U.S., Germany, France and Hong Kong.
As it may be seen from the statistical data presented, China is now a net importer of FDI, but the net investment flows (the difference between inward and outward investment) has an accelerated downward trend. According to certain specialists, based on the sustained economic growth and China’s spectacular investment appetite given by its present economic force and also encouraged by the national policies in the field, this trend will be maintained on the long run and, in 2020, outward investment will even be able to exceed the inflow of foreign capital (Hanemann&Rosen, 2012).

5. Conclusions

In the past 35 years China has passed through a number of historical economic stages and succeeded to completely change its role in the world economy: from a large country with a huge population, lagging behind and characterized by numerous shortages to the status of the largest economy achieved in 2014 (measured in Purchasing Power Standard); from a minor participant in the international flows of foreign direct investment to the largest recipient in the world (in 2014); and from a totally negligible position as outward investor to that of a growing source of capital for the rest of the world.

Such unprecedented changes have been possible due to a consistent and at the same time prudent policy promoted by the Chinese decision-makers that combined experimenting with prudence, openness with control and market economy with a planned and therefore stable business environment. From this point of view even the most skeptical analysts cannot explain 35 years of achievements only by chance or randomness.

These consistent and objective results may represent in our opinion a proof that foreign direct investment combined with a flexible but at the same time firm economic policy may represent a viable option for over passing the underdevelopment status and even for accession to a leadership position in the world economy. At a much smaller scale than that of China a similar historical evolution has been experienced by Ireland that also based its accession to the status of developed country almost entirely on foreign direct investment.

At the same time China is an interesting case study for analyzing the impact of foreign direct investment on economic development because it has passed through a full circle, from the position of an almost entirely closed economy that was a minor host country as destination for FDI inflows to that of premier destination of foreign investment in a global economy and from no participation as source of capital to that of a dynamic and important investor abroad.

These decades long transformation journey of the Chinese economy has been accompanied by qualitative transformations of the Chinese business environment, first in the Special Economic Zones and then in all the economy, as well as by a transition of the foreign investment orientation from low value added activities to an ever increasing share of the high value added ones.

Based on all the above mentioned aspects the conclusion is that at least in the case of China foreign direct investment has represented a successful factor for economic growth and development. The in-depth analysis has also revealed that this factor alone could not have contributed to such a large extent to the economic success without a permanent, flexible and strategy oriented policy that adapted and oriented the external input (foreign direct investment) to the internal characteristics and needs of the Chinese economy.

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