

**China's outward FDI:  
What explains geographical  
destination?  
Some thoughts for Europe**

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## Roadmap to presentation

1. **Why China's rapid growth in Outward FDI (OFDI) makes sense?**
2. **Some stylized facts**
3. **How to explain geographical choice?**
  - **Comparison with other Asian countries who conducted large OFDI before**
  - **Also comparison with India today being the only country of similar population size**
4. **What is it for Europe?**

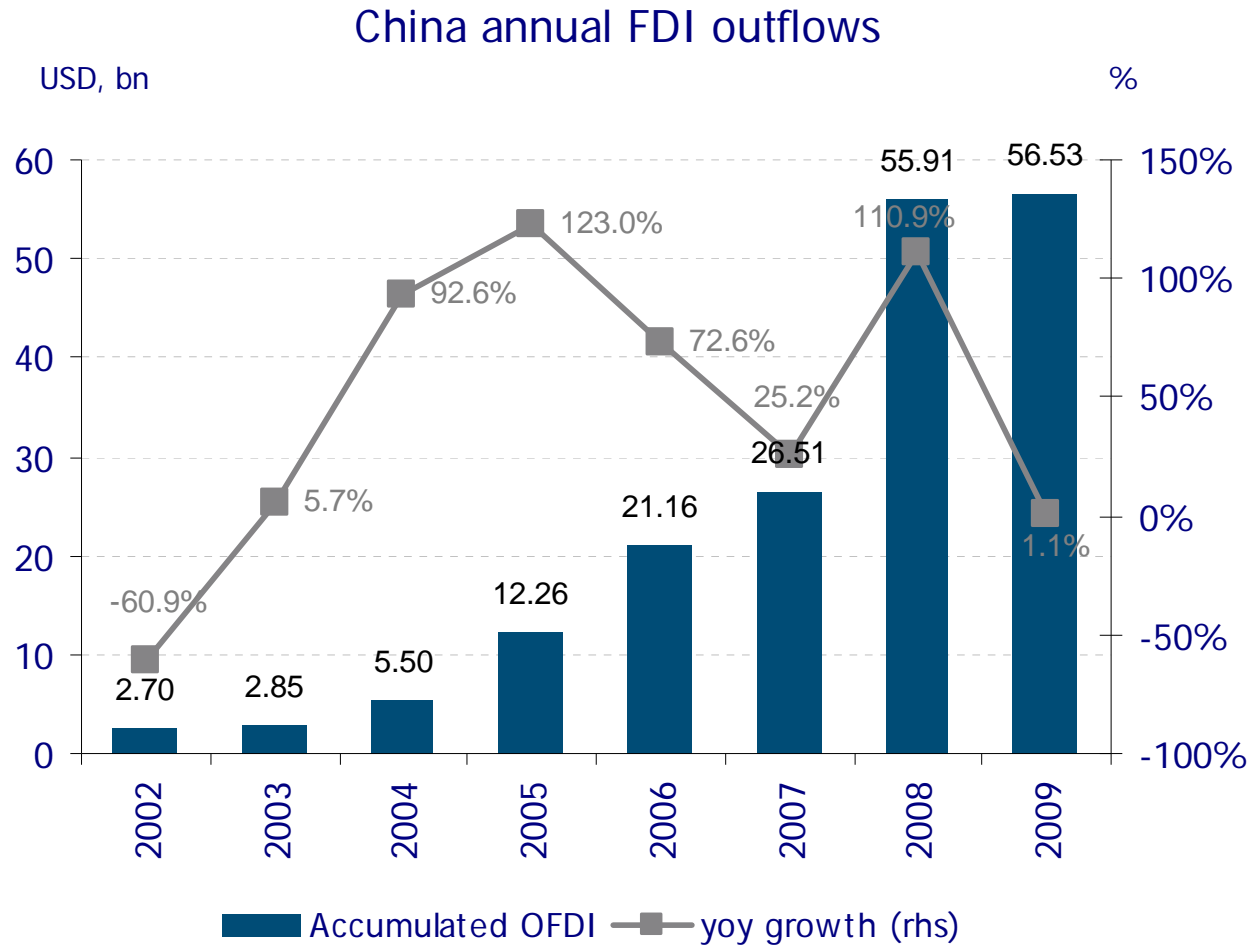
## 1. Why to invest abroad?

1. **Big economies tend to invest abroad**
  - **China is already second largest economy...**
  - **But large economies have always been wealthy**
2. **China's citizens might not be wealthy but country sitting on huge liquid assets**
3. **Outward FDI generally to export know-how but could it be a way to import it?**
  - **India is trying also, before Taiwan did**
4. **Outward FDI may be a substitute of imports for some goods**
  - **Seems to be the case for some commodities in China, specially energy**

# 1. Where does China stand?: Growing fast

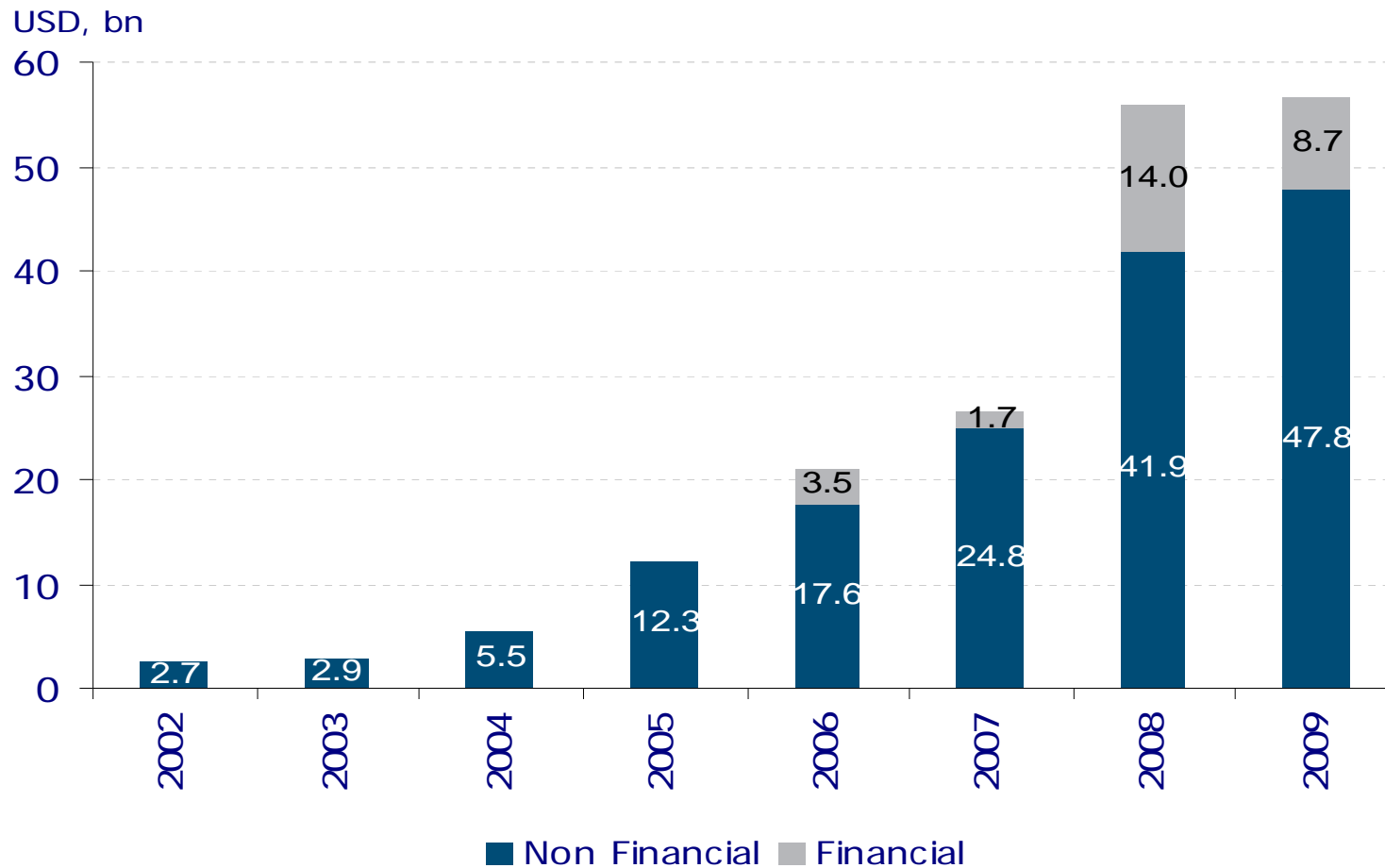


## Although moderating in 2009, 2010 should again be impressive



## Still concentrated on non financial sector

### Non-financial and financial OFDI flows

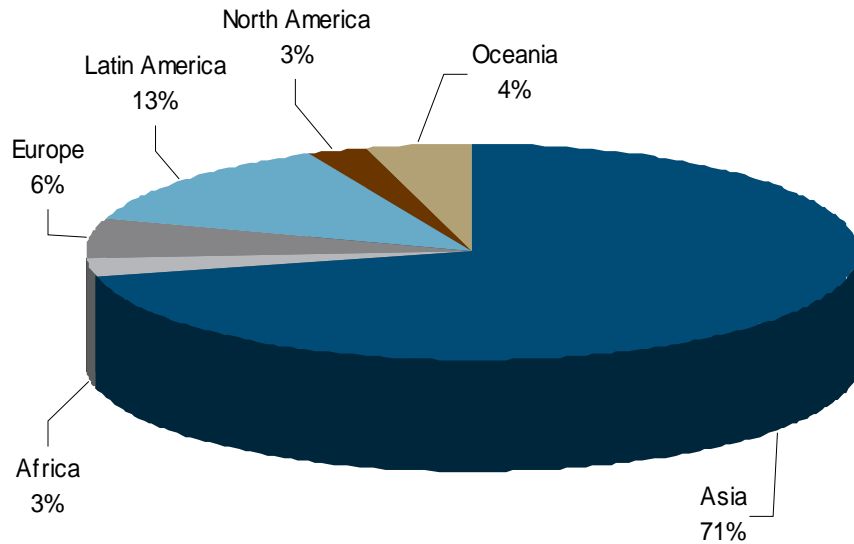


## Sector wise mining is become more important and banking less so

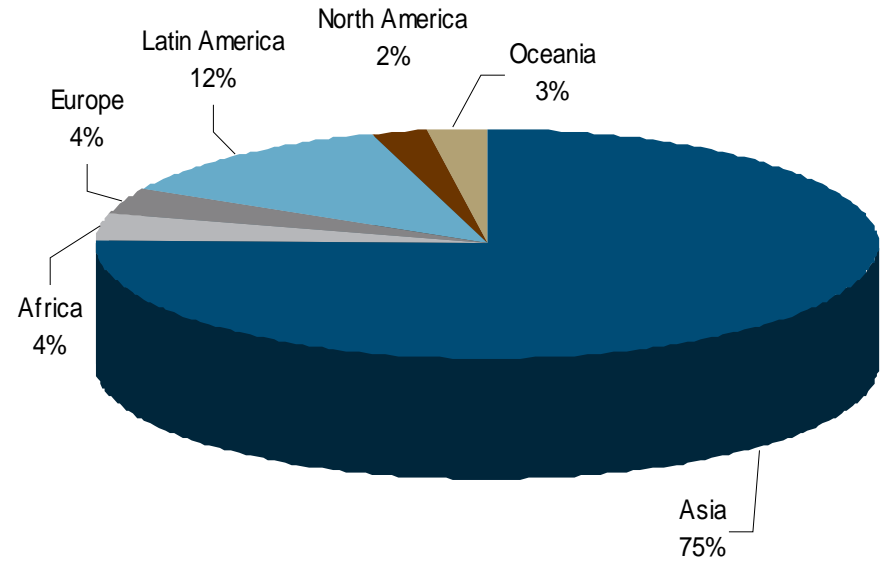
Outward flows	2006	(in % of total)	2009	(in % of total)
Leasing & Commercial Service	21,717	39	20,474	36
Mining	5,824	10	13,343	24
Banking and Insurance	14,048	25	8,734	15
Wholesale & Retail Trade	6,514	12	6,136	11
Manufacturing	1,766	3	2,241	4
Transport, Storage & Postal Service	2,656	5	2,068	4
Real Estate	339	1	938	2
Scientific Research, Poly Service & Software	167	0	776	1
Electricity, Gas & Water Production & Supply	1,313	2	468	1
Construction	733	1	360	1
Agricultural	172	0	343	1
Information Transmission, Computer Service	299	1	278	0
Residential & Other Service	165	0	268	0
Accommodation & Catering Trade	30	0	75	0
Culture, Sport & Recreation	22	0	20	0
Water Conservancy, Enviro & Public Utility Mgt	141	0	4	0
Education	2	0	2	0
Health Care, Social Security & Welfare	0	0	2	0

# Most FDI goes to Asia. Latin America as destination very resilient

2009 OFDI outflows  
(Total USD 56.53bn)



2009 OFDI stock volume  
(Total USD 245.76 bn)

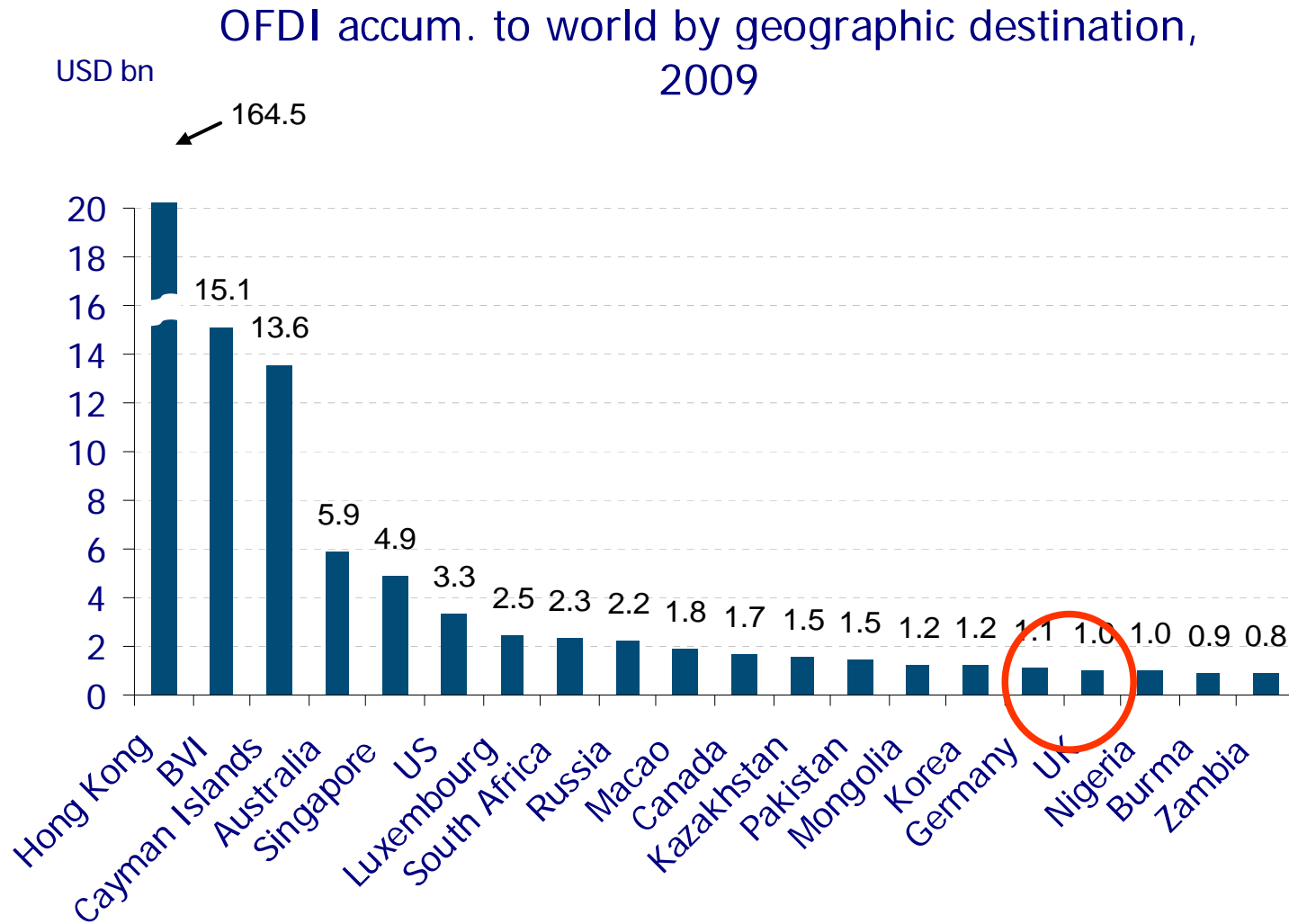


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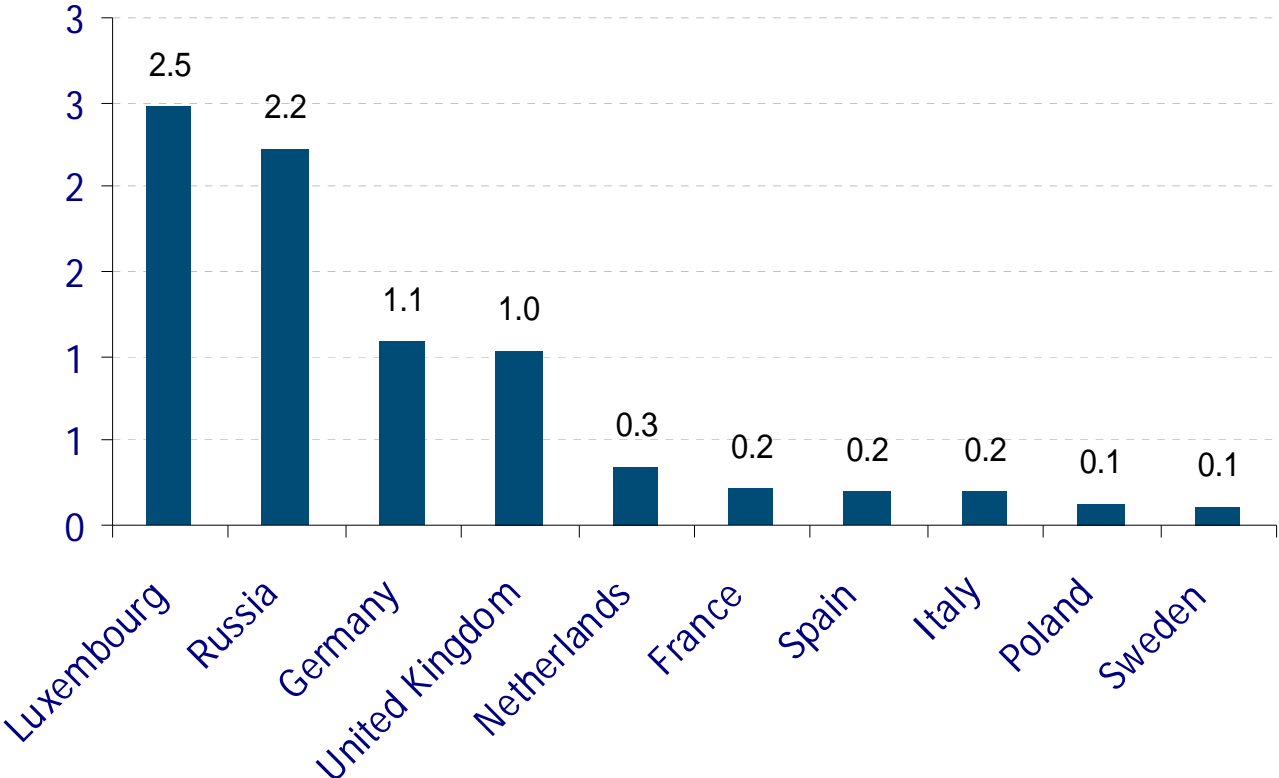


# Europe is hardly present compared to its size



# France lagging behind also Spain and Italy

OFDI accum. to Europe by geographic destination, 2009  
USD bn



## Geographical destination: Is China very different from key Asian investors?

- Fung and Garcia-Herrero (Asia Development Review 2009) analyze empirically the determinants of OFDI's geographical destination for
  - Japan
  - South Korea
  - Taiwan
  - China
  
- 1. Some historical fact on Japanese, Korean and Taiwanese OFDI
- 2. Our empirical model
- 3. Results
- 4. Implications for China

## Japanese OFDI: stylized facts

- Phases in Japanese OFDI
  - In the 1950s and 60s, mainly resource extraction; intensified during oil shock of the 70s
  - 1960s and 70s, higher labor costs led to labor-intensive manufacturing firms moving abroad
  - In 1981, US market –specially autos – due to protectionist actions in the US and elsewhere
    - *Hypothesis: FDI jumping over trade barriers*
  - From 1985 on, Yen shock
    - *Hypothesis: high yen drove FDI abroad*
- Japanese firms are famous to pay attention to quality and demand higher quality of labor (job rotation, just-in-time, etc)
  - So we also include host human capital in set of possible determinants

## Korean OFDI: stylized facts

- Phases in Korean FDI:
  - From 1968 to 1993, number one motive is to develop natural resources
  - Thereafter, securing local or third markets and utilizing low labor costs
    - *Hypothesis: Market-seeking*

## Taiwanese OFDI: stylized facts

- Taiwan's OFDI is heavily concentrated in China so conclusions on geographical destination hard to generalize
- Phases in Taiwanese OFDI
  - Before 1978, outflows were severely restricted
  - In the 1980s, easing of the restrictions, with help from Ex-Im Bank
  - The NT dollars rose in the 1980s; large foreign reserves led to inflation; higher labor costs all led to the erosion of competitiveness of Taiwanese firms, which had to go abroad
  - In the 1990s onwards, high-tech companies needed to upgrade and to acquire technology

## Our model

- *Several hypotheses for Chinese OFDI:*
  - resource extraction
  - access to markets
  - technology acquisition
- *Other potential determinants of OFDI include:*
  - openness of the host economies
  - distance
  - sharing borders
  - human capital
  - home market macro variables growth rate of GDP
  - GDP level
  - current account balance
  - money supply

## Determinants of Chinese OFDI (1991-2007)

- Market Size, positive and significant – *Preference for larger and/or richer countries*
- Human capital negative and significant – *Search for knowledge*
- Distance, negative and significant – *Preference for closer countries*
- FOOD is positive and significant – *Preference for targets with abundant natural resources, sp. food*



## Determinants of Japanese OFDI (1983-2007)

- Market size positive and significant
- FOOD is significant and positive
- Ores and metals significant and positive
- Openness significant and positive – *Opposite of hypothesis of tariff-jumping*
- No Technology acquisition
- No evidence of importance of Yen valuation for whole sample

## Determinants of Korean OFDI (1980-2007)

- Market access significant and positive
- FOOD is positive and significant
- Distance is negative and significant

## Determinants of Taiwanese OFDI (1968-2007)

- Market access significant and positive
- Investment in technology in host country significant and positive

## Overall results and conclusions

- Overall, for the full model:
  - Market access is important for all four economies
  - FOOD is important for Japan and Korea
  - Metals and ores important for Japan as well
  - Abundant technology is important for Taiwan
- After all, China's geographical strategy for OFDI does not seem so strange when comparing with its Asian predecessors
  - Europe should be in the rather because of market access considerations
  - If China were to follow Taiwan and search technology, Europe would become a more interesting destination

## China and India's comparison for geographical destination of OFDI

- Fung and Garcia Herrero (forthcoming in China Economic Policy Review 2010) analyze empirically the determinants of China's and India's OFDI
- Both countries similar in terms of stellar growth recently and population but very different in their sectoral concentration
- China plays a key role in global manufacturing while India could soon be in a similar situation for services

## Objective of empirical paper

1. Examine empirically what determines the destination of China's and India's outward FDI
  - Starting with the standard gravity model and then including other variables which proxy other motives
2. Explore the potential differences in investment behavior between India and China
  - Specially important given that most FDI from China involves the public sector while most FDI from India comes from private firms

## Model variables

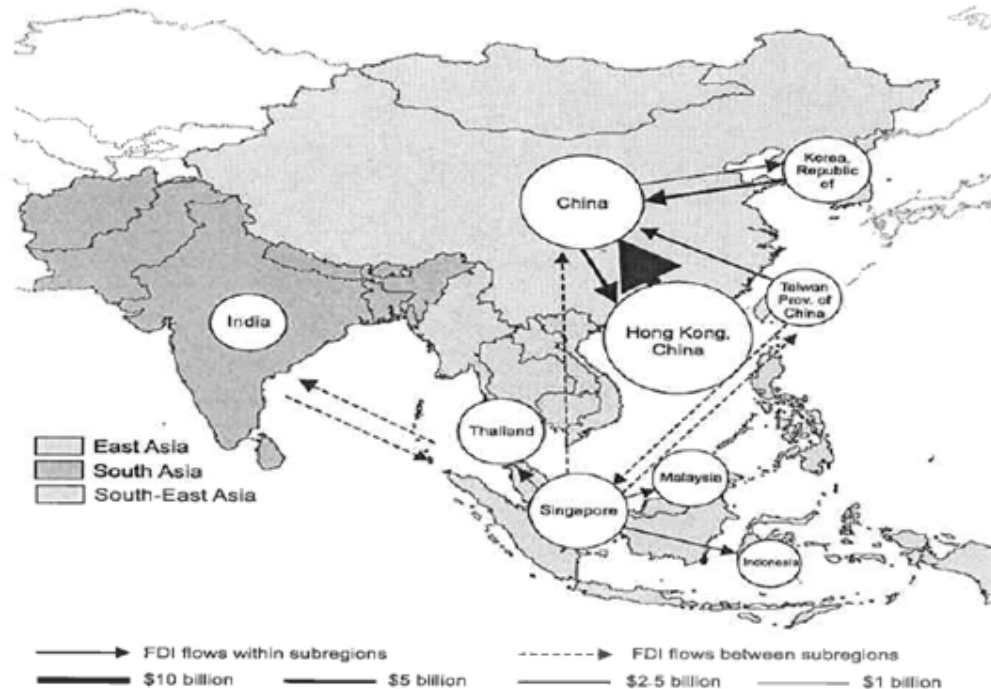
In addition to the gravity model, other outward FDI motives to be explored:

1. Institutional quality
2. Exchange rate issues
3. Search for natural resources
4. Controlling the supply chain
5. Home market conditions
6. Search for technology
7. Search for human capital

## Some stylized facts

- China's most important destination economy is Hong Kong
  - But is this real?
  - Not to a large extent because of roundtripping so we exclude it. Other off-shore centers also dropped

Figure II.10. Pattern of intraregional FDI flows in South, East and South-East Asia, 2002-2004 <sup>a</sup>



Source: UNCTAD.

<sup>a</sup> The width of arrows reflects the annual average of FDI flows during 2002-2004 (based on FDI inflow data from host economies). FDI flows below \$400 million are not shown, except for those between India and South-East Asia. The size of circles reflects the inward FDI stock in 2004.



# Findings

- **Both China and India have investment motives beyond the standard gravity model**
- **However, their investment motives are clearly different**
  - **China targets countries with worse institutions and low education**
  - **India instead prefers countries with better rule of law**
  - **China tends to go to economies with are larger but poorer**
  - **Both India and China seem to be investing in economies to seek fuels**
  - **There is also some evidence that they are investing to acquire technology**
  - **Exchange rates do not play a major role in affecting Indian or Chinese investment**

## Some tentative conclusions for Europe

- China does not seem to be very interested in Europe given the small amount of OFDI into European countries
- The motifs behind Chinese's OFDI found in Fung and Garcia-Herrero (2009 and 2010) tend to explain why such OFDI remains low
- However, there could also be protectionist reasons from the European side (not included in our analysis)
- There are reasons to believe that this will change that China may become more interested:
  - The experience of some other Asian countries with large OFDI shows that they graduated from a resource-seeking motif to others more related to market size and technology
  - India's motifs behind geographical destination today are already more akin to Europe's comparative advantage than those of China
  - According to the literature the appreciation of the RMB against the euro should not be the key determinant