Journal of Economics and Sustainable Development
ISSN 2222-1700 (Paper) ISSN 2222-2855 (Online)
Vol.9, No.2, 2018

Some Facts About Outward Foreign Direct Investment from China

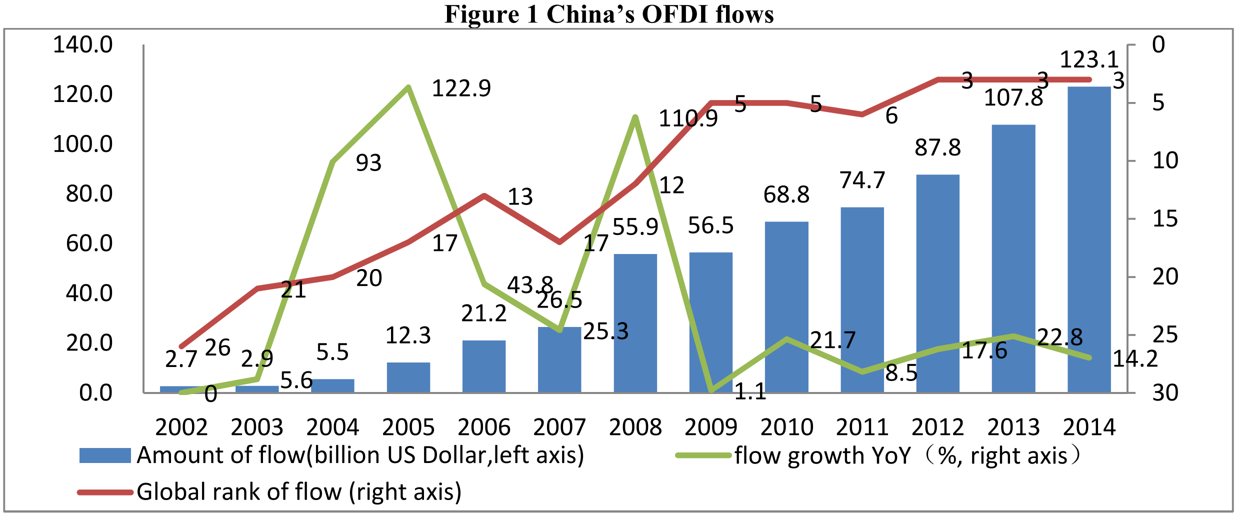
Alzaid Abdulmonim M
College of Economics, Nankai University, Tianjin, 300071, People's Republic of China

Hu Yanbin
China Everbright Group Post-Doctoral Scientific Research Workstation ,Tsinghua University PBC School of Finance Applied Economics Post-Doctoral Workstation, Beijing,100033, People's Republic of China

Chinese Outward Foreign Direct Investment:

According to the"2014 Statistical Bulletin of China's Outward Foreign Direct Investment", 2014 saw another episode of difficult and complicated recovery of global economy with a decline in global foreign direct investment. Facing the complex and volatile international situation, the Chinese government proactively promoted the establishment of "The Belt and Road Initiative", and continuously sped up the facilitation to outward foreign investment, increasing the inner motivation of Chinese enterprises to "go global". In 2014, with its outward foreign direct investment (FDI) reaching a historical record of $123.12 billion, China achieved the balance between outward and inward direct investment for the first time. 2014 saw another episode of difficult and complicated recovery of global economy with a decline in global foreign direct investment.

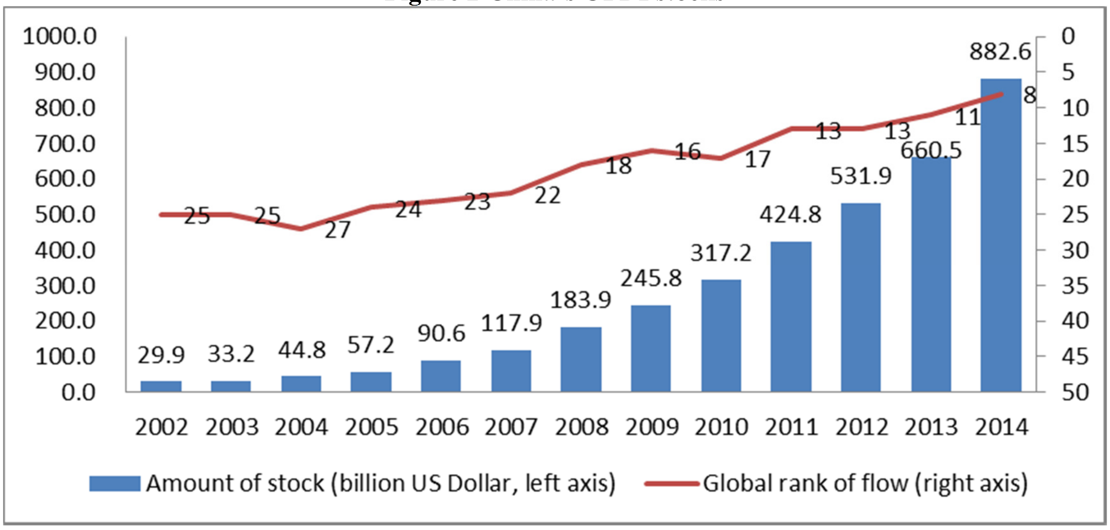
Figure 1 China's OFDI flows



Source：Ministry of Commerce, People's Republic of China

Facing the complex and volatile international situation, the Chinese government proactively promoted the establishment of "The Belt and Road Initiative", and continuously sped up the facilitation to outward foreign investment, increasing the inner motivation of Chinese enterprises to "go global". In 2014, with its outward foreign direct investment (FDI) reaching a historical record of $123.12 billion, China achieved the balance between outward and inward direct investment for the first time. The World Investment Report 2015 by UNCTAD showed that, global FDI outflows reached $1.35 trillion in 2014, and the stock had accumulated to $25.87 trillion by the end of 2014. Based on this report, China's outward FDI flows and stock in 2014 accounted for a share of 9.1% and 3.4% globally. China has ranked 3rd among all countries (regions) in terms of outward FDI flows for three consecutive years, with an increase of 1.5 percentage points, and 8th in terms of stock, compared to 11th in the previous year. Inward Foreign Direct Investment (IFDI or FDI) and Outward Foreign Direct Investment (OFDI or ODI）is an essential way of China's participation in the world economic integration process of international investment, trade, and finance, but also one of the crucial driving forces to ensure the green, healthy and sustainable development of China's economy into the 21st century. China's outward foreign direct investment flows and stocks had developed sharply to reach and accumulate to $123.12 billion and $882.64 billion, more than 40 times and almost 30 times of those in 2002 respectively.

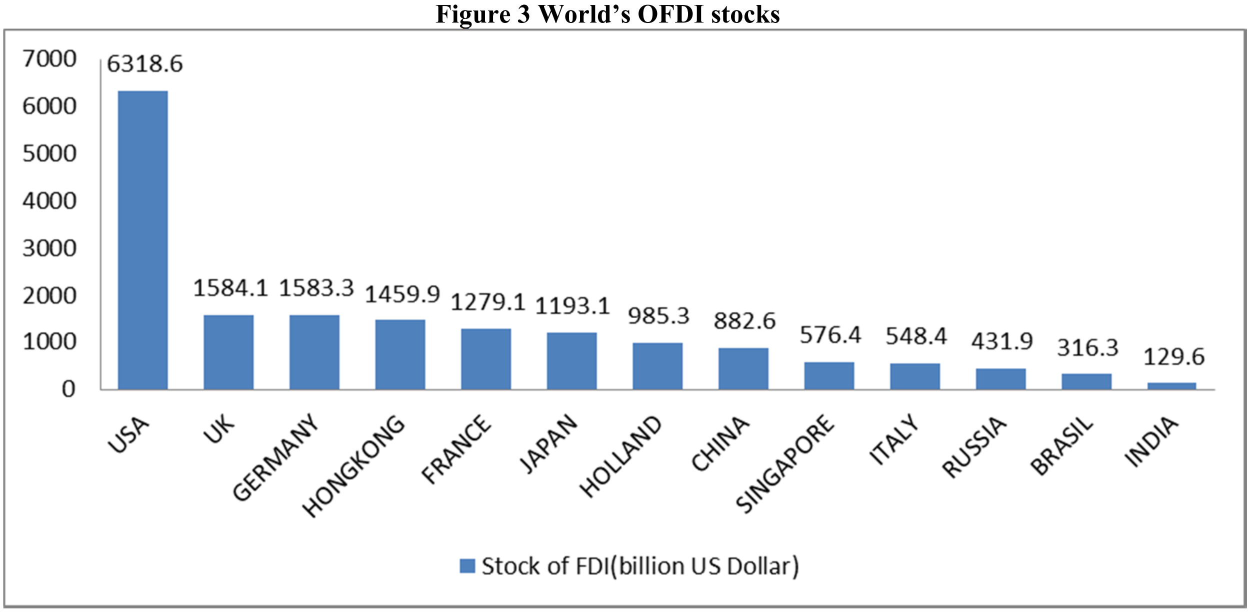
Figure 2 China's OFDI stocks



Source：Ministry of Commerce, People's Republic of China.

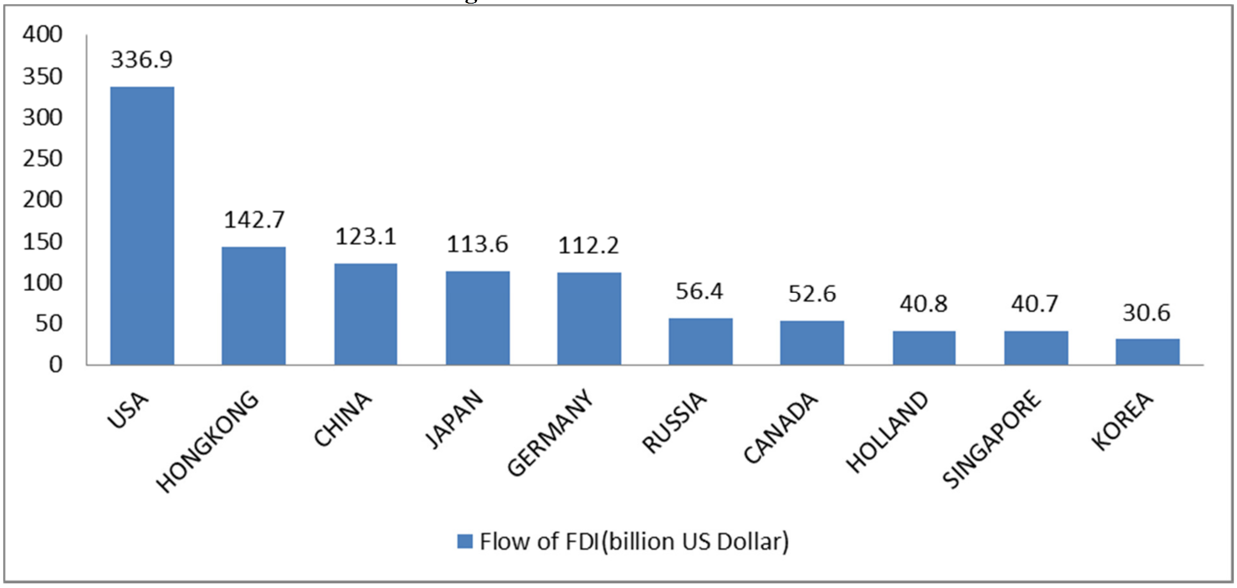
Inward and outward foreign direct investments provide a significant impetus and stimulus for the healthy and sustainable development of China's economy. However, what are the driving factors of China's inward and outward foreign direct investments? Is the inward and outward foreign direct investments government controlled or market demanded? Is sustainable growth of China's inward and outward foreign direct investments remaining the increasingly high trends? What are the main theoretic and politic causes determining China's inward and outward foreign direct investments? Where are the coordinating mechanism and policy of the two opening strategies of inward and outward foreign direct investments originated? What potential risk have the inward and outward foreign direct investments accumulated through yeas? And other related issues have become the focus of attention of international scholars.

Figure 3 World's OFDI stocks



Source：Ministry of Commerce, People's Republic of China and UNCTAD.

Figure 4 World's OFDI flows



Source：Ministry of Commerce, People's Republic of China and UNCTAD.

Melitz (2003) created the representative framework of the "New-New Trade Theory" explaining that an essential factor that enterprises take into consideration is the level of productivity when considering whether to foreign direct invest or to export. Considering producing and selling within domestic market and exporting overseas, or directly investing to produce and sale in foreign markets under the circumstances of uncertainty, enterprises must bear the fixed costs of overseas factories establishments of fixed costs, therefore, only enterprises, above a certain threshold of productivity, choose a profitable business investment overseas. Moreover, those enterprises cannot go beyond this level of productivity choose not to invest in profitable overseas production. The result depends on the productivity of heterogeneous enterprises, that is, enterprises with high productivity prefer exports, and those with low productivity remain only in the domestic market for production and sales. The so-called "New-New Trade Theory" analyzes the strategic business investment decisions of operating modes, which neglects the condition that there are corporate financing constraints; meaning enterprises are capable of obtaining sufficient financing support to invest at free will. Factually, even one enterprise's productivity level is sufficient enough to allow profiting in overseas investment and production, if companies cannot get enough financial support, the ultimate profits cannot be achieved to directly invest in foreign markets. Thus, Buch et al(2010) theoretically, concentrated on the model of foreign investment enterprises to conduct crossing the threshold of a financing constraint, which played as a more deciding role in the dilemma of financial budget than the total factor productivity in the optimal strategy of investment, production, trade, inputs, outputs and profits.

Development of international enterprises has also seen the influence since China's policy of reform and opening up in 1978. The superb rising of new emerging market economies as China foothold global economic high speed develop in the environment of weak dollar and universal excess fluidity. Up to now, Chinese enterprises' productivity improved and updated comprehensively laying a solid and firm foundation for Chinese enterprises to directly invest in foreign overseas countries and regions, under the protocol of "One Belt and One Road", Asia Infrastructure Investment Bank, Silk Road Foundation and other global and regional cooperation's. Although China's financial and capital markets gradually reform and open up versatile, especially in the initial year of "the thirteenth-five year plan", the supply-side structural reform is force storming, to complete five major tasks of "cut excessive industrial capacity, de-stock, de-leverage, lower corporate costs, improve weak links" is testing the capability of macro controlling and reform deepening, which will determine the prospect of China's economy. Chinese enterprises are facing more and more severe financing constraints. Although the development of China's financial market progress achieved to a competitive stepfoward to market-oriented, the intervention over the financial and capital markets from some central and local governments exits widespread, the phenomenon and cases of financial selective inclination and discrimination still remains prominent. State-managed interest and exchange rates, selective credits and loans, the pricing of IPO and other core financial resources have not reflected the appealing of market participants, meaning the hands of central and local administration have crossed the border of free market competition to induce a far more instructive effect on the financial resources liquidity allocation than the perfect supply-demand relation. Chinese enterprises are still facing serious financing problems, and China's financial markets did not fully realize, where the phenomenon of financial depression is obvious. Take one of the ordinary financing means for example, credits and loans, deregulation of interest rates has gained greatly, whereas, no factual differentiation is met within various financial institutions. The result of state administrative intervention from a savings deposit perspective, the results of which bank resident deposits to basically the same, and there is no price competition between banks State-owned-enterprises (SOEs), which are accounting for most credits and loans from the selective-biased administrative intervention of government remain too big to fall under the source of steady capital. SOEs take advantage of natural resources to produce at a lower efficiency rate. Comparatively, the most energetic and innovative private-owned-enterprises (POEs) and， especially small-medium-enterprises (SMEs) are far beyond the range of giant financial institutions to share a bonus, but to solve the financing constraints through the equal-fragile private owned financial and capital markets, what's more some with potential are difficult to get funds to support from banks. Despite of the financing costs, the factor relative price ratio is also affecting enterprises to choose production modes. Under the circumstances of relatively-low cost of capital， enterprises are more likely to utilize the capital-intensive modes of production, which also illustrates more propensity of innovative and outward foreign direct investment features. Such discriminatory financing environment exacerbates a certain extent of price distortions in factor markets, especially for the undervalued labor factor. For macro economy, the relatively-low price of labor means the adequacy of labor resource is overestimated. This endowments structure will attract labor-intensive industries which are most likely impede the structure transformation and upgrading of the industry according to Rybczynski Theorem; for micro economy, the relative abundance of labor resources will encourage enterprises to adopt extensive labor-intensive industries, obstructing enterprise form lower status of industry global value chain. The lack of innovation vitality and OFDI will restrain the economic growth of China as a key factor. Based on the theoretical framework above, this paper formed an endogenous model based on neo-classical framework and clarifies the affirmative and negative effects of financing environment, production factor price distortion, TFP, and innovation vitality of heterogeneous enterprises from a perspective of market-oriented finance on economic growth and outward foreign direct investment in China. This article in the "New-New Trade Theory", based on the analysis of financing constraint issues in the framework of the financial mechanism of actual distinction from the theories, financing environment, production factor price distortion, TFP, and innovation vitality of heterogeneous enterprises, outward foreign direct investment from the enterprise to use of provincial and corporate level econometric model to implement empirical research. Based on the theoretical analysis, this paper utilizes the data to examine and clarify that negative effect of discrimination financial environment and relative distortion in factor market on OFDI vitality of enterprises in China.

References

[1] Acemoglu D, Zilibotti F. Was Prometheus unbound by chance? Risk, diversification, and growth[J]. Journal of Political Economy, 1997, 105(4): 709-751.

[2] Allen, F., Qian, J. and Qian, M.Law, finance, and economic growth in China [J]. Journal of financial economics, 2005, 77(1):57-116.

[3] Anderson. "The Theoretical Foundation for the Gravity Equation." [J]. American Economic Review，1979.

[4] Antras, Pol, and Elhanan Helpman. Global Sourcing [J]. The Journal of Political Economy, 2004,112(3): 552-580.

[5] Brown, J.R., Fazzari, S. M., Petersen, B. C. Financing Innovation and Growth: Cash Flow, External Equity, and the 1990s R&D Boom. The Journal of Finance, 2009, 64(1): 151-185.

[6] Buch C M, Kesternich I, Lipponer A, et al. Exports versus FDI revisited: does finance matter?[J]. 2010.

[7] Demirgüc‐Kunt A, Maksimovic V. Law, finance, and firm growth[J]. The Journal of Finance, 1998, 53(6): 2107-2137.

[8] Eaton J, Kortum S, Kramarz F. An anatomy of international trade: Evidence from French firms[J]. Econometrica, 2011, 79(5): 1453-1498.

[9] Greenwood J, Jovanovic B. Financial Development, Growth, and the Distribution of Income[J]. The Journal of Political Economy, 1990, 98(5 Part 1): 1076-1107.

[10] Grossman S J, Stiglitz J E. On the impossibility of informationally efficient markets[J]. The American Economic Review, 1980: 393-408.

[11] Head K, Ries J. Increasing returns versus national product differentiation as an explanation for the pattern of US-Canada trade[J]. American Economic Review, 2001: 858-876.

[12] Helpman E, Melitz M J, Yeaple S R. Export versus FDI with heterogeneous firms[J]. American economic review, 2004: 300-316.

[13] Hsieh C.T. and P.J. Klenow.Misallocation and Manufacturing TFP in China and India [J]. Quarterly Journal of Economics, 2009,124(4):1403-1448.

[14] Javorcik B S. Does foreign direct investment increase the productivity of domestic firms? In search of spillovers through backward linkages[J]. The American Economic Review, 2004, 94(3): 605-627.

[15] Jensen M. C., Murphy K.J. Performance Pay and Top Management Incentives[J]. Journal of Political Economy (April),1990.

[16] King R G, Levine R. Finance and growth: Schumpeter might be right[J]. The quarterly journal of economics, 1993, 108(3): 717-737.

[17] La Porta R, Lopez-de-Silanes F, Shleifer A, et al. Investor protection and corporate valuation[J]. Journal of finance, 2002: 1147-1170.
[18] Lucas R.E. Why Does't Capital Flow from Rich to Poor Countries?[J] American Economic Review, 1990, 80(2): 92-96.
[19] Mankiw N.G., D. Romer and D.N. Weil. A Contribution to the Empirics of Economic Growth[J]. Quarterly Journal of Economics, 1992, 107(2): 407-438.
[20] Markusen, et al. "Discriminating among Theories of the Multinational Trade." [J]. Journal of International Economics，2002
[21] Melitz M J. The impact of trade on intra‐industry reallocations and aggregate industry productivity[J]. Econometrica, 2003, 71(6): 1695-1725.
[22] Rajan R G, Zingales L. Financial dependence and growth[R]. National bureau of economic research, No. 5758,1996.
[23] Rajan R G, Zingales L. Financial systems, industrial structure, and growth[J]. Oxford Review of Economic Policy, 2001, 17(4): 467-482.
[24] Rajan R G, Zingales L. Power in a Theory of the Firm[J]. The Quarterly Journal of Economics, 1998, 113(2): 387-432.
[25] Romer D. Openness and inflation: theory and evidence[J]. The Quarterly Journal of Economics, 1993, 108(4): 869-903.
[26] Schumpeter, J. A. Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalist Process. New York: McGraw-Hill, 1939.
[27] Shaw E.S. Financial Deepening in Economic Development[M]. New York: Oxford University Press, 1973.
[28] Shleifer A, Vishny R W. Politicians and firms[J]. The Quarterly Journal of Economics, 1994,109(4): 995-1025.
[29] Shleifer A, Vishny R W. A survey of corporate governance[J]. The journal of finance, 1997, 52(2): 737-783.
[30] Solow R. M. A contribution to the Theory of Economic Growth[J]. Quatterly Journal of Economics, 1956, 70(2): 65-94.
[31] Stiglitz J E, Weiss A. Credit rationing in markets with imperfect information[J]. The American economic review, 1981,71(3): 393-410.
[32] Vernon R. International investment and international trade in the product cycle[J]. 1966.
[33] Wurgler J. Financial markets and the allocation of capital[J]. Journal of financial economics, 2000, 58(1): 187-214.