Enter the dragon: Policies to attract Chinese investment

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Abstract:

Over the last ten years, Chinese enterprises have become more multi-national in nature. China's outward foreign direct investment (OFDI) has been growing at a phenomenal rate. In 2012, China became the third largest investor, after the US and Japan; and the largest investor among developing countries. How can host governments attract more of this Chinese capital? What are some short to medium term policies that host governments can initiate to make their respective nations attractive to Chinese investors? We consider these questions by utilizing a best-worst choice exercise among 114 senior corporate decision-makers of Chinese companies who have planned or are planning to globalize. Using the maximum difference scaling methodology, we rank 19 most common determinants that influence FDI location choice. We propose five "low hanging fruits" that policy-makers should consider that could ensure their countries come within the radar of Chinese multi-nationals.

JEL classification: F21, F23, F40

Keywords: Foreign Direct Investment (FDI), outward FDI, FDI policies, China, Investment, Maximum difference scaling

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Introduction

An obvious consequence of the economic crisis that started in late 2007 has been the effect on global foreign direct investment (FDI) trends. In 2012, global FDI outflows continued its downward trend, decreasing by 17 per cent from the previous year. The EU was a significant region that reduced its FDI outflow in contrast to the developing countries that became a relatively more important source of capital. The share of FDI outflows by developed economies declined from 88 per cent to 65 per cent between 2000 and 2011 while developing and transition economies increased their share from 12 per cent to 35 per cent during the same period (UNCTAD, 2013). Among developing countries, China is increasingly becoming an important source of capital. In the 1990s, the average annual FDI outflow from China was about USD 2.3 billion. In the first half of 2000s, the annual average increased to about USD 5.2 billion. Since 2006, the increase in China's outward foreign direct investment (OFDI) has been phenomenal. In 2012, China's OFDI reached USD 84.2 billion. In terms of proportion, while in the 1990s, China's outward FDI accounted for less than 1 per cent of total world FDI outflow; in 2012, this surpassed the 6 per cent mark. This is also close to 20 per cent of FDI outflow among developing countries.

The benefits that FDI brings to a nation are evident from the literature. They range from job creation to technological advancement as well as creation of new industries through the spill-over effects of FDI. The many benefits that FDI offers on one hand, and the relative scarcity of FDI outflow on the other, create a competition for foreign capital. As Chinese businesses continue their "go global" strategy, it becomes increasingly important for policy makers to identify those factors that Chinese decision-makers consider to be important location factors; and structure their policies accordingly so that their respective countries are competitive in this FDI market. The objective of this paper is to identify location factors that Chinese managers look for when making internationalization decisions and the relative magnitude of the importance of various factors. The novelty of our study lies in the type of respondents we utilize for data collection and the method of data collection. While previous studies have used China's OFDI from various sources (China's Statistical Bureau, UNCTAD, Financial Times etc.) to consider the determinants of OFDI at the macro level, we base our analysis on the choices of actual decision makers who are senior managers of Chinese companies (both state-owned and private) involved in the internationalization process of their respective companies. Furthermore, we utilize best-worst choice decisions in our questionnaire design such that decision makers must make trade-offs between various location factors, thus creating a more realistic and closer-to-live decision-making environment.

Although geography, economic size and growth, technology and natural resources are important factors that have been identified by previous studies (Buckley et al., 2007; Kolstad and Wiig, 2011; Ramasamy et al., 2011), in this study we focus on those factors that are within the control of host governments and could be implemented through agreements and policies in the short to medium term. Our findings point to five policies that require the immediate attention of host governments, especially national investment agencies.

In the next section we provide the setting of our study namely the trends of China's OFDI over the last few years. Section two builds the hypotheses of the study, focusing on ten policy factors that attract FDI. This is followed by a description of our sample, data collection procedures and the methodology of our analysis. In section four we discuss the results of our analysis. In the subsequent section we identify five low hanging fruits that host governments should consider in their effort to attract Chinese FDI. In the final section we conclude.

1. China's OFDI: Trends, destinations and sectors

Despite the brevity of China's OFDI phenomenon, the number of studies evaluating its trends, motivations and distinctness are numerous. Previous studies have also provided detailed accounts of the growth of Chinese OFDI (see for example Voss, et al, 2008). Rather than repeat these accounts and for the sake of brevity, we focus our attention on the trends in recent years, and highlight some salient points.