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An overview of outward direct investment from the Mainland

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Abstract

The Mainland has emerged as one of the major sources of foreign direct investment amid the progression of the Going Global Strategy. Using the Mainland's official statistics of outward direct investment, this article demonstrates that the Mainland's outward direct investment has spanned across various sectors and geographical regions. The diversified pattern of investment is closely linked to the development needs of the Mainland economy. The article also briefly discusses the recent trend of the Mainland's outward direct investment and its future prospects.

內地對外直接投資概況

摘要

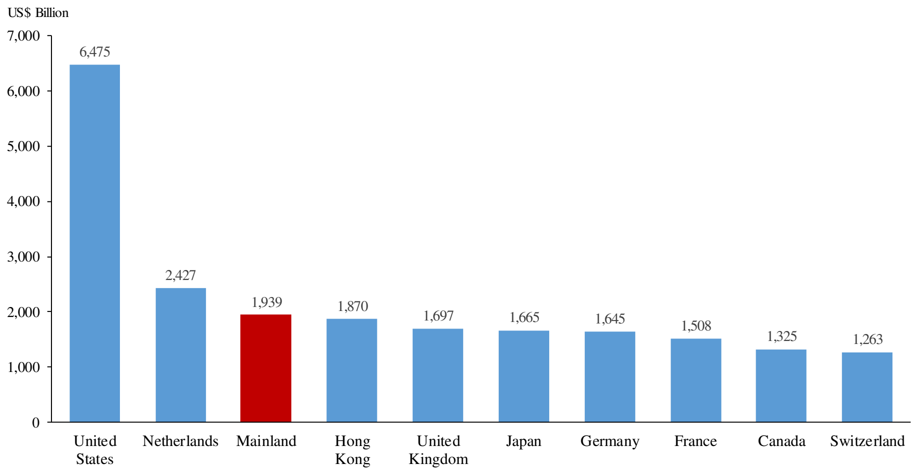
隨着「走出去」戰略的推進，內地已經成為其中一個外來直接投資的主要來源。本文利用內地對外直接投資的官方數據，顯示內地對外直接投資跨越不同產業和地域，而這多元的投資格局與內地本身的經濟發展所需息息相關。本文亦就內地對外直接投資的近期趨勢和未來前景作簡單討論。

I. INTRODUCTION

1. Foreign direct investment (FDI) plays an integral role in facilitating the development and closer integration of the global economy. From a host economy perspective, FDI helps bring in capital from other economies to support business and production activities, thereby promoting economic growth. This is especially critical for some developing economies where capital is relatively scarce. FDI also provides a channel through which the host economy can acquire technology, skills and other technical know-how from more advanced economies. These intangible assets are among the most important drivers of long term economic development. On the other hand, cross-border investment, alongside international trade, enables multinational corporations (MNCs) to optimise their production networks around the globe and enhance their operational efficiency.

2. Of particular note is the emergence of the Mainland as a major source of FDI. Since the adoption of the Going Global Strategy in the early 2000s, Mainland enterprises have been actively exploring investment opportunities overseas. According to the *World Investment Report 2019* published by the United Nations Conference on Trade and Development (UNCTAD), the stock of outward direct investment (ODI) from the Mainland amounted to US$1,939 billion as of 2018, 70 times that in 2000. This made the Mainland the third largest source of FDI behind the US and the Netherlands. It was the only emerging economy in the top 10 investors list (***Chart 1***). In the upcoming sections, we will briefly discuss the motives of Mainland enterprises to invest abroad. This is followed by a review of the geographical and sectoral distribution of the Mainland's ODI, and its linkage with the Mainland's economic development. The article concludes with a discussion of the recent trend of the Mainland's ODI and its future prospects.

Chart 1: Top 10 sources of outward FDI in stock terms in 2018



Source: World Investment Report 2019

II. MOTIVES OF MAINLAND ENTERPRISES TO INVEST ABROAD

3. Since its accession to the WTO in 2001, the Mainland has rapidly developed into a manufacturing powerhouse and leading export economy in the world. The economy has been maintaining a positive balance of trade ever since, thereby accumulating a massive amount of foreign exchange reserves. This gives ample room for the Mainland to engage in outward investment should opportunities arise. From an enterprise's perspective, the decision to invest abroad should be motivated by its business development needs, which in turn are related to the development status of the economy. Some of the factors that Mainland enterprises commonly consider are discussed in further detail as follows.

4. ***Secure the supply of key resources.*** Acquisition of natural resources has long been considered as one of the primary motives of enterprises to invest abroad. With the Mainland turning into the "world's factory", its demand for natural resources such as energy, minerals and other raw materials should rise in tandem. It is thus reasonable for enterprises to invest upstream with a view to ensuring a stable supply of inputs.

5. ***Optimise production across the globe.*** This is one of the common reasons for manufacturing enterprises to invest overseas. Thanks to increased investment in research and development, many Mainland manufacturers have successfully moved up the value chain with a stronger focus on product innovation and advanced manufacturing activities. Consequently, some traditional manufacturing activities can be relocated to other emerging economies, with a view to reducing costs of production.

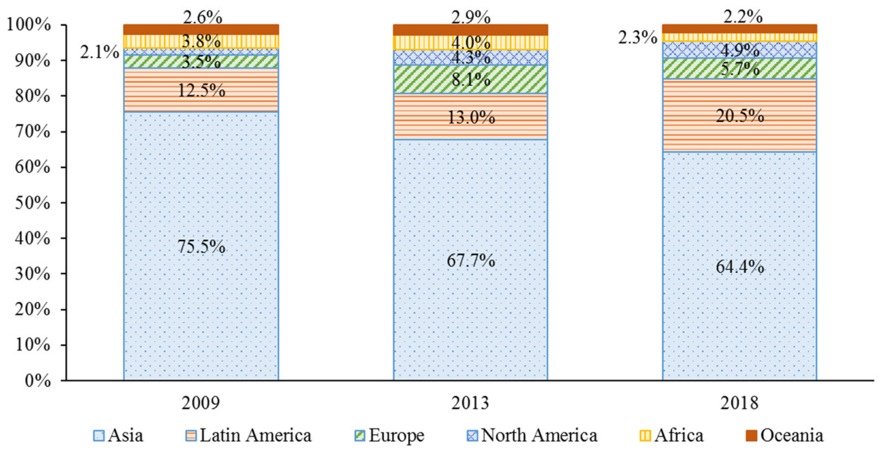
6. ***Gain access to foreign markets.*** ODI helps enterprises tap into growth opportunities available in foreign markets. For service industries such as wholesale and retail trades, accommodation and catering, and financial services, it is often necessary for enterprises to establish direct presence at targeted markets to facilitate their business development therein. Manufacturers might also find it more favourable to produce at their overseas buyers' locations rather than to produce domestically and export due to the presence of trade barriers (e.g. import tariffs) at the destination economies.

7. ***Nationwide development initiatives.*** Development strategies such as the Belt and Road Initiative and industrial upgrading play an important role in shaping the Mainland's ODI. State-owned enterprises are usually expected to formulate their investment plans in accordance with key national initiatives. Private enterprises are also motivated to invest in a similar fashion, taking advantage of the supportive measures associated with these initiatives (e.g. reduced restrictions/control on capital movement related to selected outward investment).

III. THE PATTERN OF THE MAINLAND'S OUTWARD DIRECT INVESTMENT

8. In this section, we will examine the distribution of the Mainland's ODI across different sectors and economies. ***Chart 2*** shows the geographical breakdown of the stock of the Mainland's ODI[1] over the years. While the portfolio of the Mainland's ODI has been well diversified across the globe, Asia remained the largest host for such investment as of 2018, with its stock reaching US$1,276 billion or 64.4% of the total ODI from the Mainland. Most of the Mainland's ODI stock in Asia (86.2% as of 2018) was in Hong Kong, and the ASEAN economies also accounted for a significant portion (8.1% as of 2018). Meanwhile, the share of the Mainland's ODI in Latin America has increased notably in recent years, largely driven by the surge in investment activities in the offshore financial centres therein[2].

Chart 2: Stock of the Mainland's ODI by geographical region in selected years



9. From a sectoral perspective, tertiary industry has been accounting for the largest share of the Mainland's ODI, amounting to US$1,546 billion or 78.0% of the total ODI in stock terms as of 2018. ***Chart 3*** depicts the breakdown of the stock of the Mainland's ODI by sector. Most of the service-related ODI stock went to leasing and business services, wholesale and retail trade, financial services, and information transmission, software and information technology services. These four sectors, together with mining and manufacturing, jointly accounted for 84.5% of the Mainland's ODI stock as of 2018.

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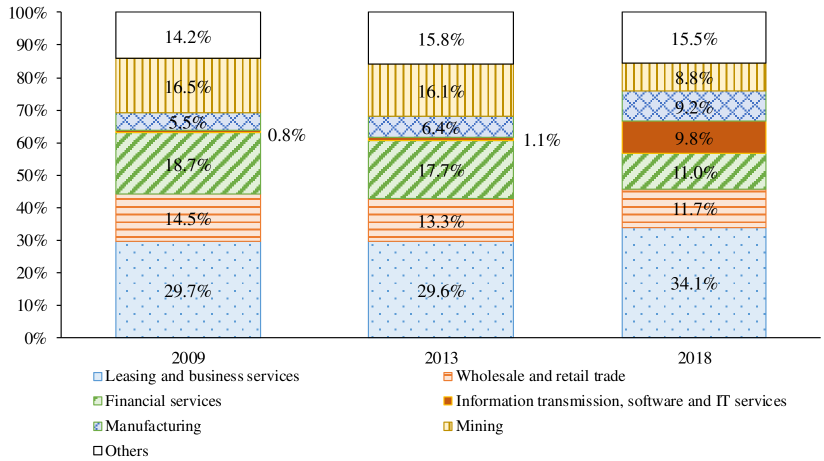
1 Unless specified otherwise, the Mainland's ODI data discussed in this section are drawn from the Statistical Bulletin of China's Outward Foreign Direct Investment, which was jointly published by the Ministry of Commerce, the National Bureau of Statistics and the State Administration of Foreign Exchange. Geographical region and sector definitions are also adopted in accordance with this Bulletin.

2 Over 95% of the Mainland's ODI stock in Latin America resided in the Cayman Islands or the British Virgin Islands as of 2018.

Chart 3: Stock of the Mainland's ODI by sector in selected years



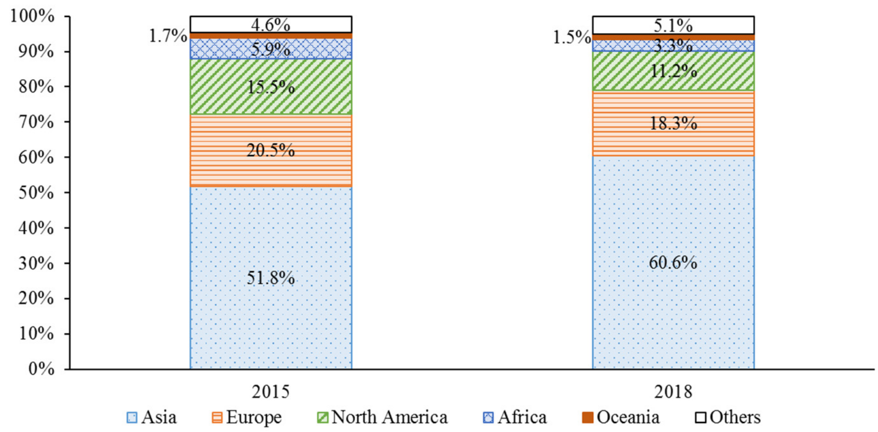
10. Generally speaking, service-related ODI as mentioned above can be roughly categorised into two main types. The first type refers to the investment undertaken by services firms (e.g. retailers, financial institutions) with a view to developing or expanding their businesses in the host economies as described in para. 6 of the previous section. Such investment is usually reflected in the Mainland's ODI in the concerned sectors (e.g. retail trade, financial services) of targeted foreign markets. The development of this type of ODI is fuelled by the Mainland's continuous transition towards a service-oriented economy, with its services providers increasingly eager to explore growth opportunities in overseas markets. Of particular note is the rapid growth of high tech-related investment, as shown in the rise in the share of ODI stock in information transmission, software and information technology services sector in recent years (9.8% in 2018 as compared to 1.1% in 2013). It is to a certain extent a reflection of the increasing importance of the high tech sector in the Mainland economy.

11. Another type of service-related ODI corresponds to corporate internal functions and services, which span across a range of corporate activities such as investment and asset management, legal services, business consultancy, marketing and advertising, intellectual property management, etc. It is classified under the umbrella of leasing and business services, which accounted for the largest share of the Mainland's ODI stock as shown in ***Chart 3*** (34.1% as of 2018). Such investment predominantly resides at major international financial centres and business hubs such as Hong Kong and Singapore, which is unsurprising as these places offer a favourable environment (e.g. free capital movement, sound legal framework, competitive tax system, large pool of talents) for corporate activities of this nature. In particular, Hong Kong has been the largest host for this type of investment, commanding a share of 79.2% of the Mainland's ODI stock in leasing and business services sector as of 2018. This signifies Hong Kong's role as a key business centre and investment conduit for the Mainland.

12. In para. 4 of the previous section, it is remarked that acquisition of natural resources is among the common motives for Mainland enterprises to undertake overseas investment. This is partly reflected in the Mainland's ODI in mining, which accounted for 8.8% of the total stock of ODI from the Mainland as of 2018. This proportion was even higher in resources-rich regions. In Oceania, for example, nearly half (48.2% as of 2018) of the Mainland's ODI stock was related to mining. Meanwhile, almost a quarter (22.7% as of 2018) of the Mainland's ODI stock in Africa was mining-related. With that said, the relative significance of mining investment has been trending downwards in recent years. Although the stock of mining-related ODI was growing by 17.5% per annum during 2010-2018, the pace was visibly slower than that of overall ODI (26.1% per annum during the same period), resulting in a decline of the former's share in the latter as shown in ***Chart 3***.

13. In contrast to mining-related ODI, the Mainland's ODI in manufacturing has been growing rapidly of late. The stock of manufacturing ODI expanded by 33.4% per annum during 2010-2018, and its share in total ODI rose from 5.5% in 2009 to 9.2% in 2018 as shown in ***Chart 3***. As noted in para. 5 of the previous section, these changes can be partly attributed to industrial upgrading of the Mainland and the migration of traditional manufacturing activities to other emerging economies. Asian economies, with their cost advantages, have emerged as popular spots for Mainland manufacturers to expand or relocate their production activities, accounting for 60.6% of the Mainland's manufacturing ODI stock as of 2018 (as compared to 51.8% in 2015; see ***Chart 4*** for further detail on the geographical breakdown of manufacturing ODI from the Mainland). Such investment has been soaring notably over the past few years. The stock of the Mainland's manufacturing ODI in Asia amounted to US$110.5 billion as of 2018, 2.7 times that in 2015.

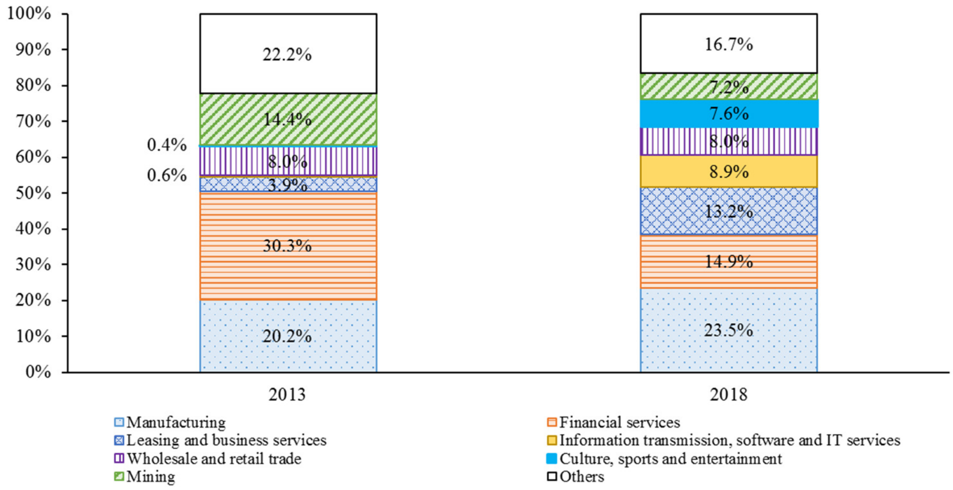
Chart 4: Stock of manufacturing ODI from the Mainland by geographical region (2015 versus 2018)



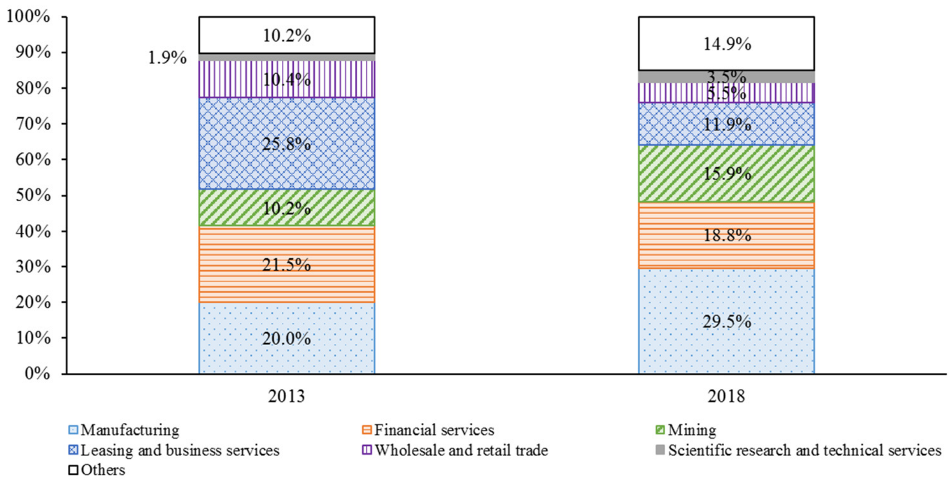
14. It should be emphasised that production cost reduction is not the sole motive for Mainland manufacturers to undertake outward investment. As shown in ***Chart 4***, nearly 30% of the stock of the Mainland's ODI in manufacturing sector in 2018 resided in Europe or North America where production costs are not likely low. ***Chart 5*** further depicts the composition of the Mainland's ODI stock in the US and EU by sector as of 2013 and 2018. The share of manufacturing investment in total ODI has increased in both the US and EU, making manufacturing the largest contributing sector of ODI in 2018. As discussed in para. 6 of the previous section, establishing production sites in these advanced economies could help manufacturers bypass trade barriers and better serve their customers therein.

Chart 5: Stock of the Mainland's ODI in the US and EU by sector (2013 versus 2018)

US



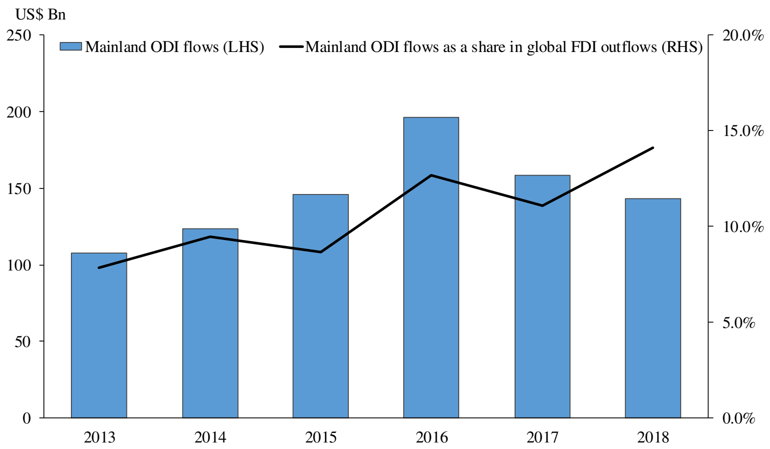
EU



IV. CONCLUDING REMARKS

15. We conclude this article with a discussion of the recent trend of the Mainland's ODI. As shown in ***Chart 6***, the share of the Mainland's ODI flows in the global FDI outflows has been on an upward trend in recent years, reflecting the increasing importance of the Mainland as an investor globally. With that said, it is noted that outward investment flows from the Mainland have moderated somewhat after peaking in 2016. It was in part due to the Mainland authorities' efforts to guide the development of ODI with a view to better aligning it with national development interests. While strategically important investment (e.g. infrastructure investment in the Belt and Road region, high tech-related investment) remained highly encouraged, certain types of investment (e.g. real estate) have been considered prone to irrational risk-taking and thus restricted[3], leading to a visible slowdown of related investment flows[4]. Despite causing a temporary moderation in ODI, the authorities' regulatory effort will help steer future investment towards areas with high strategic value and potential, thereby promoting the healthy development of ODI in the long-term.

Chart 6: The Mainland's ODI flows (2013-2018)



Sources: Statistical Bulletin of China's Outward Foreign Direct Investment 2018, World Investment Report 2019

16. Amid the continuous opening-up of the Mainland economy, its linkage to other economies is set to further deepen, thereby bringing even more investment opportunities for Mainland enterprises. In particular, with the progression of the Belt and Road Initiative, the Mainland's investment in infrastructure facilities (e.g. transportation and logistics, power supply, telecommunications, etc.) will be more prominent within the Belt and Road region.

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3 For further detail, please refer to the Opinions on Further Guiding and Regulating Outbound Investment (關於進一步引導和規範境外投資方向的指導意見) jointly issued by the National Development and Reform Commission, the Ministry of Commerce, the People's Bank of China and the Ministry of Foreign Affairs in August 2017.

4 For example, real estate-related ODI flows from the Mainland fell from RMB 15.2 billion in 2016 to RMB 3.1 billion in 2018.