The Investment Development Path in China

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Abstract. This paper introduces the past studies about the Investment Development Path theory and the current development situation of Chinese FDI. Based on the fact that China’s outward FDI first surpassed its inward FDI, this paper clearly defined each stage’s classification of the dynamic phases of Chinese investment development path by analysing the data of Chinese inward and outward FDI during 1985-2015. Meanwhile, it also points out that China has entered into the fourth stage officially in 2015. In the last, some suggestions to facilitate the further developing of Chinese FDI are brought forward.

Introduction

Since 1980s, with the fast development of foreign direct investment (FDI) and the ascendancy of multinational corporations (MNCs), more and more scholars make investigation on the theory of FDI. Among them, the most famous expert is Dunning, a British economist, who brings forward the theory of investment development path (IDP), providing a dynamic framework to explain the emerging of developing countries’ FDI.

IDP theory links a country’s economic development phase with its foreign direct investment situation, stating that a country’s net outward investment (NOI) is determined by its economic development status. According to Dunning [1], because of different economic development level, countries are different in internal economic structure, industrialization level, market size and political policy, leading to different ownership advantages (O), locational specific advantages (L) and internalization advantages (I). Based on the FDI and per capita GNP data of 67 developing and developed countries from 1967 to 1978, Dunning finds out that when the average per capita GNP of a country increased to a certain level, the FDI flows change accordingly. After years of modification and further development by Dunning and many other experts [2,3,4], the IDP theory, consisting of five stages, are eventually formed, and now becomes one of the most important theory in interpreting investment development path of developing countries.

According to per capita GNP, IDP theory divided a country’s economic development situation into five stages, and at each stage the inflow and outflow of FDI are different. At the first stage, the country’s average per capita GNP is extremely low, reflecting the situation of least developed countries. The country has neither ownership advantages nor locational specific advantages, therefore both inward and outward FDI (IFDI and OFDI) are limited. At the second stage, inward FDI grows significantly due to some locational specific advantages that making the country favourable to MNCs. Because the local economic development situation is still low, the outward FDI is limited and thus lead to an increasing negative net outward investment. When it comes to the third stage, the domestic companies become more competitive in the world market and get ownership advantages. A country’s outward FDI increases dramatically, and the OFDI growth rates may be higher than the growth rates of inward FDI, thus leading to a decreasing negative NOI. At the fourth stage, with much higher average per capita GNP, the country becomes a net investor, the OFDI flow grows at a much faster speed than IFDI, and NOI turns positive. At the last stage, which indicating the most developed countries, the outward FDI flows start decreasing, and the NOI shows an unstable development trend around zero. We can draw a picture to illustrate the IDP theory, as in Figure 1.
IDP theory has summarized the developing trend of outward direct investment of a country. It has been testified by many experts ever since the proposing. Campa and Guillen [5], Barry, Görg and McDowell [6] proved that there is certain relationship existing among FDI inflow, FDI outflow and per capita GNP by examining the data of Ireland and Spain respectively. Dunning, Kim and Lin [7] took trade into consideration, and pointed out that there might be kind of relation between IDP and Trade Development Path. According to Wasil [8], IDP has been born for more than 30 years, but it is still able to accurately predict a country’s economic development relationship with its outward FDI development stages.

The Current Situation of Chinese Investment Development

After 40 years of undertaking opening up policies, China has achieved a great success in attracting foreign direct investment. Because of good investment environment, cheap labour, vast domestic market and favourable FDI policies, China becomes one of the most attractive destinations for FDI. However, the outward direct investment of China seems growing rather slow for a long period.

In August, 1979, the Chinese government first encouraged companies to make investment abroad. But both the number and volume of OFDI projects that Chinese enterprises engaged in are limited. According to UNCTAD, from 1982 to 1991, the average annual FDI outward flow in only around US$ 0.54 billion. In 1992, Deng Xiaoaping, one of the most influential governors, delivered several speeches in southern China, emphasizing the importance of developing and foreign direct investment. Ever since then, China’s outward FDI starts rocket. China’s ODI has increased from US$ 0.91 billion in 1991 to US$ 4 billion in 1992, and the FDI outflows of China has taken 2.1% and 17.2% of the world and developing countries’ FDI outflows respectively. However, during 1993 to 2000, China’s outward FDI flows are increasing slowly, sometimes even experience decreasing. This situation has not been changed until 2001, when Chinese officials pushing the “going global” strategy.

From 2001, China’s OFDI began to enter a new stage of growth. Especially after the implementation of exchange rate reform in July 2005, with the appreciation of RMB, China’s outward FDI showed a rapid growth. By 2007, China’s OFDI reached $26.51 billion, accounting for 1.33% of world and 10.5% of developing countries OFDI respectively. Benefit from the appreciation of the RMB, improvement in capital market development, and growing Chinese enterprise strength, coupled with revising of the Law of People’s Republic of China on Foreign Exchange Control Regulations in 2008, China’s OFDI exceeded 50 billion US dollars, reaching $55.91 billion with an increase of 93.3% year-on-year, ranked number 12 in the world as the major investing country..

From 2009, China’s outward FDI showed an even more strong momentum of development. Due to the international financial crisis, developed countries experienced a slow recovery while economic growth in China keeps rocking. According to the Statistical Bulletin of China’s Outward Foreign
Direct Investment, China has become the 5th largest investing country in the world in 2009. During 2011 to 2015, China’s outward FDI totalled $539.08 billion, which is 2.4 times to the period of 2006-2010. In 2015, China’s outward FDI reached to a historical high of $145.67 billion, with a year-on-year increase of 18.3%, as indicated in Figure 2. The scale of China’s OFDI flows ranked only behind the United States and exceeded Japan to become the second in the world. Moreover, in 2015, for the first time, China’s outward FDI exceeded inward FDI, entering a period of net capital outflow.

![Figure 2. Outward FDI flows of China, 2002-2015.](image)

**China’s Investment Development Path Analysis**

At present, China’s OFDI is in the fast lane of development. In view of this, it is necessary to conduct an analysis on the development stage of China’s OFDI. A lot of Chinese scholars have undertaken research and empirical tests within the framework of the IDP theory, such as Gao Minxue, Li Yingjun [9], Li Hui [10], Zhu Hua [11], Yuan Shenglong [12]. The results show that the development of Chinese FDI conforming to Investment Development Path theory. However, due to difference research methods and data sets, China’ IDP stage is not clear. Therefore, utilizing the newly published data to clarity the classification of China’s IDP stages is crucial.

**Research method and data**

Under the framework of IDP theory, analysis of a country’s investment development phase can be achieved by drawing a scatter diagram using time serial data of net outward investment and GDP. Based on the shape of graph, compare with Dunning’s IDP theory and conclude which stage this country’s FDI development is situated.

NOI (Net Outward Investment) is the amount of net foreign direct investment, equal to the difference between annual outflow of direct investment and inflow of direct investment. In 2015, China outward FDI is $145.67 billion and inward FDI is $135.6 billion. For the first time, FDI outflows exceed FDI inflow and achieved $10 billion net outward investment.

Data used in this paper includes inward and outward FDI, GDP per capita and population of China from 1985 to 2015. FDI data are acquired from Statistical Bulletin of China’s Outward Foreign Direct Investment, while GDP per capita and population of China are obtained from UNCTAD data base.

**Define and analysis of Chinese IDP**

We draw a scatter diagram based on the historical data from 1985 to 2015, as indicated in Figure 3, to show the investment development phase of China. And then based on the diagram we can find a polynomial fitted curve. During 1985 to 2015, China’s IDP shows a “U” shape curve. Compared with Figure 1, break point for Stage I and Stage II should be in 1993, with per capita NOI of $-2.94. Before 1993, the net inward FDI increased dramatically while after 1993, the growth rate of net inward FDI has been slowed down.
The bottom break point happens in 2001, with per capita NOI of $-5.92, which divided Stage II and Stage III. During the period between 2001 and 2014, the net inward FDI keeps negative with smaller absolute value, indicating that outward FDI is growing faster than inward FDI. China was at the third stage of IDP during 2001 and 2014.

According to Figure 1, NOI >0 is the key indicator that implements a country has entered the fourth stage of IDP theory. As shown in Figure 3, the NOI per capita for the first time shows a positive value of $0.73 in 2015. Therefore, we may say 2015 is the break point between Stage III and Stage IV of Chinese FDI development phase.

![Figure 3. 1985-2015 China NOI-GDP Investment Development Path.](image)

Therefore, we summarize a table to depict the investment development path of China. Table 1 presents different investment development stages of China and their characteristics. Stage I, ranged from 1985 to 1992, shows a slow development trend of both inward FDI and outward FDI. Because of the governments’ policy of attracting FDI to facilitate economic growth in 1992, from 1993, China’s inward FDI shows a dramatic growth, indicating that China has stepped into Stage II. The inward FDI of China has experienced 9 years of rapid and smooth development. In 2001, China entered WTO successfully, which seems facilitating the growth of outward FDI of China. From 2002 to 2014, with the ascendant of technology of Chinese companies and government supportive policies, outward FDI increases at a faster step than ever before. After 13 years of strive, China finally entered the fourth stage of IDP theory in 2015. In the future, the outward FDI of China will remain in a high level of growth rate due to the One Belt One Road initiative.

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<tr>
<th>Investment Stage</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
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<tr>
<td>NOI Characteristic</td>
<td>NOI&lt;0 Slowly increasing inward FDI, none or little outward FDI.</td>
<td>NOI&lt;0 Increasing negative NOI value. FDI inflows increases fast, a little of outward FDI.</td>
<td>NOI&lt;0 Decreasing negative NOI value. Relative slow growth of inward FDI and fast increasing of outward FDI.</td>
<td>NOI&gt;0 Increasing positive NOI value. Decreasing of inward FDI and large amount of outward FDI.</td>
<td>NOI&gt;0</td>
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**Summary and Suggestions**

By analysis both inward and outward FDI flows of China from 1985 to 2015, this article sets up a polynomial fit curve for Chinese investment development path. Comparing with the IDP theory, we conclude that China has entered into a brand new investment development stage. In 2015, China’s outward FDI first exceed its inward FDI, achieving the net outflow under the financial account,
marked its entry of Stage IV under IDP theory. Moreover, we clearly defined 1993 and 2001 as the break points for Stage I and Stage II, and Stage II and Stage III respectively.

For the future development of Chinese investment, following suggestions are proposed. First, adjust the long-term objective of outward FDI development. During the past period, China has put a great emphasis on improving the scale of outward FDI. Due to the outward FDI is at a historical high peak and shows continuously growing trends, the government should guide the companies to focus on the quality and revenue of outward FDI rather than the volume. Second, China should optimize the investment environment. While focusing on outward investment, the government should put attention toward attracting inward investment, by reason of inward investment has showed a positive influences on the economic growth in China. Last, always keep an eye on the capital market changes, both domestic and international, and properly manage the fluctuation and risks.

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