

The Management of Chinese Foreign Direct Investment

China is becoming an important source country for foreign direct investment (FDI) for many African countries, catching up fast with the historical main FDI source countries to Africa, such as the United States, the United Kingdom or France. One of the charms of China to African policy makers in the last years was a change of discourse, shifting from 'challenges in development' to 'opportunities in doing business' in Africa. Popular claims link the inflow of FDI almost automatically to economic development.

This paper looks into framework conditions for investment, assuming that they matter strongly for investment to become beneficial for development. In order to better regulate, conditions in the host country have to be considered. Additionally, the investment promotion policies and institutions of the home country to investment - China in this case - need to be understood in order to engage with the right actors in the 'sending' country.

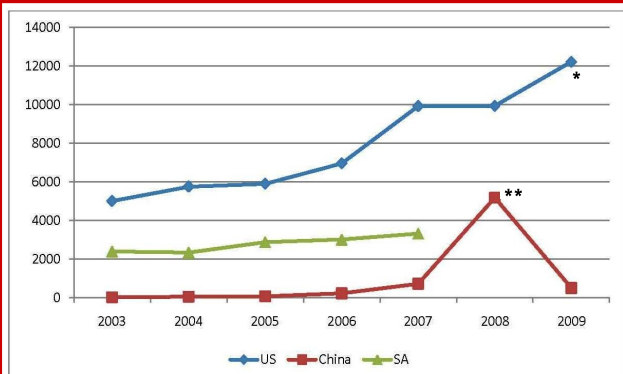
In 2009, China was the fifth largest FDI source country in the world with USD 56.5 billion of global FDI originating from China, as stated by Chinese Ministry of Commerce (MOFCOM) data. This brought Chinese FDI total stock to USD 245.75 billion; which was invested mainly in the finance, mining and retail sectors. Chinese FDI is arguably still in its infancy: to compare, China's total FDI stock is only 1.3% of the global FDI stock and far from the scale of investment of Western countries. A lack of international experience, management capacity and market share, combined with a lower proportion of overseas Chinese enterprises are mentioned as causing the gap between Chinese corporations and those from the West.

In Africa, China has dramatically increased its presence in the past decade and became the 5th largest country of origin of foreign direct investment on the continent in 2009. When FDI in the Africa, and more specifically so: the Southern African Development Community (SADC) region was negatively affected by the global economic crisis, Chinese investments also decreased, but at slower rates than investment from Western countries. This results in Chinese investment

having an even more substantial position. Chinese investment to Africa is thus not negligible and requires similar attention that from 'traditional' source countries.

Chinese policy to encourage overseas investments - including in Africa

Total FDI from US, China and SA to SADC from 2000-2009 (USD Millions)



* China figures: FDI is spread across the SADC countries more evenly, with a focus on the Democratic Republic of Congo and Zambia

The peak is due to the Industrial and Commercial Bank of China (ICBC) purchase of a 20% stake in Standard Bank (South Africa's largest bank by assets and earnings) for US\$ 5.5 billion in February 2008. This transaction represents the largest single foreign investment in South Africa to date.

** US figures: In 2009, FDI to Angola, SA and Mauritius made up more than 98% of the total.

Most nations focus on attracting FDI and are rather passive about OFDI by national enterprises. China is actively promoting both inward and outward foreign investment.

Since 1999, the Chinese government encourages Chinese enterprises to invest abroad, following its so-called “Go Out” or “Going Global” strategy. The eleventh Five-Year Plan period (2006-2010) saw the implementation of the ‘going out’ strategy in its full.

During the launch of the “Foreign Investment and Cooperation Development Report 2010” on 1 November 2010 MOFCOM assured that there is no discrimination between state-owned and private enterprises in its policies. The ministry denied that Chinese state-owned enterprises, for instance, enjoy government subsidies that private companies would not get. The role of Chinese state-owned enterprises are especially significant in Africa’s extractive industries and Chinese private sector firms are now playing a substantial role in manufacturing.

China deliberately mixes assistance and trade preferences with investment policies in its ‘South-South cooperation’. Critics point to the fact that most of Chinese FDI is invested in “resource rich” countries. Indeed, most Chinese investment is found in countries in Africa with an abundance of mineral resources; this is the economic structure of many African economies, often mainly based on trading raw materials instead of manufactured goods. The term ‘resource rich’ is mostly used to refer to countries with large oil reserves and mineral reserves such as gold, diamonds and copper.

Despite the lack of these minerals, however, Ethiopia for instance arguably has the potential for a sizeable market with its large population.

Management of Chinese FDI - Which institutions are involved?

The Ministry of Commerce (MOFCOM) is the central entity through which all kinds of outward investments are directed. MOFCOM’s tasks are:

to formulate development strategies, guidelines and policies of domestic and foreign trade and international economic cooperation, to draft laws and regulations governing domestic and foreign trade, economic cooperation and foreign investment, and to devise implementation rules and regulations. MOFCOM approves Chinese companies to invest in and set up overseas establishments (excluding financial companies) and supervises their operation. They are responsible for China’s foreign economic cooperation efforts, to work out administrative measures and specific policies guiding China’s overseas investment.

Two entities within MOFCOM stand out in governing China’s overseas FDI: the Department of Foreign Economic Cooperation (DFEC) and the office of the Economic and Commercial Counselor. DFEC is responsible for regulating Chinese OFDI and Chinese overseas labour. All overseas investments exceeding US\$10,000 are required to register. The DFEC can impose fines on or revoke overseas investment license of violators of Chinese laws and relevant regulations. The Economic and Commercial Counselor is delegated by MOFCOM to monitor Chinese firms’ foreign investment activities and is usually stationed at and administratively subject to Chinese embassies or consulates abroad.

As part of its efforts to restructure state-owned enterprises, the Chinese government established the *State-Owned Asset Supervision Administration Commission (SASAC)* in April 2003, which is mandated to develop China’s equity exchange market, while supporting Chinese foreign investments. It was established to turn the country’s top state-owned enterprises (SOEs) under its control into 50 globally active corporations that feature on the global Fortune 500 list.

Many large state-owned enterprises are under supervision of the SASAC. It has the authority to manage overseas state-owned assets; to decide whether and what acquisitions and mergers they can pursue; and to whether and in what percentage they should pay dividends to the government.

The use of foreign exchange is state controlled in China, adding another level of state involvement. Chinese firms have to apply to the *State Administration of Foreign Exchange (SAFE)* under the central bank (*People's Bank of China*) for their foreign exchange. The *People's Bank of China* has been empowered to hold and manage the state's foreign exchange and gold reserves, make payment and settlement rules in collaboration with relevant departments, monitor money-laundering related type of suspicious fund movement, and participate in international financial activities at the capacity of the central bank. Under the central bank, the SAFE is responsible for promulgating regulatory measures governing foreign exchange transactions under current account, supervise and monitor foreign exchange transactions under capital account, including inward and outward remittance and payments, and provide the People's Bank of China with propositions and references for the formulation of exchange rate policy.

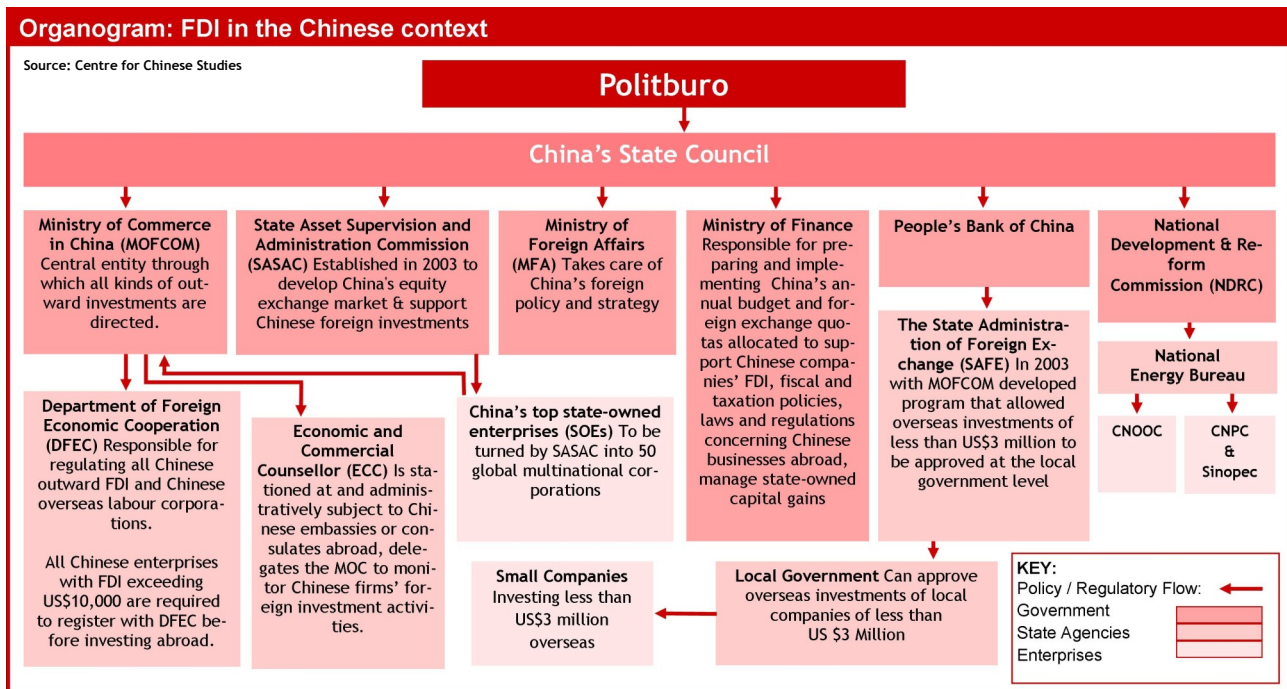
A certain decentralization in the foreign exchange policy makes the playing field less centrally controlled. Since 2003, the Ministry of Commerce (MOFCOM) and the SAFE introduced a programme that allowed overseas investments of less than US\$3 million to be approved at the local government level rather than through the

lengthy and complicated process of applying to Beijing.

As a result of this decentralisation, Chinese companies invested 92% more in offshore acquisitions and mergers in the first 11 months of 2003 than in the same period in 2002, according to MOFCOM statistics. This figure only included deals registered through the ministry; MOFCOM believed that the actual rise in investments was estimated to be much higher, i.e. official FDI records were not capturing all investments.

Africa's task: Being attractive to FDI, yet regulating for sustainable development

How should African governments engage with the opportunities in order to draw benefits for development? When asking about the poverty impact of FDI, it needs to be considered that - in simplified terms - the first priority of any private investor is to make a benefit. Private companies thus do not prioritise possible macro-effects on poverty; this is a government task. As outward FDI is driven by Chinese state policies, one avenue of engagement might be to negotiate with the officials, building on Chinese partnership rhetoric, aiming for more development-friendly investment framework.



At the level of companies, it is widely recognised in literature that the extent to which FDI inflows have positive effects on poverty reduction is highly dependent on the capacity of the receiving country's government to regulate and manage FDI. Good examples of how the Zambian government tries to better manage FDI are the fairly new rules and regulations stating that stores have to predominantly use local labour and produce.

In addition, the Zambian government has frequently pronounced import and export bans on agricultural staples, as a means to ensure the prominence of domestic supply across the country.

Recommendations

The main recommendations are directed towards the organisation of SADC and the Zambian Government.

First, more and better regulated foreign capital inflows - not least through FDI - is a precondition to achieve more gains in poverty reduction. Chinese FDI is first and foremost a business enterprise, and business engagements need to follow the rules of the 'host' country. Decision-makers need to consistently ask about effects of projects on the well-being of its citizens, future generations and the environment. Regulation of these aspects is a key task for government. This includes making information available to investors about rules and regulations in their country. In the context of aspirations to upgrade production and to create own brands, as formulated by China's 11th five-year plan, playing to the rules becomes particularly crucial for economic actors. Furthermore, governments need to have a clear understanding about their range of manoeuvre when negotiating with investors. Protecting their labour force, gain in capacities, and protecting the environment with stricter

regulation is based on a good understanding about foreign investors' domestic settings and their motives and incentives.

Secondly, channelling funding to sectors with potential impact on poverty is crucial; this can include investment in hard infrastructure, as was done in China. Funding can come through aid and FDI policies; Chinese policy on overseas FDI does not draw a clear line between both - thus engaging with the right structures on policies is crucial. Incoming funds have to be linking in a coherent step-by-step plan, which requires good data on both, aid and FDI. A more thorough and transparent recording could serve to benefit both FDI source and host countries: it could contribute to decreasing speculation of 'neo-colonialism' of FDI source countries, in addition to the possibility of attracting further FDI for host countries due to heightened recognition of the possibilities of investing in the country.

Thirdly, reducing the costs of doing business in the region is a key challenge and highlighted by all actors, including China. One way of achieving this is by speeding up set targets for political and economic integration within SADC. Improving regional interconnectivity and thereby enlarging the market size will improve the region's attractiveness. While the first and foremost aim of SADC countries might be to attract FDI, disseminating knowledge on how to manage FDI for the benefit of development should also be a key focus of SADC.

This Policy Briefing is based on a report kindly funded by Oxfam Hong Kong. The full report is available at www.sun.ac.za/ccs

Sanne van der Lugt

*Research Analyst
Centre for Chinese Studies*



Contact Us

Centre for Chinese Studies
Stellenbosch University
PO Box 3538
Matieland 7602
Stellenbosch
South Africa

Tel: +27 21 808 2840
Email: ccsinfo@sun.ac.za
Fax: +27 21 808 2841
www.sun.ac.za/ccs
Twitter: [CCS_STELL](https://twitter.com/CCS_STELL)

About Us

The Centre for Chinese Studies is devoted to the study of China-Africa relations. The CCS promotes the exchange of knowledge, ideas and experiences between China & Africa. Based at Stellenbosch University, the Centre is active in research, corporate advisory services, executive education, teaching, training, and culture.