European Bank
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Chinese investment in the transition countries

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Summary

This paper examines the pattern and magnitude of China's outward foreign direct investment (FDI) to the EBRD's countries of operations. We first analyse the recent trends of China's outward FDI, with sectoral and geographical distributions, and assess the implications for the transition countries. The paper then looks at the characteristics and activities of Chinese multinational enterprises and assesses their key motives for investing in the transition region. The paper also examines the key determinants of China's outward FDI and indicates the future prospects based on the regression model. China's FDI outflows and its stock are forecast to increase substantially during the next decade and for the transition countries, China is expected to play a larger role as an investor.

Keywords: Foreign direct investment, China, transition economies

JEL Classification Number: F21, F23, L21

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INTRODUCTION

In recent years, China – one of the world's largest recipients of foreign direct investment (FDI)[1] – significantly increased its outward investments. This is partly on the back of increased current account surpluses and foreign reserves, and China's integration into the world economy. China's outward FDI remains concentrated in Africa, Asia and Latin America but Chinese investments in transition countries have also grown rapidly.[2]

Despite this rapid increase, little is known about Chinese investments in the transition countries. This paper attempts to fill this gap by focusing on the following issues:

- general characteristics of China' overseas investment in the transition region
- sectoral and geographical distribution of the investment
- the implications for the recipient countries
- the strategy and characteristics of Chinese multinational companies
- the future prospects and implications for other foreign investors in the transition region.

This paper first analyses the pattern and magnitude of China's outward FDI using official statistics. It describes the general trend of China's outward FDI by region (and the three EBRD sub-regions of CEB, SEE and CIS+M) and analyses the regional and sectoral breakdown. It also compares Chinese outward FDI with Russia's outward FDI and identifies the differences in characteristics. In Section 2 the paper describes the nature and objectives of Chinese foreign investments, with an analysis of the pattern and activities of the main Chinese multinational companies investing in the transition region.

In Section 3 the paper examines the future prospects for China's outward FDI. We find that flows have increased significantly and we expect that China's total outward FDI stock will rise to approximately US$ 360 billion by 2015. The increase in the transition region has been well beyond that in Latin America and Africa in recent years, and the total stock for the

[1] China was among the top five FDI recipients in the world in 2007 according to World Investment Report (2008), the United Nations Conference on Trade and Development (UNCTAD).

[2] In this paper, we define the "transition countries" or "transition region" as 29 of the EBRD's countries of operations in central Europe and the Baltic states (CEB), south-eastern Europe (SEE), and the Commonwealth of Independent States and Mongolia (CIS+ M). The 29 countries this paper covers are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, the Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Turkey, the EBRD's newest country of operations, is not included in the analysis.

transition region is estimated to reach US$ 22.7 billion by 2015. Government policy influences investment decisions but commercial motives seem to be the main driving force behind investment decisions.

The paper focuses on FDI only,[3] but it occasionally refers to other business and investment activities, including construction contracts, sales networks expansion and international cooperation projects, since these activities are closely related to investment activities.

[3] Foreign direct investment represents the flows of cross-border direct investment capital, including equity capital, reinvested earnings, other capital and financial derivatives associated with various inter-company transactions between affiliated enterprises. It excludes portfolio investments (such as debt or equity investments below 10 per cent of stakes) and other investments (such as trade credits and bank deposits).

1. CHINA'S OUTWARD FDI

Trend and characteristics

One of the major constraints of an analysis of Chinese FDI is a lack of high quality data. The only readily available data are official statistics from China's Ministry of Commerce (MOFCOM), which have widely been used by analysts and scholars.[4] However, these data have a number of significant limitations and shortcomings.

- Transactions included in the statistics are on an approval/registration basis. In principle, foreign investments need to be pre-approved by MOFCOM, but in practice small-scale investments do not necessarily go through this process. The investment amounts depend on the year of approval and do not fully reflect the actual amounts of investment.
- Chinese companies registered in offshore destinations (for example, the Cayman Islands) and in Hong Kong and Macao (both Chinese sovereign territories from 1997 and 1999, respectively) are not included.
- Much of the FDI to Hong Kong (and other offshore destinations) seems to be the Chinese investment towards mainland China (this should be considered domestic investment as offshore entities later invest in China to take advantage of tax incentives offered to FDI).
- Investments in the financial sector (that is, mainly banking) are, in principle, not included.

Moreover, definitions/methodologies appear to have changed over time (and generally the quality of data has improved in recent years). Consequently, official statistics seem to underestimate the amount of China's outward FDI.[5]

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[4] The data obtained from UNCTAD are, in principle, the same as MOFCOM data. We tried to construct a transaction-level database based on databases/news article search engines including Thompson, BvD Zephyr, Merger Market and Factiva, but without success. None of these databases provides a sufficient and reliable dataset, partly because of the quality of data and lack of verification.

[5] For example, the Chinese statistics report the FDI stock for Mongolia at US$ 315 million while the Mongolian FDI agency indicates the real amount of Chinese investments in Mongolia was up to US$ 900 million in 2007. Similar differences are found in other transition countries we have studied.

According to the latest official data,[6] the stock of Chinese FDI abroad reached US$ 117.9 billion in 2007, up from US$ 75.0 billion in 2006 (see Chart 1).[7] The level of investment abroad is similar to that of Brazil and Taipei China. In terms of flows, China's FDI outflows sharply increased from US$ 12.3 billion in 2005 to US$ 17.6 billion in 2006 and to US$ 26.5 billion in 2007. According to MOFCOM, incremental equity is only about 32.7 per cent (or US$ 8.7 billion) of 2007 flows while profit reinvestment accounts for 37.0 per cent (or US$ 9.8 billion). In 2008 MOFCOM reported that non-financial outward investment flows rose to US$ 25.7 billion in the first half of the year, which represents a 230 per cent rise on a year-on-year basis. Given that global foreign investment activity decelerated or decreased during 2008 due to the global economic downturn, the 2008 trend of Chinese investment is remarkable.

These figures, in principle, do not include portfolio investments and overseas construction contracts. Financial and portfolio investment appears to be substantial, and well beyond other types of investment. According to the International Monetary Fund (IMF) IFS statistics, the stock of Chinese private portfolio investment in foreign assets alone increased to US$ 239.5 billion in 2007, up from US$ 116.7 billion in 2005. Furthermore, in 2007 the China Investment Corporation (sovereign wealth fund) was established with about US$ 200 billion of assets. It has acquired, for US$ 3 billion, a 9.3 per cent stake in Blackstone Group in June 2007 and a 9.9 per cent stake in Morgan Stanley (worth US$ 5 billion) in December 2007.[8] In terms of overseas construction contracts, sales revenue of completed construction reached US$ 40.6 billion in 2006, while newly signed deals went up to US$ 77.6 billion during the same year. These contracts are concentrated in Asia and Africa, but the market share of Chinese construction has significantly increased in some of the transition countries as well. According to MOFCOM, 743,000 Chinese people were working abroad at the end of 2007.

[6] 2007 Statistical Bulletin of China's Outward Foreign Direct Investment (2008).
[7] The amount increased to US$ 92 billion by the end of 2007.
[8] These transactions are statistically included in the investment portfolio because the ownership is below the 10 per cent threshold to be considered as FDI. The China Investment Corporation does not send any board members to these companies.

Chart 1: China's outward FDI stock, 2003-07

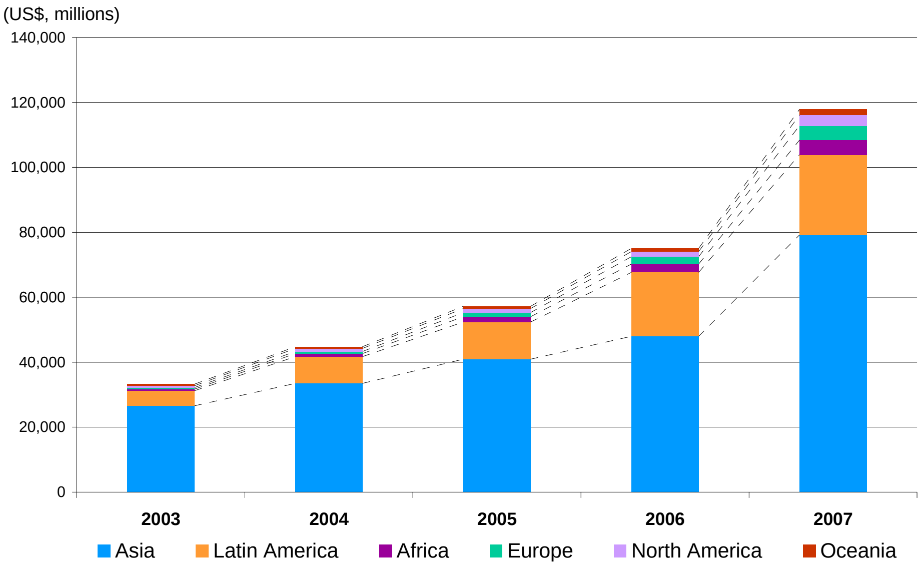
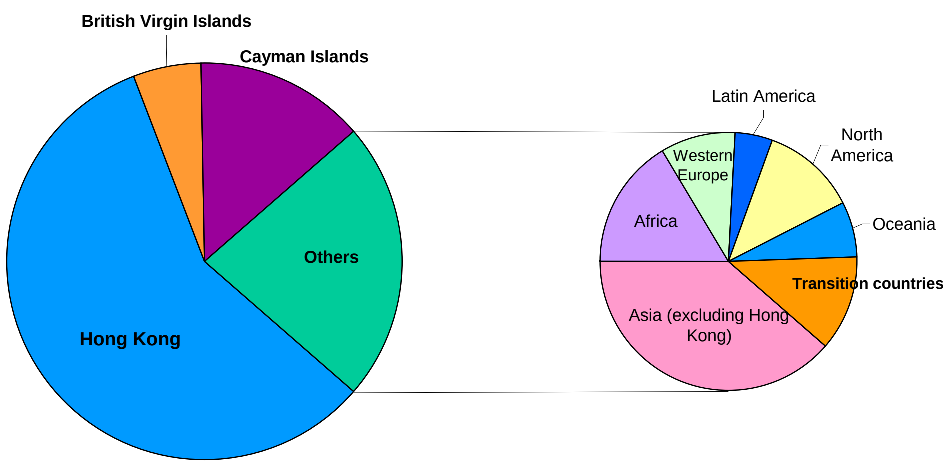


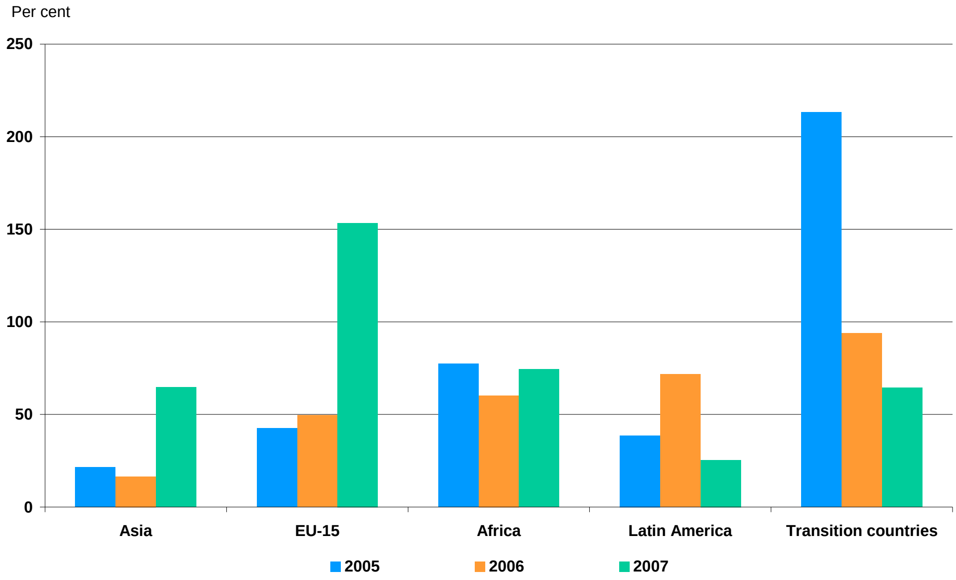
Chart 2: Regional breakdown of China's outward FDI stock in 2007



Source: 2007 Statistical Bulletin of China's Outward Foreign Direct Investment (2008).

The bulk of Chinese investment goes to Asia (about 67 per cent of the total), followed by Latin America. However, the Cayman Islands and British Virgin Islands (known as tax havens) are ranked the second and third after Hong Kong (See Chart 2). Most of the investment to Asia goes to Hong Kong (it accounts for 58 per cent of total outward FDI), but the characteristics of investment are not necessarily those of foreign direct investment (see third bullet point of the characteristics of Chinese investment on page 4). In recent years, Chinese investments in Africa often hit the headlines. Indeed, the FDI stock in Africa rose from a mere US$ 491 million in 2003 to US$ 4.4 billion in 2007, but the share of Africa in total outward FDI remains low (3.8 per cent in 2007**).**

Chart 3: China's outward FDI into selected regions (% change to previous year)



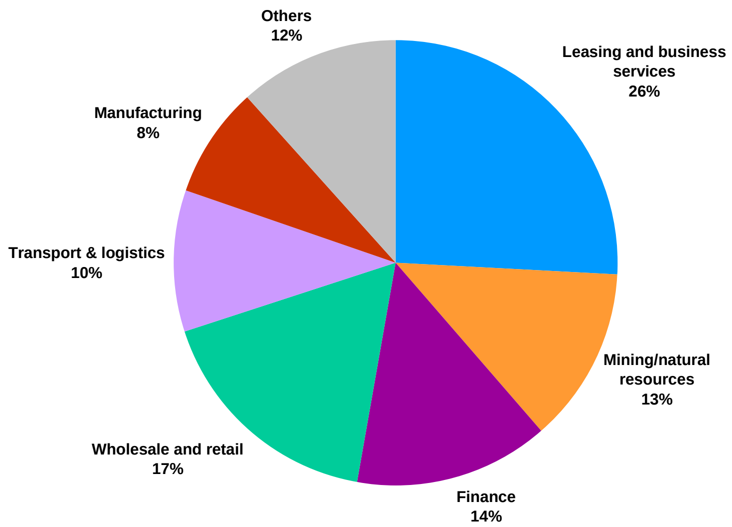
Source: 2007 Statistical Bulletin of China's Outward Foreign Direct Investment (2008).
Note: While Hong Kong is included in Asia, both the Virgin Islands and Cayman Islands are included in Latin America. New EU members (mostly transition countries) are not included in EU-15, but in transition countries.

The transition countries' share is even smaller (2.8 per cent of total), but the growth rates are actually the highest among regional groups in recent years (see Chart 3). FDI into the transition region is concentrated in the CIS+M, which attracted substantial Chinese investments in recent years (see Chart 5).

The sector distribution of China's outward FDI is relatively diversified (see Chart 4). According to the 2007 stock data, leasing and business services (including information and communication technology) account for 26 per cent, followed by wholesale and retail trade (17 per cent) and finance (14 per cent).[9] It is noted that manufacturing (including computer and electronic equipments textiles) took only a modest share in outward FDI stocks (8 per cent).

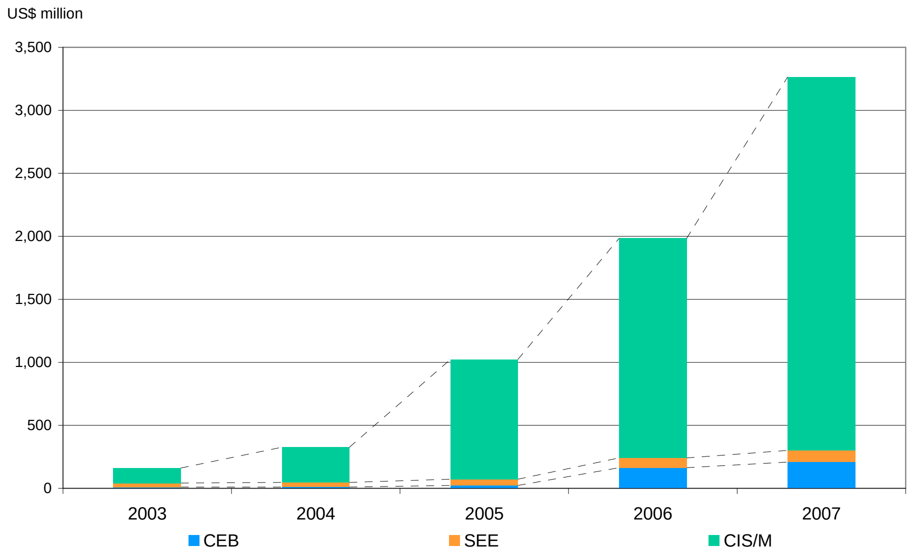
[9] MOFCOM statistics started to include "Finance" as a new item starting from the 2007 issue (that is, data for 2006), but it is not very clear what kinds of transactions are included. It reports the stock of US$ 16.7 billion and annual flow of US$ 1.7 billion for 2007. FDI transactions in finance are not included in the total or in Charts 1, 2 and 4.

Chart 4: Sectoral distribution of China’s outward FDI, 2007



Source: 2007 Statistical Bulletin of China’s Outward Foreign Direct Investment (2008).

Chart 5: China’s FDI stock in transition countries



Source: 2007 Statistical Bulletin of China’s Outward Foreign Direct Investment (2008).

There are about 160 large-scale, state-owned enterprises currently managed by the state-owned asset supervision and administration commission of the state council. In terms of stock, these large state entities account for 84 per cent of the total investment. Investments made by small and medium-sized enterprises (SMEs) only account for 16 per cent. However, as small-scale investments are unlikely to be registered or approved by MOFCOM, the official data could underestimate the importance of investment from rural areas or by SMEs.

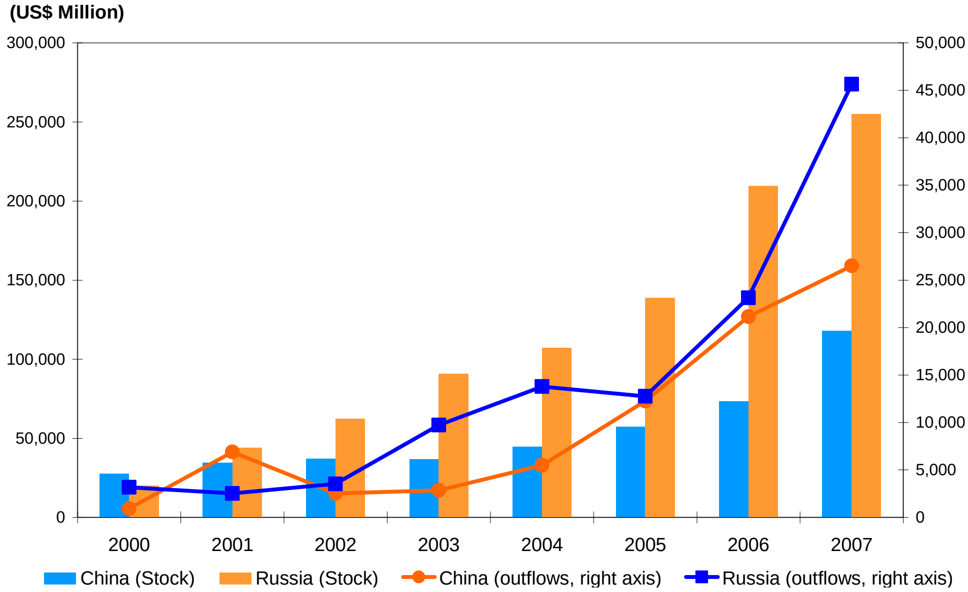
Regarding the transition countries, the FDI stock from China to the region grew from a mere US$ 162 million in 2003 to just under US$ 3.3 billion in 2007 (see Chart 5). Annual FDI flows increased from US$ 48.3 million in 2003 to US$ 1.1 billion in 2007. The bulk of Chinese investments are made in the CIS+M. A number of Chinese multinational companies have made large-scale investments in the region, while in some countries, such as Mongolia, there are a large number of small-scale investments from different regions in China.

According to official statistics, Russia is ranked sixth as a destination for Chinese investment, but as larger-scale investments are often channelled through tax havens, Russia's importance as an investment destination could be higher than statistics indicate. Excluding offshore destinations and Hong Kong, Russia is the third largest investment destination after South Korea and the United States. Among the transition countries, other large FDI recipient countries include Kazakhstan, Mongolia and Romania.

Comparison with Russia's outward FDI

Russia is another emerging market investor country that has become a prominent global investor in recent years. Comparing the characteristics of Russian outward FDI with that of China, a number of similarities and differences can be found. Both countries have accumulated large international reserves on the back of large trade surpluses (although different export products – oil and gas for Russia and manufacturing for China – drove this phenomenon). Outward FDI from both countries has increased significantly in the past five years (see Chart 6). The absolute levels are similar in terms of flows, but Russia is more than twice as big in terms of stock.

Chart 6: Stock and flows of outward FDI



Source: UNCTAD Interactive database.

Russia's FDI activity expanded relatively fast but it seems its investment activity has focused primarily on the former Soviet Union countries (for example, the acquisition of strategic assets from local governments or from Western sponsors). While both countries have been using "tax havens" extensively, it seems that China's investments are more diversified in terms of destinations (see Chart 2).

Russian outward FDI is largely limited to a few sectors – energy, metallurgy and telecommunications (see Deutsche Bank Research, 2008) – while that of China is more diversified (see Chart 4). In telecommunications, Russian companies (such as MTS, Altimo and Vimpelcom) acquired a number of assets and companies in Kazakhstan, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan. Energy companies such as Gazprom and Lukoil have been active in the oil and gas sectors. In the metal sector in recent years, larger companies such as Rusal and Severstal started buying strategic assets in the CIS. It is noted that increased Russian outward FDI is partly driven by increased corporate profits because of globally higher commodity prices (at least until recently). However, Chinese oil companies are investing abroad while these companies are making losses (or breaking even at best). The energy sector has the potential that multinational companies from both countries will be more active in acquiring assets and there will be more cases in which these companies will compete intensively for the contract and licences.

While 29 Chinese multinational enterprises are included in the Fortune Global 500 (see Annex 1),[10] only five Russian companies (Gazprom, Lukoil, Rosneft, Surgutneftegas and Sberbank) are included in the list. In both countries, publicly owned companies continue to play significant roles.

2. NATURE AND OBJECTIVES OF CHINA'S FOREIGN INVESTMENTS

Chinese multinationals

Chinese multinational companies have played a significant role in outward FDI activity. Ten years ago, only a few companies were recognised by the global market, but today 29 Chinese multinational companies (or roughly 6 per cent of top 500 companies) are listed in the Fortune Global 500 (see Annex 1). These companies are large in size.[11] Many have been listed on the international capital markets and to some extent comply with international disclosure standards and good corporate governance practices.

In the last few years, Chinese multinationals have also been active in the global mergers and acquisitions (M&A) market. High-profile deals include the 2003 purchase of Thomson's television business (France) by TCL, a Chinese consumer-electronics manufacturer, and the 2004 acquisition of IBM's PC business by China's largest computer maker, Lenovo. In 2007 the China Development Bank bought newly issued shares of Barclays Bank. Although the value of such acquisitions remains relatively small both in comparison to the total acquisitions in the world and in terms of GDP in China, many believe that this is only the beginning of a strong long-term trend, and the activity will scale up in the foreseeable future.

The biggest sources of China's outward FDI are profitable and listed state-owned companies (see Morck et al., 2007). According to Cheng and Ma (2007), the share of FDI outflows made by state-owned enterprises is approximately 83 per cent. However, most of these companies

[10] The Fortune Global 500 is a ranking of the top 500 corporations worldwide as measured by revenue. The list is compiled and published annually by Fortune magazine. There were only 11 Chinese companies listed in 2003.
[11] For example, the annual revenue of each of China's three largest companies is larger than Kazakhstan's GDP (that is, slightly over US$ 100 billion).
[13] This was partly in a bid to join the WTO (China joined in December 2001) and to strengthen China's relationships with other countries and encourage its integration into the world economy.

are listed on domestic and foreign stock exchanges and are obliged to meet certain transparency and corporate governance requirements. It is hard to tell the political motives and influences on the decision-making processes of these large enterprises and it may vary across sectors and regions. However, as in the example described below, there are clear political motives and effects in the natural resources sector (for example, political appointments and regulated prices; see Chorell and Nilsson, 2005). However, in other sectors, investment decisions appear to be on a commercial basis and only limited political involvement has been observed.

Chinese multinational companies have been active in the transition region over the last couple of years in selected countries including Kazakhstan, Mongolia, Romania and Russia. A detailed description of investment activity in each of these countries is given in Annex 2.

The following section describes the main activities and characteristics of Chinese investment in the transition countries by sector. Box 1 on page 15 lists some of the companies that are active in the transition region and describes their characteristics and activities.

Oil and gas

The three largest oil companies in China – CNPC/PetroChina, China Petroleum & Chemical Corporation (Sinopec) and CNOOC – have expanded their international presence in recent years. China is currently a net importer of oil and imports over 160 million tonnes of crude oil in 2007 (12.7 per cent rise over the previous year). However, as current per capita consumption of oil remains only about 10 per cent of that of developed nations, the demand is set to grow further. Under government policy, the three largest oil companies have been bidding for new licences at every opportunity (particularly in high-risk countries). These companies are currently engaged in over 130 projects in emerging countries.

Rich natural resources in Central Asia and Russia hold considerable attraction for these companies. In Russia, CNPC bought a US$ 500 million stake during Rosneft’s initial public offering (IPO) and Sinopec acquired a 96.9 per cent stake in Udmurtneft for US$ 3.5 billion in 2006. In Kazakhstan, China is directly involved in extracting and transporting Kazak oil to China. A 3,000 km pipeline will be jointly developed by CNPC and KazMunayGas. Furthermore, in 2005 CNPC acquired the North Buzachi oilfield in Kazakhstan through the purchase of the Canada-based PetroKazakhstan. Also, Turkmenistan agreed with China to construct a gas pipeline and export up to 30 billion cubic metres of gas a year to China through the pipeline. CNPC also has a 25 per cent stake in the Salyan oilfields in Azerbaijan.

CNPC/PetroChina, Sinopec and CNOOC remain majority owned by the state (90 per cent, 80 per cent and 67.5 per cent, respectively). Most key positions are political appointments and CEOs are often members of the communist party. Domestic retail oil prices are heavily regulated and are lower than international oil prices (or they were at least until the middle of 2008). As a result these companies are financially weak (that is, some are loss-making). These companies have frequently received special treatment from the government (such as tax exemption and occasional government subsidies).

Manufacturing

M&A activity and greenfield investments by manufacturing companies are often highlighted in the news. These investments are often for the purpose of marketing in that country or region, and they help support research and development (that is, to adopt international technologies). The five largest electricity producers (Haier, Hisense, TCL, Konka and SVA) have been trying to expand their overseas markets. As they are often targeted for anti-dumping claims, a number of companies switched their strategies to local production in some countries. Their investment activity in the transition countries is not well advanced, but outstanding investments include: Hisense's production centre in Hungary and a sales base in Russia, TCL's production factory in Poland and Russia, and SVA's production centre in Bulgaria. These companies are operated commercially and there is limited state involvement.

Automotive sector

China is the third largest car producer in the world in terms of production volumes, producing 8.8 million cars in 2007. Exports amounted to 612,000 vehicles. Main players are foreign companies who set up joint ventures in China (as the current law prevents a foreign firm from controlling more than 50 per cent of an auto assembly plant) but there are also about 100 domestic car makers in China. Domestic car makers generally lag behind their foreign counterparts in terms of technological standards and competitiveness. However, these companies expanded their businesses to some regions in the Middle East, Africa and to some extent in Russia. Under the current Five Year Plan (2006-10), overseas expansion by Chinese automakers was indicated as a national priority. In the transition countries, investment in the automotive sector is concentrated in Russia. Chery Automobile invested US$ 200 million in an assembly factory in Russia in 2006, and is now considering production plans in Pakistan, Ukraine and Venezuela. Joint production of Geely Automobile (a privately owned Chinese car maker) also started in 2007. Great Wall Motors (the largest privately owned automotive manufacturer in China) has also been considering investing in a production facility.

Financial sector

China's investment in the financial sector is at an early stage. However, the recapitalisation of state banks (including the China Development Bank) and the increase of the foreign exchange reserves (which commercial state banks are partly responsible for managing) might boost state banks' investment activity abroad in the future. By the end of 2007 Chinese state-owned banks had established 33 branch offices in 27 countries with staff numbers of 27,000. For the time being, only the Industrial and Commercial Bank and the Bank of China are active in the transition region (mainly in Hungary, Kazakhstan and Russia, but their activity is limited so far). The state-owned policy banks, notably the Export-Import Bank of China and China Development Bank, are more clearly enhancing global activity and supporting both government-related public projects and commercially oriented projects.

Textile industry

China is the world's largest textile producer and exporter. China's textiles and clothing industry had been subject to the extensive application of quotas by major importing countries, such as the United States, which is known as the Multi-Fibre Arrangement (MFA). These quotas were gradually phased out by 2005, as China joined the World Trade Organization (WTO), and most quotas had been lifted by the major importing countries. While quotas were put into place, many Chinese textile companies moved their production centres abroad as some neighbouring countries enjoyed a quota-free status. Some Chinese multinationals purchased foreign garment/textile factories (for example, in Mexico, Thailand and the United States), but more often Chinese companies simply established production bases abroad. In Mongolia, for example, there are many of these Chinese investments, a lot of which have direct trade links with the United States. However, in recent years this business model has been facing difficulties as quotas on China have been lifted and as more employment opportunities arose, Mongolian workers are less willing to work for Chinese companies.

Box 1: Selected Chinese multinationals investing in the transition region

Oil industry

CNPC/PetroChina
CNPC is a state-owned fuel producing corporation and is China's largest integrated oil and gas company, holding proven reserves of 3.7 billion barrels of oil equivalent. PetroChina is a subsidiary of CNPC. The company is majority owned by the state, but also listed on both the New York and Hong Kong stock exchanges. The CEO is appointed by the State-owned Assets Supervision and Administration Commission. The company is active in Azerbaijan, Kazakhstan and Russia.

Sinopec
China Petroleum & Chemical Corporation (Sinopec) is ranked 17th in the Fortune Global 500 and one of the major petroleum companies in China. Sinopec's business includes oil and gas exploration and other related businesses (including storage, transportation and chemical). Sinopec is active in Kazakhstan and acquired of a 96.9 per cent stake in Udmurtneft for US$ 3.5 billion in 2006.

CNOOC
China National Offshore Oil Corporation (CNOOC) is the third-largest national oil company in China. The main business relates to the exploitation, exploration and development of crude oil and natural gas. Shares are traded in Hong Kong and New York. The company is roughly 70 per cent owned by the state. The company is one of the major shareholders in the Kazakhstan North Caspian Operations Company (Agip KCO).

Manufacturing

Hisense
Hisense is a Chinese electronics manufacturer, producing televisions, air conditioners, LCDs, refrigerators and mobile phones. The sales revenue of 2007 was over US$ 1 billion. Hisense has sales/production bases in Algeria, France, Hungary, Iran, Pakistan and South Africa, and sales offices in Australia, Europe Japan, Russia and the United States.

TCL
The TCL Corporation is a Chinese electronics manufacturer, producing mobile phones, personal computers, home appliances, electric lighting and digital media. TCL is listed on the Shenzhen and Hong Kong stock exchanges. The city of Huizhou owns most of the company's shares while other shareholders include strategic foreign investors such as Phillips and Toshiba. TCL has a number of production bases abroad, including in Poland and Russia.

Automobile industry

Chery
Chery Automobile is one of the largest Chinese automobile manufacturers with total sales of 305,000 vehicles in 2006. The company is majority owned by the local government of Wuhu. Chery production is based in China, but from 2003 Chery started building production facilities overseas (in Iran in 2003). In 2006, Chery's plant in Russia became operational. Chery is also planning to begin production in Egypt, Malaysia and Uruguay.

Geely
Geely Automobile, part of Geely Holding Group, produces cars and motorcycles in China and abroad. It already sells in Bangladesh, Pakistan and Venezuela, and plans to expand its sales network in Europe. The company has a joint production base in Russia and a couple of sales companies in Ukraine.

Financial sector

Industrial and Commercial Bank of China
Industrial and Commercial Bank of China (ICBC) is the largest among the big four state-owned commercial banks in China. The bank is ranked 170th in the Fortune Global 500 with a sales revenue of US$ 36 billion. ICBC is listed on both the Hong Kong and Shanghai stock exchanges, and with a market capitalisation of US$ 254 billion (in July 2007), it is one of the largest banks in the world. The bank has offices in Kazakhstan and Russia.

Bank of China
The Bank of China is another of the big four state-owned commercial banks of China. It is believed to be the second largest lender in China and the eighth largest bank in the world in terms of market capitalisation. It used to be 100 per cent owned by the government, but the bank is currently listed on several stock exchanges. It has branches in 25 countries including Hungary, Kazakhstan and Russia.

Key motives for China's outward FDI

Assessing key motives

The Chinese government officially adopted its "*going global*" strategy in 2001.[13] Although it started as just a concept (without supporting legislation), today it is an integral part of the country's external strategy of economic openness, with related legislation and regulations. Therefore, the government has increasingly been encouraging outward FDI directly and indirectly.[14]

When assessing what motivates Chinese multinationals to invest abroad, it appears that the main motives are similar to those of other multinationals. However, there are some specific features.

- **Motive 1 – to seek foreign markets.** When looking to expand abroad, multinational enterprises will either expand their distribution networks to facilitate the export of domestically produced goods or produce locally in attractive overseas markets. Chinese domestic production capacity expanded well beyond domestic demand in the past decade. As a result, competition in the domestic market became too intense (that is, low profitability). Many enterprises believe it necessary to search abroad for new markets. The manufacturing and automotive sectors fit in this category.
- **Motive 2 – to seek efficiency**. For developed nations, it is common for multinational enterprises to seek lower-cost locations for their operations and production, and lower-cost labour. While labour costs in China have increased significantly in the last decade (particularly in urban areas), it is still possible for Chinese enterprises to find relatively low-cost labour domestically, particularly in rural areas. Therefore, efficiency is not considered a main motive for Chinese multinationals to invest abroad.
- **Motive 3 – to seek resources**, that is, to secure the supply of raw materials and energy sources. China currently imports over 160 million tonnes a year, which is about one-third of domestic oil demand. As current per capita consumption remains at only about 10 per cent of that of developed countries and the gap between domestic production and

[14] State support includes the provision of information about potential investment locations (so called "Outbound Catalogue", for details, see Buckley et al, 2008), granting permissions more smoothly and a gradual relaxation of foreign exchange controls. The state-owned banks (namely the Export-Import Bank and the China Development Bank) often provide (low interest rate) loans to support large-scale investments in line with government policies. We did not find any evidence of state subsidies (in a systematic manner) during interviews conducted in July 2007 in Beijing.

consumption continues to grow, the need to secure additional resources abroad is set to grow further (see Chorell and Nilsson, 2005). All large oil companies participate in acquiring licences all over the world. This is a clear motivation for China.

- **Motive 4 – to seek strategic assets.** Beyond the profitability of each project, multinationals often acquire strategic assets to maximise overall corporate performance. This could include brand names and new technologies. Chinese multinationals have acquired a number of well-known brand names (such as IBM and Rover) and firms with advanced technologies.
- **Motive 5 – to diversify**. It is common practice for multinationals to diversify their business portfolios, both in terms of sectors and regions, but this is a weak motive for Chinese multinational enterprises. However, it seems to be a Chinese government's strategy to develop the Japanese/Korean-type conglomerate of multinationals, and so far this strategy appears to be successful: the number of multinationals listed on the Fortune Global 500 has increased to 29 from 11 in the past five years.

Factors specific to China

Apart from these motives at the corporate level, there are a number of important features at the macro level. These mainly relate to the external environment for enterprises but there is certainly the (indirect) impact on the enterprises' decision-making process.

- **Macroeconomic background.** By September 2008, China's foreign exchange reserves reached US$ 1.9 trillion, more than three times the level of two years ago and more than one-quarter of global reserves (the highest level in the world).[15] Pressure on the currency (renminbi) to appreciate increased and caused trade disputes with developed nations whose trade accounts with China are in deficit. Under these circumstances, the Chinese government has been encouraging more imports as well as capital outflows.
- **High saving rates**. Domestic savings in China (for individuals and corporates) are at a high level. Some of the Chinese companies retain earnings excessively, but domestic investment opportunities are relatively scarce (that is, low financial rates of return). Many enterprises aim to invest in higher-return projects abroad.

[15] The level is the highest in the world, reaching US$ 1.9 trillion by September 2008.

- **Arbitrary taxation system**. While domestic tax rates for Chinese companies in China are relatively high, with 33 per cent of sales revenue being taxed, rates for foreign investments are lower or sometimes exempt. Many of the foreign investments are designed to avoid domestic tax, for example many of the foreign investments from Hong Kong are originally from Chinese enterprises in China (so-called round-trip investment).
- **Avoiding anti-dumping conflicts.** When seeking new markets, Chinese enterprises have often been faced with various trade barriers, such as quantitative restrictions and anti-dumping cases. To avoid such conflicts, one way is to move the production base closer to the market.

Main reasons Chinese multinationals invest in the transition region

Table 1 summarises they key motives for Chinese multinationals investing in the transition region. It shows that motives 1 and 3 are the most applicable.

Table 1: Key motives for Chinese companies to invest in the transition economies

Motive	**Comments**
1 – to seek foreign markets	Many of the transition countries border China, so they are geographically close, and easy to operate in these countries. The size of some economies is attractive enough for Chinese companies.
2 – to see efficiency	The labour costs in some of the central Asian countries and Mongolia are, on average, lower than those in China. But in practice, Chinese companies may be able to mobilise a low-cost labour force domestically (for example, from rural areas). Considering the land-locked nature of these countries, resulting in high transportation costs, this is not considered a key motive for Chinese multinationals.
3 – to seek resources	A number of energy companies are actively enhancing their investment activities in the resource-rich transition countries (such as Azerbaijan, Kazakhstan, Mongolia, Russia and Turkmenistan). In the medium to long terms, China needs to secure more natural resources abroad.
4 – to seek strategic assets	So far, Chinese multinationals have not actively participated in the privatisation process but they have in recent years acquired a number of high-tech companies in eastern Europe.
5 – to diversify	The implication of this motive to invest in the transition region is unclear. While each enterprise might wish to diversify its business portfolio, the transition region is not necessarily a good region to start with as developed nations and near Asian economies are more stable.

Chinese multinationals tend to prefer high risk regions or regions with geographic proximity to China. We believe these motives and determinants fit relatively well with many transition economies. For large economies, such as Russia, market-seeking is one of the key motives, but we also believe resources are a main reason for Chinese investments in resource-rich countries such as Kazakhstan and Mongolia. Other motives are less important so far, but there have been some instances of Chinese enterprises acquiring high-tech firms in eastern Europe.

3. PROSPECTS FOR CHINA'S OUTWARD FDI

Although China's outward FDI has increased substantially in recent years, China's role as an investor country remains limited to some extent (that is, it comprises about 1 per cent of the world total FDI stock). Practically, investment activity started just a few years ago, and it seems that the current level is still well below its potential level. Moreover, there remain domestic constraints for Chinese companies such as:

- **A government approval process.** A number of approvals, typically from the Ministry of Commerce and the administration of foreign exchange, are necessary before enterprises can invest abroad (for details see Buckley et al, 2008). It takes up to six months and business opportunities are often missed due to the lengthy process.

- **Access to finance.** Access to long-term finance for foreign investment is still limited. Chinese companies tend to mobilise financial resources domestically before investing abroad (rather than borrowing from commercial banks in recipient countries or international banks), mainly because interest rates are lower in the domestic financial market. However, SMEs still find it difficult to obtain financing from Chinese commercial or policy banks.

- **Lack of currency convertibility.** The capital account is formally restricted and without the necessary approval it is difficult to convert large sums of the local currency into foreign currency.

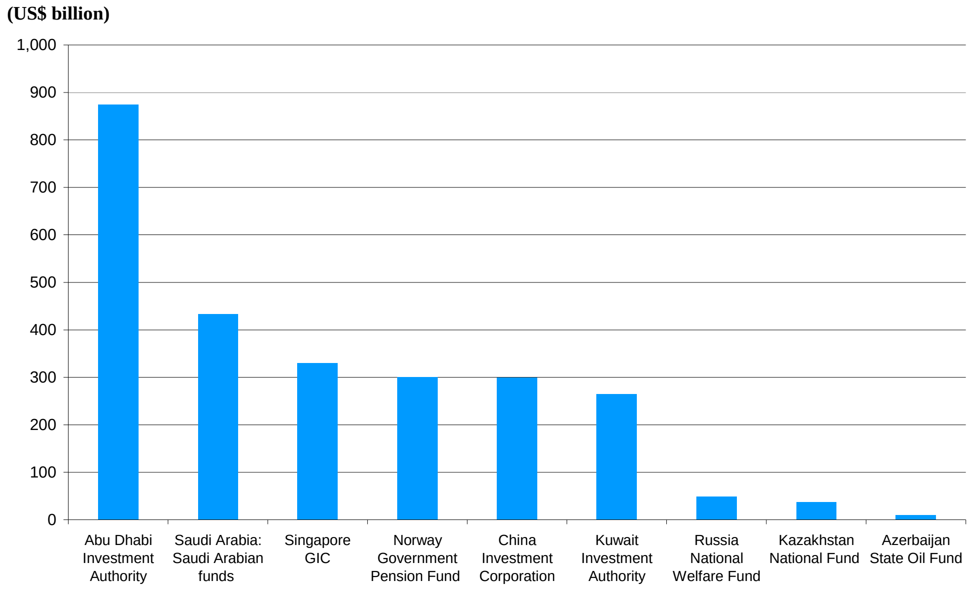
- **Lack of experience.** China's track record of outward FDI is short and Chinese enterprises do not yet fully comply with international business rules. Therefore, recipient countries have so far given only a cautious welcome to Chinese investment. In developed countries many Chinese acquisition attempts have been blocked by host countries' political considerations and employee resistance.

Some of the above constraints can be mitigated or removed over time. While the supply factor remains strong (such as the increasing investments from sovereign wealth funds), the level of China's outward investment is expected to continue rising over the next decade.

Furthermore, sovereign wealth funds could be a major source of financing (although these investments can be classified as portfolio investment statistically), and could potentially have a considerable impact on FDI outflows. The China Investment Corporation was established with capital of about US$ 200 billion in mid-2007.

Although the China Investment Corporation is not the largest fund in the world (see Chart 7), it has already made substantial investments after its establishment, and it is expected to grow further.[16] For the time being, it seems the fund does not intend to obtain majority stakes but rather stay as a portfolio investor (most equity acquisitions are under 10 per cent of total stakes). However, it also means at any time that China can become a strategic investor and participate in the corporate management of these companies.[17]

Chart 7: Estimated asset sizes of sovereign wealth funds



Sources: Economic Intelligence Unit (2007) and SWF Institute.

Regression analysis

We evaluate China's potential outward FDI (OFDI) using a simple linear model of OFDI determinants estimated on the sample of 140 countries (or 117 countries depending on the data availability), including developed and developing countries, using panel regression.

We look at the macroeconomic determinants of outward FDI. Following previous research, we tested main factors such as the exchange rate, GDP growth, trade openness (that is,

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[16] In January 2008 Prime Minister Wen Jiabao indicated that between US$ 60 billion and US$ 70 billion, out of US$ 200 billion, will be used for FDI purposes.
[17] For example, the China Investment Corporation increased its stake in Blackstone Group from 9.9 per cent to 12.5 per cent in October 2008.

exports plus imports divided by GDP), the level of development (that is, GDP per capita), the interest rate and the size of the economy (that is, population). We also included year dummies and country fixed effects as a proxy for increasing interdependence (globalisation processes) and to control for country-specific time invariant country characteristics.

To explore the effect of the factors mentioned above on OFDI we estimated a simple model presented below:

$$(1)\ \log(OFDIperCAP)_{i,t} = a_i + b_t + \beta_1 y_{i,t} + \varepsilon_{it},$$

where $\log(OFDIperCAP)_{i,t}$ is the logarithm of a cumulative OFDI per capita of country i in time t, a_i is a country fixed effect, b_t is a year dummy variable, $y_{i,t}$ is a vector of factors, which we treat as exogenous, that determine OFDI, ε_{it} error term.

We obtained the data from the UNCTAD database for FDI statistics (both for stocks and flows) and from the World Bank World Development Indicators and IMF World Economic Outlook, International Financial Statistics and Global Insight for macroeconomic variables. Table 2 gives a comparison of Chinese OFDI and macro variables with the averages for three regions (advanced economies, emerging markets and transition countries). The amount of China's outward FDI is comparatively low in international terms (with respect to GDP and on a per capita basis). While the size of the economy (in terms of nominal GDP) is one of the largest in the world, GDP per capita remains small and there is good scope for further development.

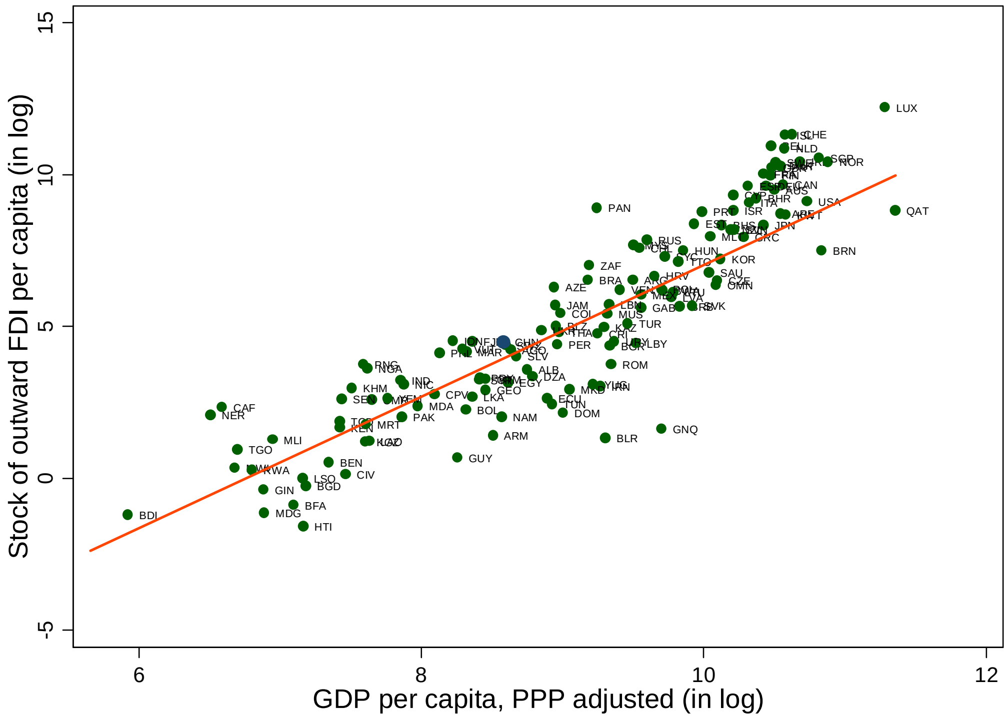
Table 2: OFDI and macroeconomic variables, 2007

	Stock of outward FDI (% to GDP)	Stock of outward FDI per capita in (US$)	GDP (US$, millions)	CDP per capita in PPP adjusted (US$)	GDP growth rate (%)	Openness (% of GDP)	Trade balance (% of GDP)
Advanced economies	34.9	33,674	1,534,347	37,940	3.6	103.6	4.1
Emerging markets	8.3	1,114	398,182	11,473	5.8	58.8	0.0
Transition countries	15.8	752	129,928	12,796	8.2	116.1	-9.7
China	3.6	89	3,280,224	5,325	10.2	72.5	9.4

Sources: UNCTAD, the World Bank World Development Indicators and the IMF World Economic Outlook database.

We use fixed effects panel data estimation models with test statistics that are asymptotically robust to general heteroskedasticity and AR(1) corrected error term. The equations are estimated for a period of 1980-2007 for 140 countries (or 117 countries) depending on the data availability. We use logarithm of the outward FDI stock per capita measured in current US dollars as a dependent variable and control for the level of the countries' development, trade indicators, domestic interest rates and exchange rates (see Table 3 for regression results).

Chart 8: Correlation between OFDI stock per capita and the level of development



Sources: World Development Indicators database and UNCTAD.

As expected, the country-specific time invariant characteristics and globalisation process are the main drivers of outward FDI at the macro level (explaining around 92 per cent of the variation of OFDI per capita). At the same time, the level of the country development (measured as PPP adjusted GDP per capita) and the country's factor endowments additionally help to explain the motives behind outward FDI (see Chart 8 for the relationship between the development and outward FDI. See Table 3 for estimation results).

With regard to how trade affects FDI, it is believed that FDI could be a substitute for exports to a host country. Buckley and Casson (1981) argue that servicing the same market with affiliate sales from FDI allows to lower variable costs of production substantially, but probably involves higher fixed costs than exports. That is why one can expect a natural progression from exports to FDI once the foreign market's demand for a particular export product reaches a large enough scale. In our regression analysis, trade openness did not show any significant results. Inclusion of exports of a host country into the regression analysis did not significantly improve the explanatory power of our model but appears to be an essential factor in explaining the decision behind the outward FDI (see column 6 of Table 3). We also tested another trade-related variable in our model: trade balances (in per cent to GDP), assuming that countries that experience persistent trade surpluses would be net exporters of capital in different forms (see columns 3 to 5 of Table 3).

Table 3: Regression results

	Dependent variable log of outward FDI per capita (in US$ dollars)							
	1	2	3	4	5	6	7	8
Log (GDP per capita PPP adjusted)		**1.04**	**1.09**	**1.19**	**1.32**	**1.29**	**1.31**	**1.77**
		*(6.37)****	*(6.59)****	*(6.91)****	*(7.14)****	*(6.81)****	*(6.95)****	*(4.65)****
Log (population)		**-1.79**	**-1.19**	**-1.10**	**-0.81**	**-0.77**	**-0.60**	**-1.75**
		*(3.16)****	*(2.65)***	*(2.53)***	*(1.78)**	*-1.64*	*-1.45*	*(2.29)***
Trade balance to GDP			**0.28**	**0.28**	**0.27**			**0.93**
			*(2.18)***	*(2.00)***	*(1.9)**			*(2.04)***
Change of exchange rate (REER)				**-0.02**	**-0.05**	**-0.07**	**-0.04**	**0.37**
				-0.47	*-0.94*	*-1.33*	*-0.73*	*(2.08)***
Domestic deposit interest rate					**0.00**	**0.00**	**0.00**	**0.00**
					0.17	*0.14*	*0.01*	*(3.51)****
Log (exports to GDP ratio)						**-0.12**		
						*(3.41)****		
Log (openness)							**-0.10**	
							-1.25	
Constant	**2.27**	**-0.79**	**1.26**	**1.42**	**2.50**	**1.42**	**1.99**	**15.70**
	*(15.34)****	*(4.63)****	*(11.47)****	*(12.74)****	*(20.47)****	*(11.52)****	*(18.19)****	*1.13*
Time fixed effect	YES	YES	YES	YES	YES	YES	YES	YES
Country fixed effect	YES	YES	YES	YES	YES	YES	YES	YES
Observations	3131	2895	2781	2602	2304	2431	2387	2518
Number of countries	140	136	131	128	117	129	127	131

Note: Robust t statistics in parentheses. * significant at 10 per cent; ** significant at 5 per cent; *** significant at 1 per cent. Regression in column 1 has been estimated using OLS for a panel of 140 countries controlling for country and time fixed effects and correcting for AR(1) in error term only. Regressions (2-7) are fixed effect models with AR(1) disturbances. Due to the data availability for real effective exchange rates and interest rate, regressions (2-8) have been estimated for less than 140 countries (that is, between 117 and 136 countries). Fixed time and country effects explain around 92 per cent of variation in outward foreign direct investment across countries. Additional regressors, which we control for in our models, further improve explanatory power of the model by 2-4 per cent.

Exchange rate dynamic (measured as a level of real effective exchange rate or REER) does not appear to be a significant determinant of outward FDI at the macro level. We included the change of REER into the model, but it does not seem to be significant either. The common wisdom was that changes in the level of the exchange rate would not alter the decision by a firm to invest in a foreign country (McCulloch, 1989). While the appreciation of a firm's home country's currency would lower the cost of investment abroad, the expected nominal return (in host country's currency) goes down as well.

Overall, the level of the country's development, the factor endowments and trade balances appear to be the main explanatory factors helping to account for the differences in a country's outward FDI. We used the results from Regression 5 to estimate the future level of China's outward FDI (based on the joint significance of variables included in the model). We input macroeconomic forecasts for independent variables from Global Insight obtained in December 2008 (see key assumptions in Table 4). According to our estimate, the level of China's accumulated outward FDI will reach US$ 360 billion in 2015.[18] This number is higher than our previous projection of US$ 315 billion made in mid-2008 based on the historical data for the 1980-2005 period. This probably reflects dynamic growth in China's outward investment activity during 2006-07. We believe that the relative importance of Chinese investment has increased as the investment from other major investing countries has decelerated during 2008.

Table 4: China's outward FDI projections

	2007 (actual)	2010	2015
China's outward FDI (US$, millions)	117,910	177,539	359,447
China's outward FDI per capita (US$)	89.7	133.0	261.8
Assumptions			
Population (millions)	1,322	1,344	1,383
GDP per capita PPP adjusted (US$)	5,919.0	7,176.2	10,966.5

Source: Author's calculations based on Global Insight forecasts.

The implications for the transition countries are less clear. Using the transition region's current share of China's total outward FDI (2.76 per cent), the expected amount for the region will remain modest at US$ 9.9 billion in 2015 (albeit with the impressive growth rate of 300 per cent over the 2007 level). However, taking into account the fact that much of China-Russia (and other transition economies) investments go through tax havens, we distributed the amount of Chinese FDI directed to the Cayman Islands and British Virgin Islands to other countries on a pro-rata basis (no weights added). As a result, the share of the transition region

[18] This is in line with the projections made by Global Insight but slightly less than the projections made by Economic Intelligence Unit (US$ 330 billion by 2011).
[20] According to the State Committee for Investments and State Property Management of Tajikistan, the total amount of accumulated FDI from China in Tajikistan amounted to US$ 44 million by the end of June 2007.

increased to 6.3 per cent or the stock of US$ 22.7 billion by 2015. If we further consider recent growth rates for the transition countries (see Chart 2), the region's expected share could increase even more.

4. CONCLUSIONS

Chinese investment in the transition countries has increased significantly in recent years. Investments began in countries close to China and tax havens, but have progressed to industrialised countries and other emerging regions, such as Africa and the transition region. Excluding offshore destinations and Hong Kong, the transition region is the third largest recipient region after Asia and Africa. Recent growth for the transition region is highest among all regional groups. Kazakhstan, Mongolia and Russia are currently among the largest FDI recipients in the region.

The key motives driving Chinese investment in the transition region are access to natural resources and the expansion of markets. Investments aimed at acquiring strategic assets have also been increasing in the last few years. Recent research (see Buckley et al., 2007) found that the key determinants of China's outward FDI include market size, geographic proximity and high levels of political risk. These determinants fit well with many transition countries. Therefore, sponsors from China, transition countries or Western countries are likely to be competing even more for new investment opportunities in the transition region.

Chinese companies still face domestic constraints when investing abroad, but they can be reduced or removed over time, and China is likely to become one of the largest foreign investors in the world during the next decade. We estimate the outward FDI stock will rise to approximately US$ 360 billion by 2015. Within this projection by 2015, the transition region may attract Chinese FDI of up to US$ 22.7 billion.

Multinational companies are responsible for most outward FDI activity. Although many of them are listed domestically and abroad (that is, with certain disclosure standards), they are still majority owned by the government or regional authorities. Political consideration cannot be ruled out but most of the investments seem to be made on economic grounds. In summary, competition in local markets in the transition region between local companies and Chinese companies is expected to rise further.

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ANNEX 1

Chinese multinationals included in Fortune Global 500 (2008)

Ranking	Company	Revenues (US$ million)	City	Ranking	Company	Revenues (US$ million)	City
16	Sinopec	159,260	Beijing	341	China Railway Group	23,732	Beijing
24	State Grid	132,885	Beijing	349	Noble Group	23,497	Hong Kong
25	China National Petroleum	129,798	Beijing	356	China Railway Construction	23,335	Beijing
133	Industrial & Commercial Bank of China	51,526	Beijing	373	Shanghai Automotive	22,607	Shanghai
148	China Mobile Communications	47,055	Beijing	385	China State Construction	22,128	Beijing
159	China Life Insurance	43,440	Beijing	398	COFCO	21,202	Beijing
171	China Construction Bank	41,307	Beijing	405	China Ocean Shipping	20,840	Beijing
187	Bank of China	38,904	Beijing	409	China National Offshore Oil	20,637	Beijing
223	Agricultural Bank of China	34,059	Beijing	412	China Minmetals	20,517	Beijing
226	China Southern Power Grid	33,861	Guangzhou	426	China Communications Construction	19,991	Beijing
257	Sinochem	30,204	Beijing	437	Jardine Matheson	19,445	Hong Kong
259	Baosteel Group	29,939	Shanghai	476	Aluminum Corp. of China	17,577	Beijing
286	Hutchison Whampoa	28,035	Hong Kong	480	China Metallurgical Group	17,515	Beijing
288	China Telecommunications	27,856	Beijing	499	Lenovo Group	16,788	Hong Kong
303	China FAW Group	26,391	Changchun				

Source: CNN.

ANNEX 2

Country analysis

This annex looks at China's overseas FDI and other project financing activity from the perspective of the recipient countries. Information and statistics are mainly from local sources and news articles, and are not fully consistent with the earlier analysis based on the official data from UNCTAD and the Ministry of Commerce of China. However, this section complements the analysis based on the official data, and helps us understand more about these investments, based on project information and other available sources. This section describes country-specific situations of four countries; Russia, Romania, Mongolia and Kazakhstan, since these countries are the main FDI recipients from China.

Russia

Of the transition countries, Russia receives the largest share of Chinese FDI. The stock of FDI in Russia is estimated at US$ 3 billion (while official Chinese statistics indicate roughly US$ 1.4 billion). Russia is one of the key markets targeted directly by Chinese investors, on par with the United States and Australia, and above Africa. But for Russia, China's investments account for less than 5 per cent of the total FDI stock in Russia. There were more than 1,000 joint ventures with Chinese capital in Russia in 2005. Most of these are trading firms set up in border areas, although there are over 200 joint ventures in manufacturing. It seems that China's investments in Russia are relatively diversified compared with other transition countries.

The large investments are concentrated in natural resources and some manufacturing sectors. In July 2006, China National Petroleum Corporation (CNPC) bought a US$ 500 million stake during Rosneft's IPO while China Petroleum & Chemical Corporation (Sinopec) acquired a 96.9 per cent stake in Udmurtneft for US$ 3.5 billion from TNK-BP International (British Virgin Islands). Moreover, there have been a couple of large-scale joint production projects in the automotive sector. Joint production of Chinese-designed Geely cars started in the Urals at the beginning of 2007, using production capacities of Ural Automobiles and Engines plant (UralAZ). Chery Automobile constructed a US$ 200 million car assembly plant in the Kaliningrad region, and started production in Russia with Avtotor Group from 2006. Changfeng Motors is reportedly discussing plans to build an assembly unit in Russia, but it has not been materialised. The largest joint investment projects include the Baltiiskaya Zhemchuzhina compound in St. Petersburg (US$ 1.3 billion investments), the Berezovskoye iron ore deposit in the trans-Baikal territory (US$ 494 million) and a paper and pulp plant in the village of Amazar in the trans-Baikal territory (US$ 270 million).

In terms of the number of investments, the majority of the projects are in the areas of wholesale and retail trade, services, agriculture and forestry, manufacturing and construction. Given that Russia's timber reserves account for a quarter of the world's total, forestry is a key area targeted by Chinese investments. Chinese companies have been also successful in winning outsourcing contracts, involving the use of Chinese labour in the construction, forestry, agriculture and textiles. The contracts signed in 2006 exceeded US$ 1 billion, bringing the total of China's contracted investments in Russia to almost US$ 7 billion. These contracts have been growing by over 40 per cent each year and are concentrated mainly in the Far East and Siberia, which suffer from the lack of available workforce. Only about 10 per cent of all Chinese investments are made in the larger cities.

Romania

Romania has a long-standing relationship with China and it receives the most amount of Chinese FDI in eastern Europe. China is Romania's main trading partner in Asia, with a total trade value of US$ 2.47 billion in 2006 (of which Romanian imports from China dominate). There are nearly 9,000 Chinese joint ventures, with a total investment of about US$ 400 million. China is ranked 16th among foreign investors in Romania and accounted for almost 8 per cent of foreign companies in 2006. The main sectors of investment are trade, light industry (clothing, wood and tobacco), the food industry, tourism, mining and power.

Some of the larger investments include that of F&J Group, which entered the Romanian market in 1991. The company invested some US$ 70 million in several sectors, including wood processing, tobacco, electronics and home appliances, textiles, fruit and vegetables. Sinoroma Industry invested initially about US$ 50 million to build a new cigarette factory in the village of Parscov (north-east of Bucharest). In recent years, two of the biggest Chinese telecommunications and computer companies, ZTE Corporation and Lenovo, started their operations in Romania.

Mongolia

The number of Chinese enterprises in Mongolia ranges from 800 to 2,500, depending on the data source, but according to the Chinese Chamber of Commerce in Mongolia there are about 200 Chinese companies currently operating in the country (that is, many of the registered Chinese companies are "paper only" and not operational). According to the Foreign Trade and Investment Agency (the state FDI agency), China's FDI stock amounted to US$ 872 million, or 67 per cent of the total investment in Mongolia (US$ 1.3 billion by the end of 2006). The key sectors include:

- mining (including copper, zinc, coal, iron and gold) – some 50 per cent of total investments
- textiles/clothing/cashmere
- trade services
- construction
- banking

It seems that the characteristics of China's investments in Mongolia differ from those of larger countries, such as Kazakhstan. Most companies are relatively small enterprises, and are private and/or family owned firms (that is, limited number of large state-owned enterprises or multinational companies). Many Chinese investors come from Inner-Mongolia (part of Chinese territory), where there is a strong ethnic link with Mongolia. According to MOFCOM statistics, FDI outflows from Inner Mongolia increased from US$ 6.7 million in 2004 to US$ 42.6 million in 2007 (accumulated stock of US$ 139.8 million). One special free trade zone was created in the border area with China.

Kazakhstan

China had been absent in Kazakhstan until a few years ago, but has now become one of its close partners, a relationship that is driven mainly by energy policy. China wants to secure access to Central Asian hydrocarbons to cater for its growing domestic demand for energy while Kazakhstan wants to diversify its export routes. Cumulative investment (committed basis) reached more than US$ 6 billion by the end of 2006. For example, China's CITIC Group (China's seventh largest financial group) acquired the Kazakh oil assets of Canada's Nations Energy Company at the end of 2006 for US$ 1.9 billion. The acquisition allowed CITIC to develop the Karazhanbas oil and gas field until 2020. Other high profile acquisitions include CNPC’s US$ 4.2 billion acquisition of PetroKazakhstan in 2004, a Canadian registered oil company, with oil exploration and refining assets in Kazakhstan; the US$ 615 million acquisition (or 8.33 per cent stake) in the Kazakhstan North Caspian Operations Company (Agip KCO) by the China National Offshore Oil Corporation (CNOOC, China’s third largest national oil company); and the US$ 325 million acquisition by CNPC of a 60 per cent stake in Aktobemunaigas in 2004. CNPC also owns smaller production assets in Kazakhstan and plans to invest some US$ 4 billion in the country over a 20-year period.

As for oil pipelines, the proposed Kazakhstan-China oil pipeline will be China’s first direct oil import pipeline linking with Central Asia. When complete, the 3,000 km and 20,000-tonne-capacity pipeline will run from Atyrau in Kazakhstan to Alashankou in China’s Xinjiang Uygur region. The pipeline is being developed by CNPC together with Kazakh oil company KazMunayGas, who are investing some US$ 1 billion. The first two sections of the pipeline were completed by 2004 and the third will be expected to reach full capacity in 2011.

Other Central Asian countries

There are a large number of Chinese investments in other Central Asian countries, but the volumes are not fully captured by either Chinese or local statistics. According to official Chinese statistics, China invested US$ 125 million (stock) into the Kyrgyz Republic by the end of 2006. Chinese companies have established more then 100 joint ventures in the Kyrgyz Republic. Key activities include wholesale and retail trade, transportation, tourism and other services. However, most of these companies are small in size while the presence of Chinese multinationals is almost non-existent. Nevertheless, in the energy sector, China invested in the Mailisu IV oilfield (Fergana Basin) and several greenfield projects, such as a cement plant and a paper mill. To support investment and trade, a number of regional initiatives are being planned, such as the Central Asia Regional Economic Cooperation (CAREC), under which the railways connecting Uzbekistan, Kyrgyz Republic and China and a couple of regional road projects are being considered.

In Tajikistan, the FDI stock appears to be relatively small (US$ 30.3 million in 2007).[20] Even though the sectoral breakdown is unavailable, Chinese investors appear to be interested in energy, transport, mining and metals processing. Despite relatively low levels of investment, there is increasing momentum in terms of government-to-government cooperation projects. In 2006 the Chinese government allocated a US$ 40 million grant to Tajikistan for the construction of the Shar-Shar tunnel located on the Dushanbe-Kulob motorway. It also allocated around US$ 300 million for the modernisation of the motorway linking with the Uzbek border. Moreover, three sizeable projects to be financed by the Export-Import Bank of China are under consideration (a total of approximately US$ 600 million): the upgrade of Dushanbe-Chanak Highway and the construction of North-South and Lolazor-Khatlon electricity transmission lines. China is likely to become the largest lender in Tajikistan once these projects are completed.