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Three challenges for China's outward FDI policy

by
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Since China adopted its "going out" policy in 2001, her outward foreign direct investment (OFDI) flows have grown rapidly, reaching US$84 billion in 2012 (although the stock remains small). That year, China was the world's third largest outward investor (after the US and Japan). This performance raises all sorts of issues, especially because state-owned enterprises (SOEs) control some three-quarters of the country's OFDI stock. Three challenges are addressed in this *Perspective*.

A *short-term challenge* for China's government is to consider what to do regarding the growing skepticism in some host countries about the country's OFDI. It is motivated partly by the usual difficulty of accommodating new competitors, concerns about national security (in light of the role of SOEs in the country's OFDI) and concerns about the impact of Chinese OFDI projects (even though this impact may not be that different from that of firms from other countries).[1] In some developing countries – especially where natural resources FDI dominates, as in Africa and Latin America – Chinese firms risk being seen as representing a new form of neo-colonialism in the context of a South-South center-periphery relationship.[2]

Addressing these concerns requires that China formulate and enforce a "going in" strategy to complement its "going out" policy. Part of this strategy requires paying considerably more attention to the promotion of sustainable FDI, i.e., FDI that contributes as much as possible to the economic, social and environmental development of host countries and takes place in the context of fair governance (including contracts in natural resources FDI).[3] One possibility would be for China to take the lead in establishing an independent facility to help especially the least developed countries negotiate large-scale contracts with firms from any country, including in natural resources.

A *medium-term challenge* is to see how China responds to efforts by some developed countries to discipline (e.g., in the context of the Trans-Pacific Partnership negotiations) the support (e.g., financial and fiscal incentives) that governments give to their SOEs investing abroad. This issue is particularly important for China, given its elaborate set of home country measures that supports Chinese firms going abroad.

However, China is not alone in rendering such support – most developed countries and a few emerging markets do the same, including for firms in the private sector.[4]

One way to deal with this challenge is to extend the discussions and negotiations of this subject to all measures available to firms investing abroad, regardless of whether they are government-owned, in the interest of full competitive neutrality. However, since home country measures in some sense mirror incentives to attract FDI, and efforts in the past to discipline the latter have come to naught, disciplining OFDI incentives will be a challenging endeavor.

Finally, a *long-term challenge* is for China to determine what role she wants to play in constructing a multilateral framework for investment. Given that direct investments of Chinese firms often face host country resistance – which may well intensify as China's OFDI grows – it is in China's interest that multilateral rules that enshrine a proper balance between protecting FDI and leaving sufficient policy space for governments to pursue legitimate public policy objectives are in place. With the rise of China as an investor, its interests as a *host* country to protect its policy space have increasingly been complemented by its interests as a *home* country to protect the investments of its firms abroad, reflected in the evolution of its international investment agreements. In fact, if one wanted to pinpoint the precise date at which China's home country interests became equal to, or more important than, its host country interests, one might point to July 11, 2013, when China agreed, in the context of the US-China Strategic and Economic Dialogue, to continue negotiations of an investment treaty with the US on the basis of pre-establishment national treatment and the negative list approach to exceptions to such treatment.[5] This conceptual and policy breakthrough could lay the ground not only for an agreement between the two countries, but also for a broader investment framework.

China did not participate in the creation of the world's financial and trade frameworks. If and when this issue reaches the international agenda again, it has the opportunity to participate actively in the process of creating a multilateral investment framework, perhaps even taking the lead in this process.

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[1] *See, e.g.*, "China finds resistance to oil deals in Africa," *New York Times*, September 18, 2013.

[2] To quote L. Sanusi, Governor of the Central Bank of Nigeria: "So China takes our primary goods and sells us manufactured ones. This was also the essence of colonialism", *Financial Times*, March 12, 2013.

[3] It should be noted that although the OECD has adopted voluntary guidelines, most developed countries do not have comprehensive guidelines in place for their outward investors. This approach would be asking more from China than from other countries, putting China in the position to set an example.

[4] *See*, Karl P. Sauvant et al., "Trends in FDI, home country measures and competitive neutrality," in A. Bjorklund, ed., *Yearbook on International Investment Law and Policy 2012-2013* (New York: OUP, forthcoming).

[5] *Xinhua*, July 12, 2013.

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