Forty Years Development of China's Outward Foreign Direct Investment: Retrospect and the Challenges Ahead[1]

Bijun Wang, Kailin Gao[*]

Abstract

Outward foreign direct investment (OFDI) has increasingly become an important method for China to integrate into the world economy. This paper comprehensively reviews and analyses policy development and the changing pattern of China's OFDI over the past 40 years. We divide the development into "restricted" (1978–1999), "relaxed" (2000–2016) and "regulated" (2017 onwards) stages. This paper also reviews literature on the impact of Chinese OFDI on China and host countries. Despite its generally positive effects, large-scale and unbalanced OFDI activities have alarmed Chinese policy-makers. Both developing and developed host countries have expressed their concern over national security and the misbehavior of some Chinese overseas enterprises. Therefore, greater supervision and adjustment from quantity to quality growth is necessary for the future development of China's OFDI.

I. Introduction

Since the reform and opening up in 1978, China has become a staunch supporter and active participant in economic globalization and is increasingly integrating into the world economy through outward foreign direct investment (OFDI).[2] Before 2000, capital shortages prompted China to restrict capital outflow and only invite capital inflow. In 1991, the *Opinions on Strengthening the Management of Overseas Investment Projects* submitted by the State Planning Commission[3] to the State Council claimed that China "does not possess the conditions to pursue large-scale outward investment" (State Council, 1991). This document became the most influential source of policy guidance over the coming decade, setting "restriction" as the main tone of China's OFDI policy.

To prepare for World Trade Organization (WTO) accession, China started on a new journey of liberalization and its overseas investment witnessed a sharp increase. The "relaxed" policy drove the growth of China's OFDI flow and the 2008 global financial crisis provided new opportunities for Chinese investors. In 2016, China

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[*]Bijun Wang, Research Fellow, Institute of World Economics and Politics, Chinese Academy of Social Sciences, China. Email: wangbijun@cass.org.cn; Kailin Gao, PhD Candidate, National School of Development, Peking University，China. Email: kailingao@pku.edu.cn.

[2]In this paper, "China" refers to the "Chinese mainland" unless otherwise stated.

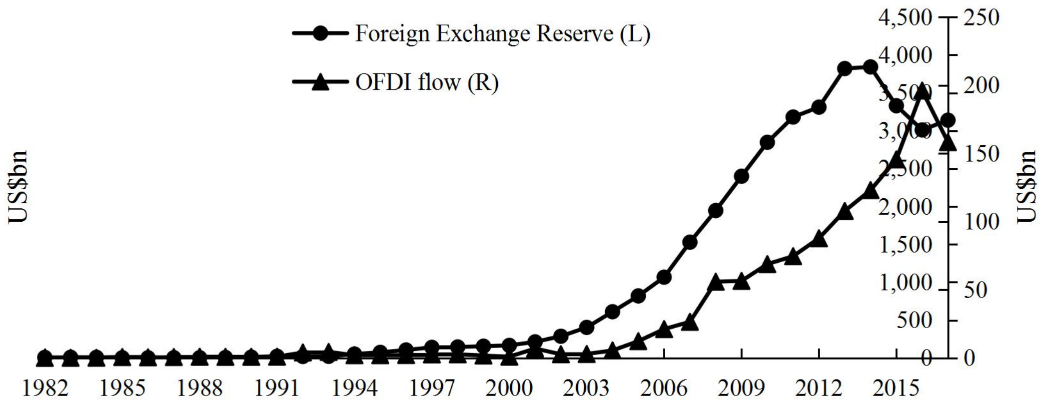
[3]The State Planning Commission was founded in 1952. It was renamed the State Development Planning Commission (SDPC) in 1998. After merging with the State Council Office for Restructuring the Economic System and part of the State Economic and Trade Commission in 2003, the SDPC was restructured into the National Development and Reform Commission.

became the world's second largest outward investor after the US, with US$196.2bn of OFDI flow.[4]

However, with large-scale and rapid growth, China's OFDI has revealed weaknesses in legal compliance, social responsibility, investment decisions and debt structure. Both developing and developed host countries have expressed their concern over national security and the misbehavior of some Chinese overseas enterprises. As a result, at the end of 2016 China strengthened OFDI regulations to support eligible enterprises investing abroad and to improve investment quality and efficiency.

China's OFDI has experienced three stages of development: "restricted" (1978–1999), "relaxed" (2000–2016) and "regulated" (2017 onwards). Because China's capital account has not yet been fully liberalized, the changes at different stages of China's OFDI are closely related to policy shifts. Although policy shifts are affected by many factors, one direct indicator is China's foreign exchange reserve (Figure 1).[5] Investing abroad requires foreign exchange reserve, however China's foreign exchange reserve was limited before 2000, which was an important reason for China's restrictions on OFDI at that time. In 2015 and 2016, China spent nearly US$1tn of foreign exchange reserve to stabilize the exchange rate. This was also an important trigger for China to move from relaxed to strengthened supervision of OFDI.

Figure 1. China's Foreign Exchange Reserve and Outward Foreign Direct Investment (OFDI) Flow, 1982–2017



Sources: CEIC database, UNCTAD Statistics (http://unctadstat.unctad.org/EN/) and MOFCOM-NBS-SAFE (2018).

This paper comprehensively reviews and analyses the policy development and the

[4]All of the Chinese OFDI data in this article was obtained from the *Statistical Bulletins of China's Outward Foreign Direct Investment*, unless otherwise indicated. In 2016, in terms of OFDI stocks, China ranked sixth in the world, with a total of US$1357.4bn.

[5] he correlation coefficient between China's foreign exchange reserve and its OFDI flow is as high as 0.91 (author's calculation) .

changing pattern of China's OFDI over the past 40 years, discusses the impacts of China's OFDI at home and abroad and identifies the current challenges. The aim is to provide an overall picture of the changes in China's OFDI and a clear understanding of the background logic.

Most of the published literature has focused on the determinants or the domestic impact of China's OFDI from a specific but unavoidably narrow perspective, and the research data are relatively dated. This paper will review the development logic of China's OFDI over the past 40 years from a broader perspective and over a longer time span. In particular, it analyzes new policy changes and their impact on China's OFDI since 2017, and discusses the prospects and challenges for Chinese OFDI in the context of the US−China trade conflict.

The paper is structured as follows. Section II summarizes the development of China's OFDI before 2016, including the restricted and relaxed stages. Section III introduces the regulated stage from 2017 onwards, and discusses the existing problems and subsequent policy changes. Section IV reviews the impact of China's OFDI at home and abroad. Section V identifies the challenges ahead. Section VI concludes the paper.

II. China's Outward Foreign Direct Investment Development in 1978–2016: From Restriction to Relaxation

In this section, we review the development of China's OFDI during 1978–2016. It includes the restricted stage from 1978 to 1999 and the relaxed stage from 2000 to 2016. In each stage, we analyze the patterns of China's OFDI, as well as the features and impacts of major policies.

1. Restricted Outward Foreign Direct Investment: 1978–1999

Before 1991, few laws and regulations were issued to direct OFDI.[6] Only state-owned enterprises (SOEs) were allowed to invest abroad (Voss et al., 2008) and case-by-case approval was required, regardless of the investment amount. China's foreign investment at that time was dominated by window companies,[7] trading companies and a small number of enterprises in primary processing industries (NDRC, 2017a). From 1982 to 1991, China's annual average OFDI flow was only US$537m, with stock amounting to US$5.4bn in 1991.[8]

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[6]Regulations before 1991 include, but are not limited to, *Provisional Regulations Governing the Control and the Approval Procedure for Opening Non-trade Enterprises Overseas* in 1985 and *Regulations Governing the Approval of Establishing Trade-related Enterprises Overseas* in 1988. Both were issued by the Ministry of Commerce of China.

[7]Window companies refer to the economic entities established in Hong Kong or Macao by government agencies of the Mainland. They perform administrative functions in Hong Kong or Macao for enterprises from the Mainland.

[8]China's OFDI flow data were obtained from UNCTAD Statistics (http://unctadstat.unctad.org/EN/) and NDRC (2017a).

There were two reasons for such small-scale OFDI. On the one hand, with few exports and limited foreign currency, China had to restrict foreign exchange to the purchase of urgently needed materials, equipment and technologies overseas. On the other hand, China was still a centrally planned economy before 1991 and enterprises were not highly motivated to invest overseas. At that time, the raw materials needed for production were centrally allocated. Under little market pressure, Chinese SOEs had little incentive to invest abroad. Private economy was still in its infancy and conditions for globalization were insufficient.

Entering the 1990s, both persistent trade surpluses and high FDI inflow had helped China accumulate foreign exchange. Its foreign reserve holdings increased from US$21.7bn in 1991 to US$154.7bn in 1999.[9] During the 1990s, China gradually transformed from a planned economy to a socialist market economy. The market became an important channel for resource allocation.

Faced with increasingly fierce competition, enterprises needed to obtain reliable, low-cost supplies of raw materials and enter the international market to seek more opportunities. Therefore, OFDI became a topic of wide concern. The average OFDI flow from 1992 to 1999 was US$2686m (0.8 percent of the world market on average), compared to only US$537m from 1982 to 1991 (0.4 percent of the world market).

Despite the stringent restrictions imposed by the *Opinions on Strengthening the Management of Overseas Investment Projects* in 1991, Deng Xiaoping's southern tour in 1992 gave Chinese investors the confidence to invest abroad. China's OFDI flow rose sharply from US$931m in 1991 to US$4bn in 1992. However, in 1994, China unified the dual-track exchange rate system and adopted the one-time depreciation of RMB of approximately 50 percent,[10] leading to a 55 percent reduction in China's OFDI flow from US$4.4bn in 1993 to US$2bn in 1994.

In the wake of the 1997 East Asian Financial Crisis and to prevent the potential risks of capital flight OFDI policy was further tightened. China's OFDI flow stagnated at just above US$2.5bn in 1997 and 1998, and the number of OFDI projects approved dramatically declined.

2. Relaxed Outward Foreign Direct Investment: 2000–2016

To prepare for WTO accession, China embarked on a new journey of liberalization. In 2000, the "Going Out" strategy was proposed. Afterwards, China continued to relax regulations on OFDI and assumed an increasingly prominent position in global overseas investment. From 2002 to 2016, China's OFDI flow developed rapidly, registering a 35.8 percent average annual growth rate (NDRC, 2017a). It ranked 26th in 2002 but had risen to second in the world by 2016, with world share increasing from 0.5 to 13.5 percent during the same period.

Although the "Going Out" strategy had been proposed in 2000, the implementing

[9]Data was obtained from the CEIC database.

[10]In 1994, China unified its dual exchange rate system by aligning official and swap centre rates, officially devaluing the yuan to the swap centre rate of 8.7 to US$1, which was much weaker than the official rate of 5.8 to US$1.

rules were not introduced until 2004. In July 2004, the State Council issued the *Decision on Reforming the Investment Systems* (State Council, 2004), and later in October 2004, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) promulgated corresponding detailed policies to simplify the approval procedures, delegate approval authority and increase approval efficiency (MOFCOM, 2004; NDRC, 2004).

In the aftermath of the 2008 global financial crisis, numerous enterprises from developed countries confronted a shortage of funds, shrinking markets and operational difficulties, opening doors to Chinese enterprises. While global FDI inflows fell by 14 percent in 2008 (UNCTAD, 2009), China's OFDI flow more than doubled to US$55.9bn in 2008. In response to the OFDI growth, MOFCOM in 2009 and NDRC in 2011 further decentralized their approval authority (MOFCOM, 2009; NDRC, 2011). The approval threshold was raised to over US$300m for resource development projects and over US$100m for other projects.[11]

A more fundamental policy relaxation in 2014 ushered in a "registration-based and approval-supplemented" stage for China's OFDI (MOFCOM, 2014; NDRC, 2014). Under this system, only projects involving sensitive industries or countries, or with Chinese investment of over US$1bn, need to obtain official approval. Other projects only need to submit relevant materials and a record file directly to the provincial Development and Reform Commission (DRC) at their locality, and the provincial DRC will submit an opinion on the projects and report to the NDRC for registration. Established Chinese overseas enterprises are exempt from the approval and registration procedures.

These policies lifted China's OFDI more than three-fold from 2008 to 2016. Following this round of decentralization, China became the world's second largest source of OFDI flow in 2016.

3. Evolution in Destination, Industry and Investor Structure

In addition to volume growth, profound changes also occurred in regard to Chinese OFDI in destination, industry and investor structure.

Table 1. Top 10 Destinations of Chinese Mainland Outward Foreign Direct Investment (OFDI) Stock, 2003 and 2016

Rank	2003			2016		
	Destination	Stock (US$bn)	Share (%)	Destination	Stock (US$bn)	Share (%)
1	Chinese Hong Kong	24.6	74.2	Chinese Hong Kong	780.8	57.5

[11] Special projects, regardless of the investment amount, must first be reviewed by the provincial Development and Reform Commissions or central SOEs, and then approved by the NDRC; otherwise, they must be approved by the NDRC and then by the State Council. These special projects include investment in a country with no diplomatic relations with China, countries under international sanctions and those afflicted by war and turmoil, as well as investments in sensitive industries including telecommunications, cross-border water utilization, large-scale land development, electricity networks and news media.

2	Cayman Islands	3.7	11.1	Cayman Islands	104.2	7.7
3	British Virgin Islands	0.6	1.6	British Virgin Islands	88.8	6.5
4	US	0.5	1.5	US	60.6	4.4
5	Chinese Macao	0.5	1.3	Singapore	33.5	2.5
6	Australia	0.4	1.3	Australia	33.4	2.5
7	Korea	0.2	0.7	Netherlands	20.6	1.5
8	Singapore	0.2	0.5	UK	17.6	1.3
9	Thailand	0.2	0.5	Russia	13	1
10	Zambia	0.1	0.4	Canada	12.7	0.9
Total		30.9	93.1		1165	85.8

Source: MOFCOM-NBS-SAFE (2004, 2017).

The top three destinations for Chinese mainland OFDI stocks have long been Chinese Hong Kong, the Cayman Islands and the British Virgin Islands, as these destinations are likely transit points for tax avoidance and serve accounting purposes. Subsidiaries located there often do not conduct real economic activities, such as employment and production. Some parent companies establish investment firms for OFDI (registered as a business services industry) at these destinations and then use them as a springboard to invest in other countries and even partially return investment to the Chinese mainland.

However, the Hong Kong and Macao market shares dropped significantly. Although Hong Kong remained the top destination, its share decreased from 74.2 percent in 2003 to 57.5 percent in 2016 (Table 1). During the same period, Macao plunged from the fifth (1.3 percent) to the 15th (0.5 percent). These changes reflect that more Chinese mainland enterprises were able to directly invest into other destinations without using Hong Kong or Macao as investment platforms.

Developed countries accounted for a growing share of China's OFDI stock. Among the top 10 destinations, the number of developed countries rose from 4 in 2003 to 6 in 2016, with their share from 4 to 13.1 percent.[12] Particularly noticeable was the US, whose share increased by 2.9 percent.[13] The Netherlands and Canada ascended significantly to seventh and 10th, respectively, in 2016.[14] Meanwhile, the proportion of Chinese OFDI in high-tech industries, such as information transmission, computer services, software, scientific research and technical services, also expanded (Table 2). The rising shares of developed economies and technology-intensive industries indicate the significance of technology-seeking OFDI, which helps Chinese enterprises enhance their competitiveness and promote in the value chain.

Table 2. Sectorial Distribution of China's Outward Foreign Direct Investment (OFDI)

[12] Calculated from Table 1 data.

[13] Calculated from Table 1 data.

[14] The shares of China's OFDI stock in the Netherlands and Canada are not available from the MOFCOM-NBS-SAFE (2004), as they only released the top 20 destinations.

Stock, 2006 and 2016

Sector	2006		2016	
	Stock (US$bn)	Share (%)	Stock (US$bn)	Share (%)
Leasing and business services	19.5	21.5	474	34.9
Financial intermediation	15.6	17.2	177.3	13.1
Wholesale and retail trades	13	14.3	169.2	12.5
Mining	18	19.8	152.4	11.2
Manufacturing	7.5	8.3	108.1	8
Information transmission, computer services and software	1.5	1.6	64.8	4.8
Real estate	2	2.2	46.1	3.4
Transport, storage and post	7.6	8.4	41.4	3.1
Construction	1.6	1.7	32.4	2.4
Production and supply of electricity, gas and water	—	—	22.8	1.7
Scientific research, technical services	1.12	1.2	19.72	1.5
Services to households and other services	1.2	1.3	16.9	1.2
Agriculture, forestry, animal husbandry and fishery	0.8	0.9	14.9	1.1
Culture, sports and entertainment	—	—	7.9	0.6
Hotels and catering services	—	—	4.2	0.3
Management of water conservancy, Environment, public facilities	0.9	1	3.6	0.3
Health, social security and social welfare	—	—	0.9	0.1
Education	—	—	0.7	0.1
Others	0.5	0.6	—	—

Source: MOFCOM-NBS-SAFE (2004, 2017).
Notes: The *2003 Statistical Bulletin of China's Outward Foreign Direct Investment* only included 11 sectors, compared to 14 in 2006 and 18 in 2016. To better illustrate changes in various sectors, we compare sectoral distribution between 2006 and 2016, rather than 2003 and 2016. "—," data are not available. Leasing and business services have always been the largest industry for China's OFDI, and saw a rapid increase from 2006 to 2016. This is partly because the current official industry distribution only shows the industry invested in the first destination, which may not reflect the ultimate industry.

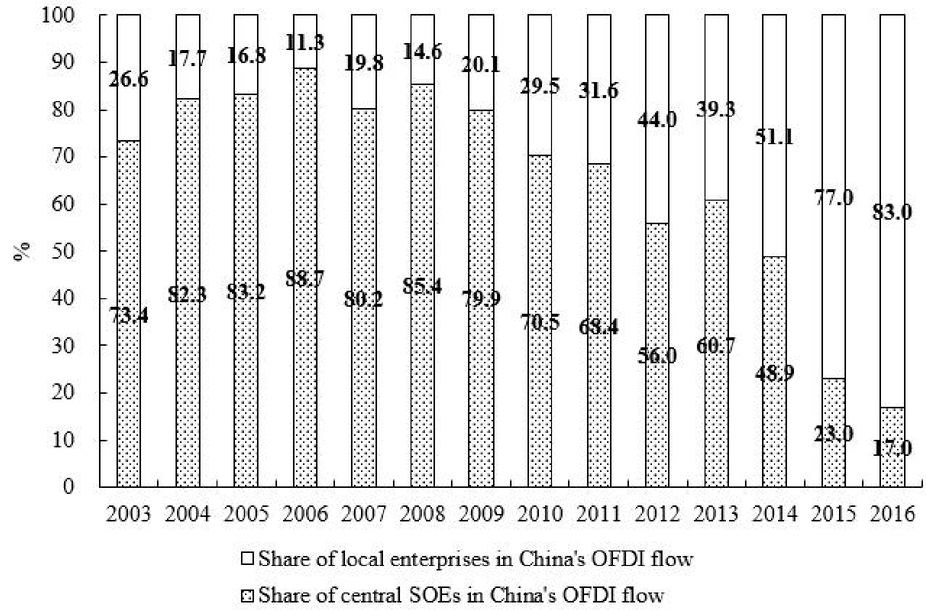
Table 2 shows that OFDI in resources declined. The largest decline among all industries was in the mining sector, from 19.8 percent in 2006 to 11.2 percent in 2016. With economic transformation and rising environmental awareness, China has decreased its dependence on resource-intensive products. Moreover, the decline in commodity prices after 2013 reduced the attractiveness of resource-oriented overseas investment.[15] In addition, the decrease in these investments was also related to the

[15]According to the annual indices of the World Bank Commodity Price Data, the real price of energy resources

slowdown in OFDI by central enterprises. From 2003 to 2016, the share of OFDI flow by China's central enterprises decreased from 73.4 to 17.0 percent (Figure 2). Because a number of investments suffered huge losses, some central enterprises have become more cautious in investing in foreign resources.

Chinese enterprises investing abroad are increasingly diversified (Figures 2 and 3). Local enterprises[16] are developing rapidly, and have surpassed central enterprises since 2014, becoming the main force of China's non-financial overseas investment. From 2003 to 2016, the share of local enterprises in China's non-financial OFDI flow increased from 26.6 to 83.0 percent. Such increase mirrors the declining share of central enterprises. It was also driven by the relaxation of policies and the inherent need for enterprises to invest overseas under rising production costs and fierce competition at home. But in the meanwhile capital flight was also significant.

Figure 2. Share of Outward Foreign Direct Investment (OFDI) Flow of Central and Local Enterprises in China, 2003–2016



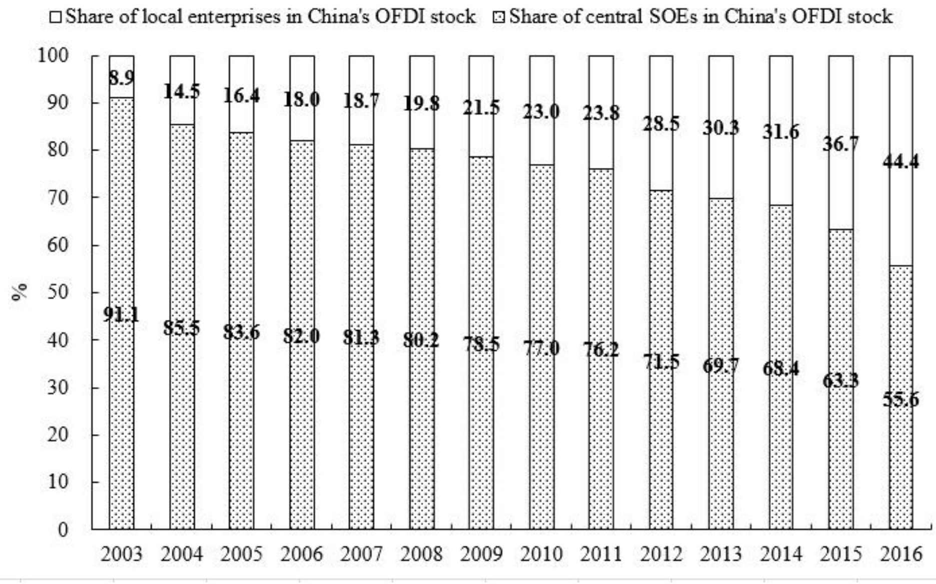
Source: MOFCOM-NBS-SAFE (2004–2017).

Note: SOEs, state-owned enterprises.

Figure 3. Share of Outward Foreign Direct Investment (OFDI) Stock of Central and Local Enterprises in China, 2003–2016

declined to US$58 (in terms of real 2010 US$) in 2016 after it peaked at US$126 in 2008 and US$116 in 2013. Data were accessed in June 2018 available from: http://pubdocs.worldbank.org/en/226371486076391711/CMO-Historical-Data-Annual.xlsx.

[16]Local enterprises include SOEs owned by provincial, city-level and county-level governments; privately-owned enterprises; and foreign enterprises.



Source: MOFCOM-NBS-SAFE (2004–2017).
Note: SOE, state-owned enterprise.

III. Regulated: 2017 Onwards

In this section we will identify the existing problems of China's OFDI and summarize the subsequent policy shifts.

1. The Trigger for Change

The year 2017 was a turning point in China's OFDI policies, which moved from relaxed to regulated. In 2016, global OFDI dropped by 2 percent (UNCTAD, 2017), but China's OFDI soared by 34.7 percent. Chinese non-financial OFDI flow increased even faster, registering growth of 49.3 percent. Some industries have shown unusually strong growth: the OFDI flow in the hotels and catering industry increased by 124.8 percent; followed by 121.4 percent in culture, sports and entertainment industries; and 95.8 percent in real estate.

Against the backdrop of a weakening RMB and China's rapidly shrinking foreign exchange reserve since the end of 2015, the rapid and imbalanced expansion of OFDI caused more concern for the Chinese government. From the end of 2016, China began to strengthen examination of the authenticity of overseas investment and pay closer attention to OFDI in real estate, hotels, cinemas, entertainment and sports clubs, which were regarded as "irrational" growth because of their weak links to either the real economy or firms' main businesses. After a series of interim measures, Chinese OFDI reversed for the first time since 2003, down 19.3 percent in total to US$158.3bn in 2017 (MOFCOM-NBS-SAFE, 2018).

Apart from "irrational" OFDI, there are two major problems. One problem is that some overseas Chinese enterprises have low awareness of legal compliance in host countries and a weak sense of social responsibility, which has damaged the reputation of Chinese enterprises and China's international image (Brautigam, 2009). The other problem is that large-scale Chinese OFDI has adversely affected the country's balance of payments and exchange rate stability (Sang, 2016). The expansion of overseas investment causes capital flow out of China. Meanwhile, as relative newcomers to the international investment arena, Chinese enterprises lack investment experience and have poor access to information, which leads to information asymmetry, decision-making mistakes and thus serious economic losses.

Moreover, capital flight by way of OFDI activities has taken various forms (He and Wang, 2014). Some enterprises have relocated headquarters to tax havens and underreport profits through transfer pricing. Some illegally acquire foreign exchange, transfer assets abroad and engage in money laundering. Others appropriate state assets in foreign countries, taking advantage of weak supervision overseas. These factors can intensify risks to China's balance of payments and exchange rate stability.

2. More Measures: Encouraged Development plus Negative Lists

Aware of the risks mentioned above, China released new rules directing Chinese overseas investment based on a model of "encouraged development plus negative lists" (State Council, 2017). It was emphasized that enterprises should take the lead in overseas investment based on the market-oriented approach in accordance with business principles and international practice, and promote mutual benefits with local governments and enterprises. In turn, the Chinese government should innovate relevant mechanisms to facilitate overseas investment, advance streamlining of administration and delegation of powers, and proactively monitor all stages of OFDI from beginning to end.

OFDI was classified into three categories: "encouraged," "restricted" and "prohibited" (State Council, 2017). The encouraged category includes OFDI in: (i) infrastructure projects relevant to the Belt and Road Initiative (BRI); (ii) promoting the export of advantageous production capacity, quality equipment and technology standards; (iii) cooperation with foreign high-tech and advanced manufacturing enterprises and the establishment of overseas R&D centers; (iv) exploration of natural resources on the basis of careful evaluation of economic benefits; and (v) agriculture, forestry, animal husbandry, fisheries, trade, culture, financial institutions, logistics and other services fields.

The restricted category includes: (i) OFDI in countries that have no diplomatic relations with China or are currently at war, or sensitive countries and regions in which OFDI should be limited based on a bilateral/multilateral treaty; (ii) OFDI in real estate, hotels, cinemas, entertainment and sports clubs; (iii) overseas investment platforms without specific industrial projects; and (iv) OFDI that does not meet the technical standard requirements, environmental protection, energy consumption, and safety standards of the host economies.

The prohibited category includes: (i) OFDI involving any technology, process, or product whose export is prohibited; (ii) OFDI in gambling or pornography industries; and (iii) other OFDI that impairs or may damage China's national interests or national security.

China has closed regulatory loopholes and strengthened supervision at all OFDI stages (NDRC, 2017b). First, it has extended the regulations to overseas investment by foreign entities controlled by Chinese enterprises and citizens. In order to make a sensitive investment using a foreign controlled entity, the investor needs to seek approval from the NDRC.[17] To make a non-sensitive investment over US$300m using a foreign controlled entity, the investor needs to submit a report to the NDRC, but no approval or registration is required.[18] Second, China has innovated regulatory mechanisms to improve collaborative supervision and project monitoring. The methods include online monitoring, written inquiries, random verification, and the introduction of project completion reports, significant adverse event reports, and inquiries on important issues. Third, China has also improved disciplinary measures and proposes establishing a record of violations,[19] which will be released on national credit information sharing platforms to facilitate joint punishment with other relevant departments.

The recent policy changes do not signal less support for Chinese OFDI. China has adopted several approaches to facilitate overseas investment. For example, it eliminated the information report system and the confirmation letter from the NDRC is no longer required. It also allows local enterprises to file directly with the NDRC for approval and has eliminated provincial-level review.

However, the new policy development has shifted its focus from relaxation to regulation. The aim is to improve the quality of China's OFDI, support qualified and capable enterprises investing abroad and promote OFDI projects that are conducive to China's economic transformation and upgrading.

IV. Impacts of China's Outward Foreign Direct Investment

China's OFDI aims to utilize markets and resources at home and abroad more effectively, promote openness and achieve mutual benefits. Although it is a relatively new phenomenon, China's large scale and rapid growth has drawn worldwide attention. In this section, we will review the literature that has analyzed the impact of

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[17] Sensitive projects include projects in sensitive countries or regions, and sensitive industries. These projects are subject to examination and approval from the NDRC. Sensitive countries or regions include those with no diplomatic relations with China, those afflicted by war and turmoil, those under international sanctions and other sensitive countries or regions. Sensitive industries include development, production and maintenance of weaponry, cross-border water utilization, news media, and other industries where OFDI needs to be restricted under relevant Chinese laws, regulations and policies.

[18] To make a non-sensitive investment below US$300m using a controlled entity, no approval, registration or reporting is required.

[19] It clarifies punishments for misconduct and violations including malicious partition, false declaration, unfair competition, illegal financing, failure to report when necessary, improperly obtaining approval or registration documents, implementing projects without approval, and situations that threaten or harm national interests and security.

China's OFDI on China and host countries.

1. Impacts on China

Traditionally, enterprises can overcome the inherent disadvantages met by overseas operations in a host country when they have significant advantages over local and third-country enterprises in that country. However, most Chinese enterprises do not have such absolute competitive advantages. Therefore, an important reason for Chinese enterprise investment abroad is to improve technology and competitiveness. Overseas subsidiaries can transfer the acquired strategic assets back to parent firms within multinational internal networks. OFDI has increased Chinese firms' research and development (R&D) spending and new product sales through reverse knowledge spillovers and exposure to fierce international competition (Mao and Xu, 2014).

There are pre-conditions for positive reverse knowledge spillovers. OFDI in developed countries helps Chinese firms leapfrog to the technology frontier, but this effect is contingent on host country features and firm characteristics, such as in-house R&D, strategic orientation and international experience (Fu et al., 2018). Parent firms' absorptive capacity, a firm's ability to recognize and acquire global assets and make further innovations, is essential for positive reverse knowledge spillovers (Cohen and Levinthal, 1990; Huang and Zhang, 2017). Chinese parent firms without state ownership but with stronger absorptive capability can gain greater and more sustainable productivity improvement (Li et al., 2017). Despite the positive impact on firms' productivity growth, the effects of China's OFDI on innovation quality are mixed. Further research needs to be conducted as to whether China's OFDI will boost its indigenous innovation capabilities.

The reverse knowledge spillovers of OFDI also contribute to domestic provincial economic growth through demonstration and imitation, labor movement, and backward and forward industrial linkages (Chen, 2018). First, when the parent company adopts new technology or knowledge from overseas subsidiaries to produce new products, local enterprises in the same industry will learn and imitate. This demonstration and imitation effect may intensify competition, encourage innovation and thus drive economic growth (Aitken and Harrison, 1999; Chen et al., 2013). Second, returnees who have worked in overseas subsidiaries may help the parent company to innovate, start their own businesses or gain employment at other enterprises. This can promote the dissemination and utilization of overseas knowledge. In addition, these returnees may also make fully use of the established overseas network to benefit local enterprises. For example, these networks may help firms open new export markets (Dai and Liu, 2009). Third, for upstream suppliers of the parent company, backward industrial linkages can push the suppliers to improve product quality; for downstream manufacturers of the parent company, when the parent company produces better quality intermediates, forward industrial linkages can improve the quality of intermediate products acquired by downstream firms. This can promote the accumulation of knowledge and technology (Javorcik, 2004) and boost regional economic growth.

As both are methods to serve foreign markets, one of the hot debates is whether OFDI substitutes or complements Chinese export to host economies. Most of the literature found that OFDI generally promotes Chinese export. Chinese OFDI not only expands domestic export, but also improves export product quality (Jing and Li, 2016). The reverse knowledge spillovers from OFDI help Chinese firms to upgrade their products. Resource-seeking OFDI saves input costs and thus Chinese firms can allocate more resources to R&D activities.

Such positive impact on Chinese export contributes to the positive effect of OFDI on home employment. China's OFDI generally increases home employment, regardless of ownership types and host countries' income (Li et al., 2016). Certain differences exist as a result of various investment motivations. Among the resource-seeking OFDIs, investments in mining industries do not show a significant effect on home employment, while investments in non-mining industries, such as the metallurgical industry, exhibit a positive effect, because it is likely that these investments are aimed to obtain intermediate inputs that need to be further processed in China.

One potential risk of large scale OFDI is the hollowing-out of domestic industries. Therefore, an important issue under discussion is whether China's OFDI crowds out domestic investment. If OFDI is mainly financed through domestic savings, it will generally reduce domestic investment, especially when domestic firms face severe financial market constraints. But different investment motivations can have different impacts on domestic investment (You and Solomon, 2015). Resource-seeking OFDI can provide input supplies, which in turn facilitate domestic production and stimulate domestic investment. Market-seeking and efficiency-seeking[20] OFDIs shift production abroad and replace exports, but at the same time may increase exports of intermediate inputs. Their impacts on domestic investment are still unclear. Technology-seeking OFDI helps firms establish their ownership advantages at home and abroad, which may benefit their long-term development and thus stimulate domestic investment.

In conclusion, the impact of OFDI on domestic investment can be negative, neutral or positive, depending on the home country features and OFDI motives. You and Solomon (2015) found a positive impact of OFDI on China's domestic investment and attributed it to China's abundant domestic savings, vast foreign exchange reserve and the role of the state.

2. Impacts on Host Economies

Beyond the impact on its domestic economy, OFDI is also an important channel through which China contributes to the world (Wang et. al, 2014; Wang and Li, 2017). For example, taxes paid by overseas Chinese enterprises totaled nearly US$30bn in

[20]Market-seeking OFDI aims to supply the local market or markets in adjacent areas. Efficiency-seeking OFDI takes advantage of various factor endowments, institutional arrangements and market structures by concentrating production in a limited number of locations to supply multiple markets (You and Solomon 2015).

2016 (MOFCOM-NBS-SAFE, 2017). Moreover, China has become an important source of foreign investment for Association of Southeast Asian Nations (ASEAN) countries (Table 3). While the surge in China's OFDI has attracted worldwide attention, rigorous assessment of its impact on host countries has only just begun.

Table 3. Rank of Chinese Mainland's Outward Foreign Direct Investment Flow in ASEAN Countries

Country	Rank	Origins of investment ranked in descending order of investment value
Singapore	12	US, Japan, Virgin Island, Cayman Island, Netherlands, UK, Bermuda, Luxembourg, Chinese Hong Kong, Switzerland
Indonesia	3	Singapore, Japan, Chinese mainland, Chinese Hong Kong, Netherlands
Lao PDR	1	Chinese mainland, Vietnam, Malaysia
Vietnam	4	Korea, Japan, Singapore, Chinese mainland, Chinese Taiwan
Myanmar	3	Singapore, Vietnam, Chinese mainland, Thailand, Chinese Hong Kong
Thailand	2	Japan, Chinese mainland, Netherlands, US, Australia
Cambodia	1	Chinese mainland, Chinese Hong Kong, Vietnam, Japan, Singapore
Malaysia	3	Singapore, Japan, Chinese mainland, Netherlands, US
Philippines	—	Netherlands, Australia, US, Japan, Singapore, Korea, Germany, UK
Brunei	—	UK, Netherlands, Japan, Singapore, Malaysia

Source: Tang (2018).

Notes: Singapore data is from 2015 and other countries from 2016. "Rank" indicates the rank of Chinese mainland's investment in the corresponding country. ASEAN, Association of Southeast Asian Nations.

The most substantial contribution associated with Chinese OFDI in host countries is the local employment opportunities that have been created. At the end of 2016, the total number of employees in Chinese OFDI firms in host economies was 2.87 million, of which 1.43 million (46.9 percent) were foreign employees (MOFCOM-NBS-SAFE, 2017). Job creation in Africa has been even more significant. Chinese firms created 38,417 jobs in Africa in 2016, more than three times the number created by US firms in Africa (Ernst & Young, 2017). In addition to employment opportunities, Chinese OFDI in Africa has also played a vital role in increasing Chinese imports from Africa, particularly the import of raw materials and manufactured goods (Kabia et al., 2016).

A large amount of China's OFDI has been made in infrastructure, such as transportation and electricity. This strengthens regional and domestic connectivity, and helps many developing countries overcome infrastructure bottlenecks (Lin, 2011). With China's domestic labor costs increasing, many Chinese enterprises are also investing in manufacturing in regions such as Africa and ASEAN countries, shifting some labor-intensive industries abroad, which not only creates jobs but also boosts local industrialization (Lin and Wang, 2014). Meanwhile, China has actively participated in the construction of industrial parks in developing countries. In Africa, nearly 100 industrial parks have been built or are under construction, among which more than 30 have commenced operation. In ASEAN countries, 7 out of 10 members currently host China's overseas economic and trade cooperation zones.

An important issue is whether China's OFDI can promote the economic growth of the host country. This depends on multidimensional complementarity between investment activity and the host economy, of which there are three channels (Fu and Buckley, 2015). The first is the development financing effect of host economies. China's OFDI is often made in infrastructure that lacks investment in Africa, thus meeting the need of the host country. The second is the knowledge transfer effect of host economies. This channel depends on the degree of the technology difference and the interaction between Chinese and local enterprises. The third is the competition and crowding out effect of host economies. In Africa, Chinese enterprises often invest in industries where local capital is scarce and is more likely to complement African local investment. In contrast, China's investments in Asia are often market-seeking or efficiency-seeking, and more likely compete with local companies. In Latin America, China's investment is concentrated in resources, where the industrial linkages are limited and the complementarity with local economies is weaker. Through these channels, China's OFDI has had a significant positive impact on Africa's per capita output growth. The effect is less significant in Asia and not significant in Latin America. However, Mitchell Omoruyi (2015) found that China's OFDI has no significant impact on Africa's per capita income growth. Thus, more research is warranted to reconcile these differences.

In developed countries, Chinese investors have gone well beyond the role of finance providers. He and Khan (2017) observed multiple types of upgrading in a subsidiary operating in the UK acquired by a Chinese firm.[21] After the acquisition, the subsidiary was able to expand its R&D expenditure, which not only led to sophisticated new products, but also to significant progress in fundamental research. Its business expanded from the marine drive sector to the railway and low carbon sectors. The subsidiary benefited not only from financial support from the Chinese parent firm, but also from its parent's key design know-how and improved market access to China.

Nevertheless, technology transfer to host countries from Chinese investors is still quite limited. According to a field study by Shen (2015) of five African host countries (Ethiopia, Liberia, Nigeria, Rwanda and Zambia), although three admitted that Chinese investment in their labor-intensive sectors had facilitated local industrialization, none of them gained substantial technology transfers from Chinese investments. However, Auffray and Fu (2015) found that despite linguistic and cultural barriers, positive managerial spillovers to African countries had been achieved by Chinese firms' localizing their managerial workforce.

[21]The Chinese firm is Times Electric, a prominent maker of traction systems for locomotives and a subsidiary of China Railway Rolling-stock Corporation (CRRC). CRRC is a Chinese publicly traded rolling stock manufacturer and one of the world's largest suppliers of rail transit equipment. Times Electric bought a 75 percent stake in Dynex in 2008 (https://www.dynexpower.com/company/key-data). Dynex is one of the world's leading suppliers of high power semiconductor products.

With more eligible enterprises investing abroad under the supervision of the Chinese government, greater contributions of technology transfer and industrial upgrade to host economies are expected. But the impact of any investment, whether Chinese or otherwise, is limited by the existing business environment in the host country. Poorly qualified local supplier networks naturally limit FDI linkages and spillovers, as no recipients are present. Similarly, improvements in human capital are limited by the absorptive capacity of employees (Kubny and Voss, 2010).

V. The Challenges Ahead

Despite the generally positive effects of Chinese OFDI at home and abroad reported by the existing literature, the large scale and rapid growth of OFDI from a large country like China has faced some challenges. In developed countries, Chinese enterprises are facing increasingly higher investment barriers aimed at curbing China's access to advanced technology. Therefore, some Chinese firms have turned their attention to developing countries where the investment risks are generally higher, subsequently impacting the safety and profitability of China's OFDI.

1. Investment Barriers in Developed Countries

The US is one of the major countries where Chinese OFDI has faced more obstacles. In the Section 301 investigation report released in March 2018, the US accused China of making investments driven by non-market factors, investing heavily in acquiring US companies and assets to obtain cutting-edge technology (USTR, 2018). The US is concerned that China's OFDI in the US will achieve China's industrial policy objectives and thus place a significant burden on US businesses.

The Committee on Foreign Investment in the United States (CFIUS) has, on many occasions, prevented Chinese firms from acquiring American high-tech firms in the name of "national security." The US issued new legislation to further expand the authority of CFIUS. On 13 August 2018, US President Donald Trump signed the National Defense Authorization Act, which includes the Foreign Investment Risk Review Modernization Act (FIRRMA). The new law stipulates that a transaction will be subject to scrutiny if it involves a country of special concern that has a strategic goal of acquiring critical technology or infrastructure that would affect US leadership in areas related to national security (CFIUS, 2018).

The FIRRMA includes a section specifically on Chinese investment. From its enforcement date in 2018 to 2026, CFIUS must submit a report on China's investment in the US every two years. The report should include a breakdown of investments from China by value, industry, investment type, and whether it is from the government. It should also report a list of companies incorporated in the US purchased through Chinese government investment, the number of US affiliates of entities under the jurisdiction of China, the total employees at those affiliates, and the valuation for any publicly traded US affiliate of such an entity. In addition, it should also examine whether the investments align with the objectives outlined in "Made in China 2025," including a comparative analysis of investment made by China to other countries in the US (CFIUS, 2018).

In addition to the US, many European countries, including France, Italy, Germany and the UK, have also expressed their concern over China's investment in high-tech manufacturing, energy and infrastructure sectors (UNCTAD, 2018). The measures under discussion include establishing an investment review mechanism similar to that of the CFIUS to examine investments that may weaken the technological advantages in Europe, in particular, investments involving security issues and where the technology has been subsidized.

2. Investment Risk along the Belt and Road Initiative

Because of the increasing investment barriers in developed countries, Chinese firms are expected to invest more in areas along the BRI. Compared to the overall decline of 29.4 percent in China's total non-financial OFDI in 2017, Chinese non-financial investments along the BRI dropped by only 1.2 percent, accounting for 12 percent in total, a 3.5 percent increase in its share.[22]

Investment risks along the BRI have also drawn widespread attention. According to the *2018 Report of Country-risk Rating of Overseas Investment* (Zhang and Wang, 2018), Singapore is the only country along the BRI that has low investment risk. Among the five indicators, namely economic risks, debt risks, political risks, social risks and relations with China, the BRI countries only outperform the average in terms of relations with China (Table 4). The other four indicators all show lower scores. In particular, the political risk scores of the BRI countries are 8.8 percent lower than the overall average, implying significantly higher political risks.

Table 4. Investment Risk Assessment Score Comparison between Belt and Road Countries and the Sample Average

	Overall score	Economic risk	Debt risk	Political risk	Social risk	Relations with China
Belt and Road Countries' Average	0.579	0.547	0.583	0.528	0.663	0.575
All Countries' Average	0.595	0.569	0.595	0.579	0.667	0.564

Source: Zhang and Wang (2018).

Note: Lower scores imply higher risks.

In addition to investment risks, the host countries have also expressed concerns over the BRI. One concern is the debt problem (Hurley et al., 2018). China's BRI will provide trillions of dollars in infrastructure financing to Asia, Africa and Europe. If the initiative follows Chinese practices to date for infrastructure financing, which often entails lending to sovereign borrowers, then China will face the risk of debt

[22]See http://www.fdi.gov.cn/1800000121_33_10060_0_7.html, cited August 2018.

distress in some borrower countries. Another concern is that the host countries still do not understand the actual content and nature of the BRI and suspect that there may be intentions beyond economic cooperation. For example, India is concerned that the BRI will increase China's political influence in the Indian Ocean (Chung, 2018).

China has clearly stated that the BRI adheres to the principle of engaging in extensive consultation, making joint contributions and sharing benefits, and that it is an open platform for cooperation among economies in the world. However, in the process of advancing BRI, some problems still exist, such as transparency of project information, policy coordination and communication, and concerns of project implementation. In order to promote the BRI, China should strengthen the focus of project's specific industries and areas, and Chinese firms should increase communication with relevant parties at all levels in host countries.

VI. Concluding Remarks

China is now playing a significant role in the international investment arena. Although China's OFDI has generally brought positive impacts at home and abroad, the criticism and investment risks still need to be seriously considered. Supervision should be strengthened, but Chinese policymakers need to respect the status of enterprises as the main players and let the market play the decisive role in allocating resources.

Developed economies will continue to be the preferred areas for Chinese OFDI because of their high asset values and low investment risks. However, with the persistence of trade frictions between China and the US and strengthening of the US national security review mechanism, Chinese investment in the US will gradually become difficult. Under the premise that enterprises are the mainstay of foreign investment, China can encourage capable enterprises to use their own advantages and development strategies and invest in other areas, such as Europe.

Although there is no national security review mechanism similar to the CFIUS in Europe, Europe is also increasingly concerned about China's investment in high-tech fields and critical infrastructure. Therefore, Chinese enterprises should fully consider the conditions and actual needs of different countries in Europe, particularly focusing on mutually beneficial cooperation with local governments and enterprises. Enterprises should make full use of China's expanding consumer market, integrate China's investment in Europe and European investment in China, help European investment partners establish links with the Chinese market, and enable Chinese investment to create more economic and social benefits for Europe.

As for developing countries, ASEAN is a potential destination for China to transfer labor-intensive industries and advantageous production capacity because of its abundant natural and labor resources. Chinese enterprises should take advantage of the opportunities offered in ASEAN countries and make arrangements to invest in these countries as a priority. However, Chinese enterprises' investment in some

ASEAN countries will be affected by the situation in the South China Sea. The way in which the Chinese government resolves the dispute over the South China Sea in the future will have a lasting and far-reaching impact on economic cooperation between China and ASEAN countries.

In the past 40 years, especially since the global financial crisis in 2008, China has witnessed rapid expansion of OFDI, and further lessons can be drawn from past experiences. Although some relevant government departments have irregularly held different forms of investment exchanges, the impact is still limited because of the lack of an institutionalized mechanism. Therefore, the Chinese government should develop a long-term experience sharing platform by establishing think tanks, clubs or committees for overseas Chinese entrepreneurs, or by allocating academic funds to support universities and think tanks to build a case database for China's OFDI experience and share it with investors. This could pave the way for more eligible Chinese firms to invest abroad.

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