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Foreign Direct Investment from Emerging Countries:

Chinese Investment in Latin America

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Abstract

A prominent feature of recent trends of FDI flows is emerging in the global economic landscape. Developing countries are surging as potential contributors of outward FDI. This new trend also reveals that investment from emerging countries to emerging countries is growing faster than that from developed markets to emerging. Perhaps the latter is the most extraordinary role that emerging countries are playing in the global economy. The emergence of China as a source of outward FDI is an interesting case study to follow. Investing in Latin America indicates that Chinese MNEs are willing to compete at the global level and to take on the challenge of the 'liability of foreignness', which carries an element of risk. Nonetheless, it is worth noting that outward FDI from China to Latin America is influenced by political considerations including home government mandate and host country governments' receptivity to Chinese investment. The purpose of this paper is to analyse this new phenomenon in the context of Sino Latin American relationships with a particular focus on China's inward investment into the Latin America region. From this analysis a model of government influence on FDI is developed.

1. Introduction

The participation of emerging countries[1] in FDI flows has varied considerably during the past 30 years. The importance of FDI in economic growth has led emerging markets to increase their efforts to create a better climate for investment. It is conceded that FDI has the potential to generate jobs, enhance exports and contribute to long-term economic development (World Bank, 2004). FDI inflows to emerging markets have increased considerably since the 1980s, reaching 36 percent of the world FDI inflows in 2004 (UNCTAD, 2005a p.7). Although there are many reasons behind these changes, they are mainly related to the economic dynamism of emerging markets in the global economy over the last decades. Emerging markets have played an important role in the rapid increase of foreign investment (Meyer and Estrin, 2004).

Another prominent feature of recent trends of FDI flows is emerging in the global economic landscape. Developing countries are surging as potential contributors of outward FDI. This new trend also reveals that investment from emerging countries to emerging countries is growing faster than that from developed markets to emerging markets (UNCTAD, 2004a p.3). Moreover, current trends suggest that emerging markets are growing faster as investors than the developed countries as a group. Emerging countries are

[1] In principle, this paper uses the term 'emerging countries' as synonymous with 'developing countries'.

also becoming potential consumers of merchandises produced by other emerging countries (UNCTAD, 2004b). All of these factors suggest that emerging countries are increasing their role in the global economy and strengthening South-South cooperation, marking the beginning of a new economic order.
In relative terms, emerging markets have increased their share of FDI outflows from 1.29 percent in the 1970s to 11.10 percent during the 1990s, while FDI outflows from developed countries had decreased in proportion from 98.69 percent during the 1970 to 88.61 percent during the 1990s. During 2002-2004, the ratio of FDI outflows to gross fixed capital formation in Singapore, Hong Kong, Taiwan, China and Chile ranked higher than those of the United States, Germany and Japan (UNCTAD, 2005a p.9). Singapore, for instance, scored a ratio of 25 percent compared to the 8 percent obtained by the United States (UNCTAD, 2005a p.9).

The increase of FDI outflows from emerging markets to emerging markets has been driven by a combination of intense competitive pressure and favourable policies for FDI in emerging markets. Traditionally, much of the FDI from emerging markets has been directed to emerging markets with geographical proximity and similar economic and cultural backgrounds; for example, a great proportion of FDI outflows from Asia went to China and other Southern Asian countries (UNCTAD, 2005a), with the exception of South Korean investment in Europe and North America. Similar geographical strategies to the Asian MNEs were adopted by Latin America, the South-East European countries, the Common Independent States group and African multinationals. In recent years, however, MNEs from emerging markets have moved towards other emerging markets outside their regions. In the last couple of years, China has emerged as an important investor in Latin America. Although FDI from China to Latin America is small, it is estimated that in 2004, half of the Chinese investments were directed to the Latin American countries (UNCTAD, 2005a, p.58).

The pull factors of Chinese investment to Latin America are based on stable supplies of natural resources to support China's added value industries (Gottschalk and Prates, 2005). Latin America can also offer large markets for China's manufacturing exports which accounts for about 90 percent of China's total exports (Loser, 2005). Chinese investment has been mainly directed to the oil and mining industry in Peru, Chile, Mexico, Venezuela and Brazil (IDB, 2004). China's growing demand for commodities has also led to closer in trade relations with Latin America.

The increased participation of China in the global economy is unprecedented. Economic prosperity has placed China as a major economic and political player in the world (Brookes, 2005).The emergence of China as a source of outward FDI is an interesting case study to follow. In 2003, China became the 6th largest investor among the emerging countries. The purpose of this paper is to analyses this new phenomenon in the context of Sino Latin American relationships with a particular focus on China's inward investment into the Latin America region.

The remainder of this paper is organised as follows: The next section assesses the prominent feature of recent trends of FDI flows in emerging markets. Data on FDI inflows into the emerging countries are briefly considered. The nature of FDI flows and their determinants are examined. Recent trends in FDI are examined on a region by region basis. The next section focuses on the specific case of South-South flows involving China FDI into Latin America. In the two following sections, these flows are analysed in the light of the major internationalisation theories and a number of conclusions are drawn.

2. Foreign Direct Investment and Emerging Countries

The rapid expansion in the financial markets has emphasized the importance of private capital flows in generating the growth of the global economy. During the past two decades, emerging countries have particularly focused on attracting foreign investment. FDI has been a central component of policies of emerging countries. It is conceded that foreign investment has a large multiplier effect in the host country

(IMF, 2003). As a result, during the 1990s, FDI became the single largest component of capital flows to emerging markets. At present, FDI continues to be the largest component accounting for 51 percent all capital flows to emerging countries (UNCTAD, 2005a p.7).

As displayed in Table 1, in 2002 emerging markets received an important proportion of FDI from developed countries. However, a significant proportion of FDI into emerging markets has emanated from emerging markets. The Asian region stands out amongst the other emerging regions in that the proportion of total FDI received from developed countries in 2002 accounted for 38.2 percent, while 53.4 percent came from emerging countries. Similarly, intraregional investment in Asia is also higher than the other regions, 37.7 percent of FDI was Asian. Latin America obtained 72.7 percent of FDI from developed countries and 16.4 percent from emerging countries. Intraregional Latin America FDI accounted 14.9 percent. Africa was the region that obtained the highest proportion (87.7 percent) of FDI from developed countries and the smallest proportion (12 percent) of FDI from emerging countries. Intraregional investment was also small with only 2.9 percent of FDI coming from the region.

The *World Investment Report 2005* introduced a new group of countries into the category of world economies. This group is composed of South-East European countries and the Commonwealth Independent States (CIS)[2].

Table 1: Foreign Direct Investment to Emerging Countries 2002

In percentage

Source of FDI	**Destination**			
	Latin America	***Asia***	***Africa***	***Central Estern Europe***
Developed Countries	72.7	38.2	87.7	87.9
Emerging Countries	16.4	53.4	12	5.4
Intra-regional investment				
Latin America	**14.9**			
Asia		**37.7**		
Africa			**2.9**	
Central Estern Europe				**2.9**

Source: UNCTAD (2005), 'Policy Issues Related to Invetsment and Development' Table 3

2.1. FDI Outflows from Emerging Countries

Although developed countries continue to be the most significant source of FDI in emerging counties, Table 2 shows that the share of FDI outflows from emerging countries has increased from an average rate of 1.29 percent obtained during the 1970s to 11.10 percent gained during the 1990s. The dynamic cooperation that started in the previous decade stimulated the growth of bilateral investment agreements (BIT) among emerging countries. The number of BITs increased from 44 BITs in 1990 to 635 BITs in 2004, accounting for 28 percent of worldwide BITs (UNCTAD, 2004d). Emerging markets have also created Outward Investment Agencies (OIA) to promote and facilitate FDI in other emerging countries.

[2] South-East European countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania, and Serbia and Montenegro.
Commonwealth Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan. Turkmenistan discontinued permanent membership in August 2005.

This progress suggests MNEs from emerging countries are building up financial and technological capability to compete in the global market (UNCTAD, 2005b).

Table 2: FDI outflows by Regions and Major Countries

Million of dollars

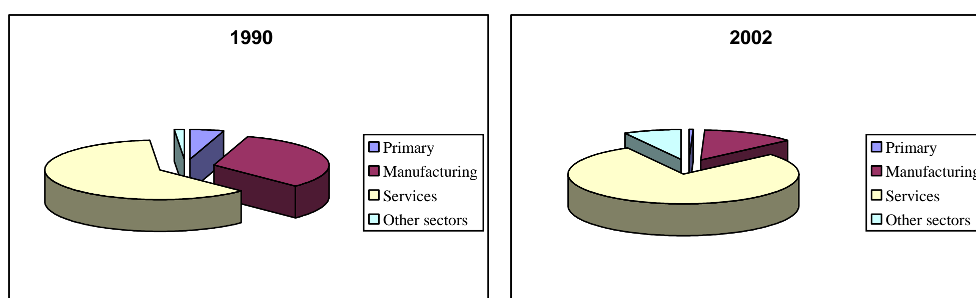
	1970-1979	%	1980-1989	%	1990-1999	%	2000-2004	%
World	**282634.1604**		**933157.5263**		**4189680.259**		**3981974**	
Developed countries	**278926.5461**	**98.69**	**876294.8373**	**93.91**	**3712545.838**	**88.61**	**3569524**	**89.64**
Developing countries	**3649.612262**	**1.29**	**56750.09702**	**6.08**	**465170.1399**	**11.10**	**381779**	**9.59**
South-East Europe and the Comm	**58.00206**	**0.02**	**112.59199**	**0.01**	**11964.28106**	**0.29**	**30671**	**0.77**
Latin America and the Caribbe	***1543.296***	***0.55***	***8518.78***	***0.91***	***113774.4***	***2.72***	***122538***	***3.08***
Brazil	864.5	0.31	2241.3	0.24	9245	0.22	12226	0.31
Mexico	2.6	0.00	816.6665537	0.09	5709.307536	0.14	10342	0.26
Chile	20	0.01	126.7	0.01	9264.598074	0.22	8767	0.22
Panama	383.7	0.14	2708.702144	0.29	10412.56901	0.25	6665	0.17
Venezuela	0	0.00	781.33334	0.08	5033	0.12	2721	0.07
Colombia	117.3	0.04	437.28	0.05	2663.081343	0.06	2278	0.06
Argentina	-83	-0.03	-64.40111782	-0.01	13754.32132	0.33	1528	0.04
Asia and the Pacific	***89.3506***	***0.03***	***42964.91***	***4.60***	***329866.6***	***7.87***	***255759***	***6.42***
Hong Kong, China	0	0.00	11731	1.26	164957	3.94	133405	3.35
Singapore	525.26	0.19	2153.87	0.23	45588.0425	1.09	46263	1.16
Taiwan Province of China	25.10001	0.01	12146	1.30	34841	0.83	29894	0.75
Korea, Republic of	98.798	0.03	3980.3	0.43	29111.6	0.69	18253	0.46
China	0	0.00	3625	0.39	23229	0.55	11972	0.30
Africa	***1207.9653***	***0.43***	***5266.4102***	***0.56***	***21529.057***	***0.51***	***3481***	***0.09***

Source: UNCTAD Foreign Direct Invetsment Statistics 2005

Asia and Latin America have been the major suppliers of foreign investment from emerging countries; these include those countries that have greatly benefited from FDI inflows (see Table 4). The largest contributing region of FDI outflows is Asia. FDI outflows in this region have also been growing faster than the rest of the emerging regions. During the 1970s, Asia and the Pacific region contributed 0.03 percent of world FDI, 4.6 percent in the 1980s and during the 1990s FDI outflows reached 7.87 percent of total FDI. During the period 2000-2004, the proportion of outflows reached 6.28 percent. Major Asian investors are Hong Kong, Singapore, Taiwan, South Korea and China. India is also expected to play a role as an investor in the near future.

The second largest emerging region source of FDI outflows is Latin America, contributing 1.36 percent of total FDI outflows. Mexico, Chile, Panama, Venezuela, Brazil and Argentina are amongst the most important countries that contribute outward FDI.

Figure 1 reveals that the composition of outward FDI from emerging countries has changed over the period 1990-2002. In 1990, the primary sector accounted for 4.7 percent, manufacturing 32.9 percent, services 61.1 percent and, other unspecified sectors 1.3 percent. In 2002, the primary sector accounted for 0.5 percent, manufacturing 13.2 percent, services 78.1 percent and other sectors 8.1 percent (UNCTAD, 2005b). Emerging countries are also growing as major importers and consumers of commodities produced in developing countries (UNCTAD, 2004c p.9)



Source: UNCTAD (2005), 'Policy Issues Related to Invetsment and Development' Annex Table p.18

Fig. 1: Estimated Outward FDI stock from Emerging Countries by Sector 1990 and 2002

2.2. FDI Inflows in Emerging Countries

The increase of FDI inflows to emerging markets has been characterised by three prominent features. The first feature is that FDI flows directed towards developing countries have been aimed at a limited number of countries (Addison and Heshmati, 2003). The competitiveness of the market site for FDI has been strong among countries that have used different mechanisms to make a country an attractive location for FDI (Blomström M., 2001). Trends and determinants of FDI have changed significantly. For instance, Latin America traditionally regarded as an attractive location for FDI, started to lose its attractiveness during the 1980s, while Asia emerged as an important recipient of FDI inflows in the developing world. Africa has endured similar experiences to Latin America, while Central and Eastern Europe have increased their share of FDI inflows during the boom of the 1990s (see Table 4).

The second most prominent characteristic is that FDI to emerging markets has largely attracted FDI in the form of M&A due to the process of privatisation of state firms that many emerging countries have gone through since the 1980s (IMF, 2003). Therefore, in many countries, 'greenfield' investments that create new plants that increase productive capacity and provide greater national value-added have been absent. In Latin America, for example, FDI spillovers have been mostly missing (ECLAC, 2003 p.20; ECLAC, 2004, p.29). Finally, emerging markets have moved from traditionally attracting resource-seeking investment to attract efficiency-seeking FDI. A large number of studies have found that education and training have positioned emerging countries as attractive locations for foreign investment. More recently, market-seeking FDI has been increasingly taken place in emerging markets; obvious examples are China, India and Brazil.

2.2.1. Determinants of FDI in Emerging Countries

Since the 1980s, developing countries have implemented macroeconomic policies; however, research shows that macroeconomic policies have fallen short as the determinants of FDI have enlarged. According to the Climate Investment Survey 2000-2003, there are 19 factors that influence the investment climate for FDI (see Table 3). Nonetheless, traditional factors (natural resources, country location and infrastructure) continue to remain important in balancing benefits, costs, and risks associated with doing business in the host country (Nunnenkamp and Spatz, 2002).

Table 3: Determinants of FDI for the firm's perspective

Market Factors
Access to land
Access to financing
Cost of financing
Skills and education of available workers
Government Services
Tax rates
Tax administration
Customs and trade regulations
Labour regulations
Business licensing and operating permits
Stability and Crime
Economic and regulatory policy uncertainty
Macroeconomic instability
Corruption
Crime, theft and disorder
Legal system/conflict resolution
Infrastructure and informality
Telecommunications
Electricity
Transportation
Anti-competitive or informal practices

Source: World Bank, 'Climate Investment Survey 2000-2003'

Countries have also encouraged foreign investment through industrial policies (Blomström M., 2001). For instance, education and training have become new and important determinants of FDI (Borensztein, De Gregorio and Lee, 1998; Blomström M., 2001; Zhang, 2001; Addison and Heshmati, 2003).MNEs moved to Malaysia, Singapore, Taiwan and China because of their educated and trained population (Addison and Heshmati, 2003).; although it must be noted that these countries have greatly benefited from what is called 'agglomeration economy' (Cheng and Kwan, 2000).

Research also identified institutional features (the degree of political stability, government intervention in the economy, trade openness, property rights' legislation, red tape and tax systems) as the new and significant determinants of FDI. These variables seem to have strong weight among the determinants of FDI in developing countries (De Mello, 1997; Rodrik, 2002). Kolstad and Villanger (2004) found that by improving political rights and civil liberties, the attractiveness of the market site for FDI substantially increases. Studies have also highlighted crime and corruption as important deterrents of FDI, as crime and corruption increase the level of risk to operations and costs (Mauro, 1995; Oman, 2000; Church, 2002); nevertheless, despite corruption some countries were able to attract foreign investment (Kolstad and Villanger, 2004).

2.2.2. Recent Trends of FDI to Emerging Countries

Despite the rapid increase of FDI flows to emerging markets, the recent trends of FDI among emerging countries are uneven. From Table 4 it is clear that the trends of FDI inflows to emerging markets have considerably changed since the 1980s. In the 1970s, Brazil received 20 percent of FDI inflows directed to the developing world representing the largest share of such inflows. During the same period China received zero percent. During period 1980-1999, Brazil share of FDI inflows to the developing world had fallen considerably while China became the favourite location for FDI (attracting about 24.19 percent of total foreign investment directed to emerging markets during the 1990s). During period 2000-2004, however, both Brazil and China increased their share of FDI inflows to the developing world. The reasons behind these changes are closely related to the changes that the global economy has gone through. Nonetheless, new determinants of FDI in emerging markets have been the main factors influencing the behaviour of these trends.

Table 4: FDI inflows to Developing Regions and Major Countries

(Millions of dollars)

Region/economy	1970- 1979	%	1980-1989	%	1990-1999	%	2000-2004	%
World	**244 121**		**936 330**		**4 040 622**		**4 219 336**	
Developed countries and territories	**180 389**	**73. 89**	**722 956**	**77. 21**	**2 788 101**	**69. 002**	**3 100 554**	**73. 484**
Developing countries and territories	**63 732**	**26. 11**	**213 296**	**22. 78**	**1 200 309**	**29. 706**	**1 026 116**	**24. 319**
South-East Europe and the Commonwealth of Independ		**.**	**78**	**. 01**	**52 212**	**1. 292**	**92 666**	**2. 196**
Developing countries and territories	**63 732**		**213 296**		**1 200 309**		**1 026 116**	
Africa	**11 242**	**17. 64**	**21 622**	**10. 14**	**64 772**	**5. 396**	**78 742**	**7. 674**
Latin America and the Caribbean	**32 695**	**51. 301**	**74 413**	**34. 89**	**439 216**	**36. 592**	**351 580**	**34. 263**
Argentina	1 306	2. 05	5 844	2. 74	68 131	5. 676	20 874	2. 034
Brazil	12 698	19. 92	17 214	8. 07	99 217	8. 266	100 136	9. 759
Chile	591	. 93	4 376	2. 05	32 467	2. 705	23 598	2. 3
Venezuela	- 1 048		1 563	. 73	21 426	1. 785	13 343	1. 30
Mexico	6 015	9. 44	23 873	11. 19	84 258	7. 02	87 520	8. 529
Asia and Oceania	**19 796**	**31. 06**	**117 261**	**54. 98**	**696 322**	**58. 012**	**595 794**	**58. 063**
China	0	.	16 187	7. 59	290 427	24. 196	**254 470**	**24. 799**
Hong Kong, China	2 676	4. 2	21 333	10. 002	90 326	7. 525	143 041	13. 940
Korea, Republic of	1 094	1. 72	3 305	1. 55	24 169	2. 014	26 730	2. 605
Taiwan Province of China	659	1. 03	4 717	2. 21	14 591	1. 216	12 833	1. 251
India	373	. 59	1 048	. 49	15 166	1. 264	18 775	1. 830
Malaysia	3 262	5. 12	9 647	4. 52	48 158	4. 012	14 642	1. 427
Singapore	3 013	4. 73	19 068	8. 94	84 669	7. 054	61 818	6. 024
Thailand	798	1. 25	5 102	2. 39	31 824	2. 651	11 199	1. 091

Source: UNCTAD Foreign Direct Invetsment Statistcis 2005

Latin America and the Caribbean Region

Latin America received 51.3 percent of FDI inflows going to the developing world, during the 1970s. In the 1980s the share fell to 34.9 percent. The region traditionally has attracted resource-seeking FDI. Natural resources such as petroleum, gas, and the mining industry have been the main pulling factors of FDI during the last 100 years (ECLAC, 2002). During the period 1970-1980, the price of raw materials in the international market started to fluctuate bringing devastating consequences to the region. Yet, the decline of the share of FDI inflows to Latin America also responded to the passivity of the policies towards FDI compared with those implemented by other competitors in the emerging world.

Resembling the characteristic of FDI inflows in the developing world, FDI flows into Latin America have been largely restrained to five countries (Brazil, Mexico, Argentina, Chile and Venezuela) that have attained 69.82 percent of total FDI going to the region during the period 2000-2004. Brazil and Mexico have been traditionally important markets for FDI, while Argentina, Chile and Venezuela have emerged since the 1990s. Brazil receives the highest percentage of FDI in the region, attracting both resource-seeking and market-seeking FDI. The size of its domestic market has been targeted by the food and beverage industry followed by investment in the telecommunications sector. Mexico is the second largest recipient of FDI in the region, attracting the textile, electronic and automotive industry. At present, Mexico faces a competitive challenge from China and other Central American countries in the manufacturing sector (ECLAC, 2004). Argentina has been greatly affected by the financial crisis of 1999, although in the last few years, Argentina has started to recover. Chile is emerging as a potential market for FDI. Chile was one of the few countries in the world that increased its FDI share. Venezuela was the other major FDI receptor during the 1990s; however, the situation has changed much in the last few years. The political situation of the country influenced negatively the investment climate (ECLAC, 2004).

Asia and the Pacific Region

During 1980s, Asia and the Pacific were the largest recipients of FDI in the developing world, obtaining 54.98 percent of total foreign investment directed towards emerging markets. There are two main characteristics of FDI in the region. First, unlike Latin America where privatisation played a major role in attracting FDI, most of the investment is in the form of "greenfield" investment (Athukola and Rajapatirana, 2003, p.619). Secondly, FDI remains concentrated in eight countries that attracted during the period 2000-2004, 91.3 percent of FDI inflows into the region (see Table 4). China and Hong Kong attracted most of the FDI in the region, followed by Singapore, the Republic of Korea and India.

Efforts to create a favourable climate for FDI continue in the Asian countries. Although the manufacturing sector has become of vital importance in the region, receiving about 44 percent of FDI (UNCTAD, 2004a), Asian countries are targeting FDI in services. The ASEAN Framework Agreement on Services signed in 1992 has been the basis of the effort to eliminate restrictions on trade in services. Other favourable policy measures were introduced recently, such as the bilateral investment treaties (BITs) and double taxation treaties (DTTs).

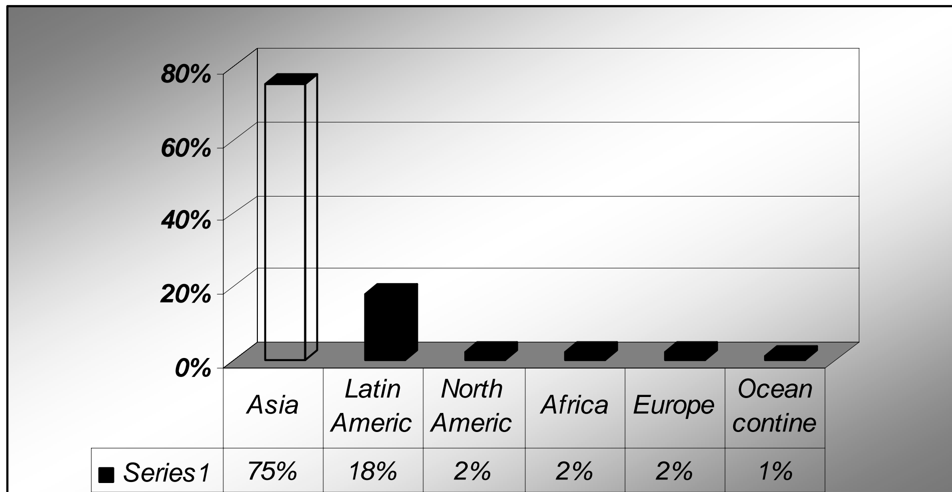
Africa Region

In spite of the rapid increase of FDI flows in recent times, Africa has been relatively unsuccessful in attracting foreign investment. Although in 2004 FDI flows to Africa increased by 39 percent, in 13 countries inflows fell. It has been frequently argued that African countries have a hostile environment to FDI (Jenkins 2002). Most African countries have made strong efforts to bring macroeconomic stability, but adequate infrastructure, skilled labour and high productivity continue to be scarce in the region. The increase of FDI inflows in 40 African countries in 2004 conforms to the demand for natural resources, plus the high prices for oil, diamonds, gold and platinum (UNCTAD, 2005a).

3. Chinese Investment in Latin America

During the last three decades, there has been an extraordinary transformation in the economy of China. The economic reforms of the 1970s and the incorporation of China as a member of the World Trade Organisation in 2001 have led to the emergence of an economy based on greater openness and competition. A notable aspect of China's international openness is the rapid increase of FDI inflows that represented of 0.0 percent of FDI outflows in the 1970s, 7.6 percent in the 1980s, to 24.2 in the 1990s and 24.8 during the period 2000-2004 (see Table 4). An important aspect of its economic competitiveness is the fast increase of its exports that grew at an average rate of 5.7 percent in the 1980s, 12.4 percent in the 1990s and 20.3 percent during 2000-2003 (IDB, 2005). The contribution of FDI and increase of exports in the economy of China is reflected in the impressive growth of the GDP. In the 1970s the average rate was 6.0 percent while in the 1980s it was 9.9 percent, 10.3 percent in the 1990s and 8.2 percent during 2000-2003 (IDB, 2005).

Its extraordinary economic growth has led China to emerge as a source of outward FDI. Although China is in its infancy as a foreign investor, in 2003, China became the 6th largest investor among the emerging countries (UNCTAD, 2004a). As Figure 2 shows the largest recipient of China's FDI is Asia; cumulative FDI by the end of 2004 to this region has accounted for 75 percent. Latin America follows as the second most important market site for FDI from China reaching 18 percent. North America, Africa and Europe each obtained 2 percent and the Ocean Continent received 1 percent of cumulative FDI from China by the end of 2004.



Source: Ministry of Commerce, China State Bureau of Statistics 2005

Fig. 2: Cumulative FDI from China by the end of 2004

The emergence of China as a global investor has been attributed to the Chinese government (APFC, 2004). In 1999, the Ministry of Foreign Trade and Economic Cooperation together with other Chinese departments launched the 'Going Global' scheme to support the internationalisation of indigenous enterprises. Policies were designed to encourage Chinese firms to invest and set up factories overseas. Among the policies and measures implemented were the establishment of the *Database of Foreign Countries' Investment Environments*, which provides relevant information about investment opportunities, market research and other types of necessary information in the assessment of foreign investment. The scheme also provides training programmes given by 162 training centres. The training emphasises international strategies and languages, especially Spanish and French. These policies and measures were adopted in line with the instruction made by the Party's General Secretary Jiang Zemin:

> *'At the time of expanding export energetically, we shall, with proper steps and under the leadership, organize and support a batch of enterprises with advantages and strength to go abroad to make investments and set up factories there, particularly in Africa, the Middle East, East Europe and South America*'.

A variety of reasons have been offered for the emergence of Chinese FDI. These include the support of exports, the expansion of market presence, the acquisition of foreign skills and the establishment of local distribution networks. The increasing financial strength and the growing exposure of Chinese companies to International Business have also been suggested as explanations. Increased domestic competition and as in the case of the bicycle industry, the need to relocate mature industries to lower wage sites are also counted as factors. Finally, the goals of building international brands, accessing advanced technologies and establishing R&D centres in developed countries help to explain the rise of Chinese FDI.

China has been seeking investment opportunities in Latin America to maintain its added value industries, especially targeting Brazil, Peru, Chile and Venezuela as stable suppliers of petroleum and minerals (IDB, 2004). Brazil has received FDI from China in the steel and agricultural industries, Chile and Peru have attracted investment in the copper industry, and Venezuela obtained investment in the petroleum industry (Gottschalk and Prates, 2005). Mexico has also awakened Chinese investors' interest for its access to the United States' market (Dumbaugh and Sullivan, 2005). China has also invested a considerable proportion of FDI in the Virgin Islands, Cayman Islands and the Bahamas (see Table 5). These three Latin American

islands, known as financial havens, have been high on the list of China's FDI so that some critics have questioned Chinese FDI figures (FDIM, 2003).

Table 5: China FDI outflows to Latin America

(thousand dollars)

	2003	2004
Argentina	1000	1120
Bahamas		43560
Brazil	6670	6430
Cayman Islands	806610	1286130
Chile	200	550
Colombia		4530
Cuba	1430	
Ecuador	270	300
Honduras	130	1380
Mexico	30	27100
Panama	10	100
Peru	120	220
St. Vincent Grenadines	5600	
Suriname	650	1130
Uruguay	550	
Venezuela	6220	4660
Virgin Islands	209680	385520

Source: Ministry of Commerce, China State Bureau of Statistics 2005

Chinese investment directed to Latin America has grown rapidly in the last couple of years. This trend promises to continue growing. In 2004, China's FDI to Latin America accounted for about 50 percent of total Chinese foreign investment (UNCTAD, 2005a) and materialised into 300 projects worth $4.52 billion (Siwei, 2005). This represents a major increase in the proportion of Chinese FDI going to Latin America. China has been signalling its intent to expand its investment programme to Ecuador, Colombia and Bolivia in the extraction of oil and natural gas (Funakushi and Loser, 2005). In his recent official visit to Latin America (November 2004), President Hu Jintao promised to invest $100 billion in the region over the next decade, signing 39 agreements with Argentina, Brazil and Chile (Landau, 2005). China has endeavoured to invest heavily in Brazil, Argentina and Venezuela; Argentina alone will obtain $20 billion over the next 10 years (Dumbaugh and Sullivan, 2005).

Strong trade relations are also emerging between China and Latin America. Latin American exports to China have expanded from 0.7 percent of total exports obtained in 1998 to 2.9 percent in 2003. The main trade partners are Brazil, Mexico, Chile, Argentina, Peru and Panama. Brazil and Argentina supply mainly soybeans; Chile and Peru export cooper and iron ore; Ecuador, Mexico and Venezuela supply oil (Gottschalk and Prates, 2005). China's exports to Latin America have also expanded from 0.5 percent obtained in 1998 to 4.8 percent in 2003, leaving in deficit the Chinese balance of trade with the region. China mainly supplies Latin America with manufacturing products such as textiles, toys, apparel and electronic components (Loser, 2005).

In 2004, China signed trade cooperation agreements with Argentina, Chile and Brazil, its main sources of imports from Latin America (Economist, 2004). In November 2005, China concluded its first bilateral free trade agreement when it agreed with Chile to cut almost all tariffs in their bilateral trade to zero within ten years from July 1, 2006. The Chinese government is also pursuing further negotiations with

Peru, Ecuador, Bolivia, Colombia and Venezuela, countries that supply energy, since China is the second biggest consumer of oil after the United States (FTIU, 2005).

Table 6: China's Trade with Major Latin American Partners

In percentage

Region/Country	*Exports* 1998	*Exports* 2003	*Imports* 1998	*Imports* 2003
Latin America	***0.7***	***2.9***	***0.5***	***4.8***
Brazil	1.8	6.2	1.8	4.4
Mexico	0.1	0.6	1.5	5.5
Chile	2.9	8.6	3.8	6.6
Argentina	2.5	8.4	3.6	5.2
Peru	4.1	7.7	1.3	3.5
Panama	0.7	1.2	0.4	9

Source: IMF Direction of Trade Statistics, obtained from Funakushi and Loser (2005) Table 1

Despite the major cultural, historical and political differences that exist between China and Latin America, economic co-operation is getting stronger. The visit of President Hu in 2004 was seen in Latin America as an important step to consolidate economic cooperation with the ‘Giant’. Moreover, the visit from the Vice-president Zeng Qinghong to Mexico, Peru, Venezuela, Trinidad and Tobago, and Jamaica in January 2005 has shown China’s commitment to cooperate with Latin America (Siwei, 2005). To broaden cooperation, China has also signed collaboration agreements in mineral exploration, aerospace, technology, science, satellite and nuclear energy with Chile, Argentina, Peru and Brazil (MCPRC, 2004). More recently, the China-Latin America Friendship Association was launched to strengthen these new-fangled ties. This suggests that China has moved from being a strong competitor of the Latin American countries to being both competitor and partner in the global economy.

4. Analysis of Outward FDI from China to Latin America

The surge of foreign direct investment in recent years has generated a growing body of literature in FDI; however, the theory of internationalisation and the eclectic paradigm have been widely utilized. While the theory of internationalisation focuses on entry modes and competitive advantages of a firm, the eclectic theory incorporates a holistic explanation of why a firm moves abroad, suggesting that location-specific advantages arise from using endowments that are tied to a particular location (Dunning, 1998).

4.1. Theory of Internationalisation

The most prominent model of internationalisation among the traditional models of internationalization is the Uppsala-model (Saarenketo, 2003). This model is based on the *behavioural theory of the firm* and has been developed by Johanson and Vahline (1977). The Uppsala-model focuses on the different stages of the internationalisation process of a firm, suggesting that a firm with a competitive advantage in its domestic markets will seek to move abroad to exploit its competitive advantages. This model entails that lack of knowledge of foreign markets is the main obstacle of a firm to operate in foreign markets, but the firm will gain knowledge through the process of internationalisation via exports. The Uppsala-model has been widely used to test the internationalisation process of large and small-medium size firms (SMEs) gathering approvals and disapprovals of its validity (Bjorkman and Forsgren, 2000).

One of the most important contributions of the internationalisation theory is the differentiation of the five phases of the internationalisation process of a firm through the process of *incremental learning* (Saarenketo, 2003). At the first stage, the firm is not involved in exports but is gaining knowledge of a foreign market. The second stage of the firm's internationalisation is characterised by occasional exports through an agent. In the third stage of the process of internationalisation the firm is involved with foreign markets through agents and subsidiaries. In the fourth stage, the firm establishes a subsidiary in a foreign market. At the final stage the firm is producing in a foreign market (Johanson and Wiedersheim-Paul, 1975).

According to the Uppsala-model, firms usually invest in a particular country or region with similar characteristics to its domestic market (Coviello and Munro, 1999). Through the process of *incremental learning,* firms gain experience and expand their business into markets with greater 'psychic distance' (idiosyncratic differences), including geographical distance (Hashai and Almor, 2002). On the other hand, a firm that possess little experience in the international market invests in near 'psychic distance' markets (Johanson and Vahline, 1990).

In recent years, the internalisation model has been challenged by different scholars (Coviello and Munro, 1995; Almor, 2000; McNaughton, 2000; Hashai and Almor, 2002). While the Uppsala-model implies that the process of internationalisation of a firm is based on incremental learning, recent studies have shown that the 'global phenomenon' have driven firms with little experience on foreign markets to penetrate and integrate with other foreign markets. This has introduced the term "Born global" into the literature (Hashai and Almor, 2002).

4.2. The Eclectic Paradigm

The eclectic theory of John Dunning (1988, 1993) addresses the strategies and aspects of production of multinational enterprises (MNEs) in a foreign market. Dunning's theory suggests that FDI is a function of ownership-advantage (O), location-advantage (L), and internalisation-advantage (I). The model argues that a MNE invests when these three conditions are satisfied. Firstly, in order for FDI to be beneficial, the MNE must own a unique competitive advantage in a foreign market. This parameter will differ depending on the characteristics of the firm and the market. Secondly, by locating investment in a foreign market, returns must be higher that those obtained in the domestic market. Finally, the MNE must benefit from controlling the foreign business activity rather than hiring an independent local firm.

The framework of the model is particularly useful for analysis and explaining the motivation and location of MNEs' activities in foreign markets. The ownership-specific advantage explains whether the firm will have success or not in the particular foreign market. According to the theory, a MNE must posses an exclusive asset in the chosen foreign market that is tied to income generating resources. The internalization-advantage expounds the modes of entry that a MNE may use in the specific foreign market, while location-advantages help to explain 'where' investment is going to take place. The eclectic theory notes that MNEs will invest in the most advantageous locations (Sethi, 2003) that result from combining its own unique assets with a particular market site.

The framework of the eclectic theory identifies FDI strategies and categorizes these by market expansion seeking strategies, resource seeking strategies and efficiency seeking strategies. Market-driven FDI aims to penetrate new markets and to avoid restrictions on trade, such as tariffs. The determinants of this type of FDI are market size, the growth of the market, access to other markets and the structure of the market. Resources seeking investment is mainly motivated by the availability of raw materials and minerals, low-cost labour, the availability of skilled labour and the quality of physical infrastructure. The third type of FDI that motives investors to move into a specific country is efficiency seeking FDI which focuses on the

productivity of labour, the cost of resources, input costs and participation in regional integration frameworks (Kinoshita and Campos, 2004).

4.3 Assessing Outward FDI from China to Latin America

Outward FDI from China to Latin America is perceived as a new phenomenon. In the last two years, China has deepened its relationship with Latin America through strong investment growth. Although Chinese investment in the region is relatively small, this trend has shown to be an extraordinary one, worthy of reflective examination from both the theoretical and international business viewpoints. Outward FDI from China to Latin America conforms to the stages of the internationalisation theory. The evolution of internationalisation of Chinese firms to Latin America has a trajectory background based on the evolution of trade. Interestingly, two features of outward FDI from China to Latin America challenge the conventional understanding of internationalisation. These features are 'psychic distance' and the political aspect of the internationalisation of Chinese MNEs.

The Eclectic Paradigm of internationalisation explains that firms invest in locations tied to income generating resources despite idiosyncratic variations (Sethi, 2003 p.316). According to the Uppsala-model of internationalisation of FDI, firms invest in countries or regions with similar idiosyncratic features. Mainstream theories of internationalisation assume that dissimilarity in cultural, linguistic, institutional and developmental levels between the investor and the host country increases the cost of doing business which finally results in a competitive disadvantage for the MNE (Child and Rodriguez, 2005 p. 385).

In the case of China and Latin America, apart from the common denominator that both belong to the developing world, the 'psychic distance' between China and the Latin American countries is enormous. Although China is not the first country that has challenged conventional theory in this respect, the question is whether Chinese investment in Latin America will be successful. The challenge of 'liability of foreignness' is however present and since local firms in emerging markets are less mature than those of the developed world (Hitt, Li and Worthington, 2005 p.356), Chinese investment carries an element of risk.

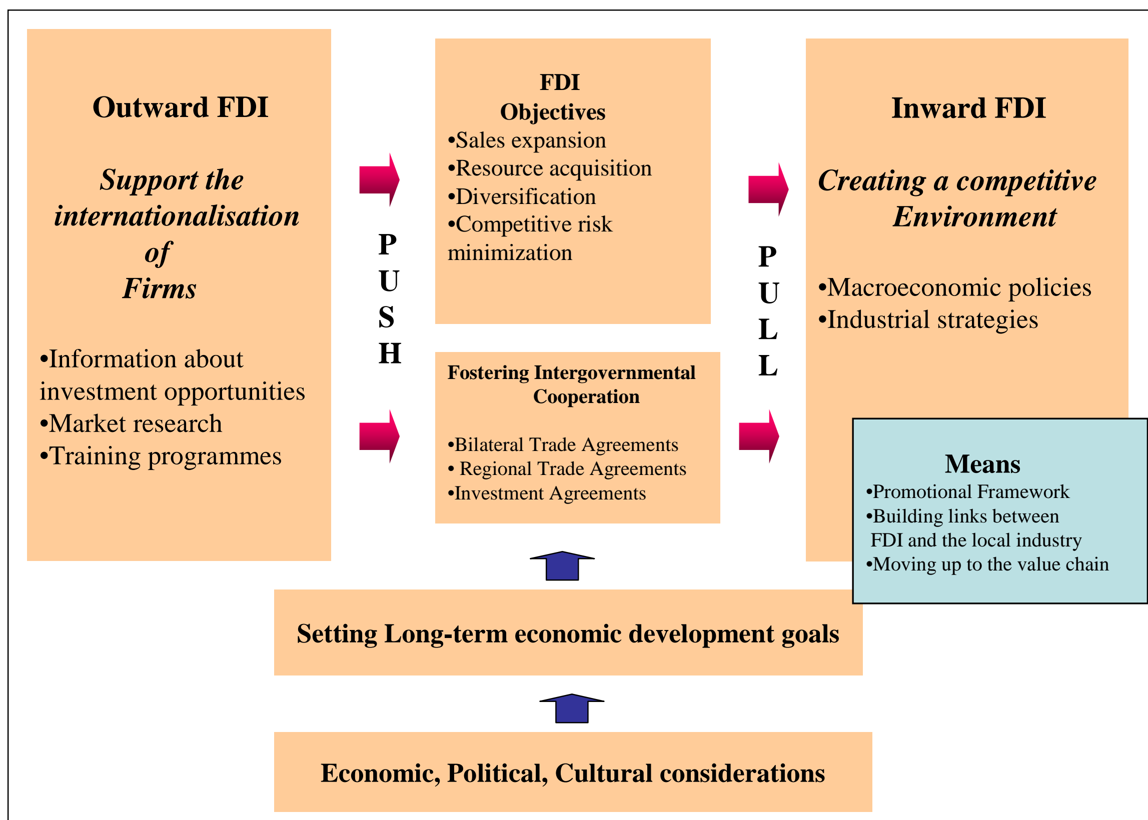
The other aspect of this case that challenges conventional theory is the political aspects of outward FDI from China. In the internationalisation process of Chinese firms, government policies have played an important role. Since the implementation of the market economic model in the late 1970s, the traditional Chinese family owned firm, oriented to the domestic market has evolved into a modern Chinese firm oriented to expand internationally (Erdener and Shapiro, 2005).

With the Chinese government's launch of 'Going Global' in 1999 and China becoming a member of the WTO in 2003, an opportunistic approach has characterised the internationalisation of Chinese firms. The rapid expansion of the Chinese industrial sector during last decade has meant that the supply of primary resources and opening markets for exports have been important issues on the agenda of the Chinese government. Latin America seems to be the perfect market to look for both commodities and export market expansion.

A favourable political environment also exists in Latin America for Chinese FDI. Currently nearly 300 million of the continent's 365 million people live in countries with left leaning governments (Forero, J., 2005). As these countries retreat from their embrace of free market capitalism, they are more receptive to closer relationships with China and its companies.

While most governments nowadays are playing an active role in creating incentives by adjusting economic policies to encourage FDI (Blomström M. 2001), mainstream theories remain largely focused

on the economic factors of FDI that influence the decisions of foreign investors and fail to consider the influence of governments on FDI. Nowadays, governments' policies are playing an important and strategic role in the dynamics of FDI in the global economy. As Figure 3 illustrates, governments are focused on creating a competitive environment to attract (pull) FDI and supporting the internationalisation of firms to promote (push) outward FDI. Governments of host countries are implementing macroeconomic policies and industrial strategies to create a competitive environment for FDI; they also promote, coordinate and enhance competitive advantages through different means. The later, has been broadly recognised as the most effective government strategy (Morriset and Andrews-Johnson, 2005; Loewendahl, H., 2001 p.8). Governments also support the internationalisation of firms by providing quality information about investment opportunities, preparing market research and given training to nationals on topics concern with international business. However, setting long term strategic goals in the light of national priorities and taking into account economic, political and cultural considerations, governments are fostering intergovernmental cooperation. Bilateral investment treaties (BITs) and regional trade agreements (RTAs) have been acknowledged as important facilitators of FDI in the global economy and particularly of the dynamics of Emerging Markets in recent years (UNCTAD, 2005b). Does, as illustrated in Figure 3 governments play both "pull" and "push" roles in relation to FDI.



Rios-Morales and Brennan 2006

Figure 3: Government Influence on FDI

In the case of China, governmental policies have strongly influenced the internationalisation process of firms (Child and Rodriguez, 2005 p.384) and of the outward FDI from China to Latin America. The Chinese and some Latin American governments have promoted new commercial relations (Dumbaugh and Sullivan, 2005). Such activities are not exclusive to China and Latin America; nowadays, governments take an active role in promoting FDI. Outward investment agencies (OIA) and investment promotional agencies (IPA), for instance, are generally government entities. Studies suggest that

effective promotion of these agencies depends largely on the active involvement and financial support of governments (Morriset, 2003).

Since China's industrial cost advantages depend greatly on an efficient supply of primary resources, investment in Latin America has opened new realities to Chinese investors that in many ways satisfy the O-L-I strategic advantages. A Chinese firm will gain ownership advantages from expanding to an outside market and growing exposure to international business.

> *'The consequences for the internationalisation of Chinese firms could be significant. For instance, it will be seen that many of the larger Chinese firms, which have been singled out as "national champions", received financial support and protection from the Chinese authorities. If a late-coming disadvantaged firm is to acquire assets that enable it to compete in the world market, it may indeed require direct or indirect government funding to make the purchases '* (Child and Rodriguez, 2005 p.385).

Although, the main motives of location advantages of Chinese firms in Latin America are resource seeking and markets seeking, by locating investment in Latin America, Chinese firms are not only expanding their market presence in the region, but also they are acquiring foreign skills, establishing local distribution networks and supporting Chinese exports. Chinese firms benefit from controlling the supply of commodities to the Chinese industrial sector, replacing in one way the dependency on foreign controlled imports.

5. Conclusion

Data and scholarly research on the topic of FDI from emerging countries and on the emergence of China as a potential investor in Latin America are limited. Since emerging markets play a growing role as sources of FDI, it is expected that scholarly research will increase in the future. Whereas the conventional theories of internationalisation and the Eclectic Paradigm offer some insights into Chinese FDI into Latin America, they provide an incomplete understanding of the drivers of this new phenomenon. Outward FDI from China to Latin America has some common features with FDI from the developed world. Similar to the growth trajectory of those American, European and Japanese companies which evolved from relatively small national players to major global competitors (Barlettt and Ghosal, 2000), Chinese FDI is targeted on locations that are not of highest priority for companies from the developed world. Investing in Latin America indicates that Chinese MNEs are willing to compete at the global level and to take on the challenge of the 'liability of foreignness', which carries an element of risk. Nonetheless, it is worth noting that outward FDI from China to Latin America is influenced by political considerations including home government mandate and host country governments' receptivity to Chinese investment. A number of Latin American governments have shown enthusiasm in engaging commercially with China, while China is determined to guarantee for itself access to resources that Latin America possesses in abundance to ensure the long term security of its economic advance. The latter is a product of a key aspect of Chinese culture - long term orientation – and this is fundamental to understanding the drivers of Chinese FDI into Latin America. This suggests that theories of internationalisation need to adjust to the new global context in which the attainments of economic goals are underpinned by cultural and political fundamentals. Understanding the emergence of Chinese FDI into Latin America requires drawing on the rich multidisciplinary mosaic that is International Business.

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