Understanding the Logic and Impact of Chinese Direct Investments in the Developing World

Alvin A. Camba, Tufts University

When companies or individuals make investments in a business in another country, experts call this “foreign direct investment.” Today, China is the fastest growing source of such investments. From the early 1990s to 2015, Chinese and Hong Kong’s foreign direct investments increased from a few hundred million to $2.5 trillion, largely because of China’s financial system and falling rates of profitability for Chinese companies. New Chinese companies continue to form and Chinese citizens need somewhere to invest given low yields at home.

For developing countries on the receiving end, Chinese investments make create dilemmas, because they can either propel growth or contribute to stagnation. Amid the explosion in Chinese foreign direct investment, many western news outlets have painted China as the unscrupulous and greedy new player at the table – and such vilification of the Chinese and their investments reverberates in the developing world.

For example, an article in *The New York Times* claimed that “Beijing is building and financing some 50 new coal plants across Africa” while another argued that “China established a new $60 billion fund to finance infrastructure projects in Africa, mostly with Chinese lending." Further analysis of these articles by researchers proved that the reporters stretched, misinterpreted, and sensationalized the data. Nevertheless, such articles tap into historically rooted depictions that increasingly resonate with contemporary characterizations of China and the developing world.

China’s export manufacturing economy relies on massive imports of foreign-produced natural resources, and it is undeniable that Chinese investments in some parts of the developing world have contributed to deindustrialization, labor exploitation, and environmental degradation and helped to make some developing economies overly dependent on resource extraction. But this behavior is not unique to China. Western and Japanese colonialism lasting hundreds of years exported capital to acquire natural resources. In the 1980s, Japanese development assistance efforts and foreign direct investments supported Japanese companies, imported natural resources, and spurred environmental damage across Latin America and Southeast Asia. Similarly, when their companies need strategic resources or cheap labor, the French and British still invest in the western Sahara and in former colonies with questionable human rights and governance records.

The Varied Logics of Chinese Foreign Direct Investment

Popular and scholarly discourse falsely portrays Chinese foreign direct investments as following a single pattern illustrated with a few select cases, but my research classifies these investments into three types, each with its own logic:

- ***China's Official Development Assistance program agrees to build infrastructure and mega facilities in a developing country.*** Such Chinese state investments include primary roles for Chinese state-oriented enterprises and rules about labor practices, goods production, and profits that benefit China. Although private Chinese companies can take leading roles in these projects, the Chinese state decides which projects to fund – and does so in part with political circumstances and advantages in mind.

- ***Private investments are made by companies wholly or partially owned by Chinese citizens.*** In this scenario, Chinese investments occur within the rules and structures of the host country, often in partnership with local officials or business groups. Because these specific investment arrangements are often smaller and flow into non-strategic sectors, they focus on profit-making above all else and can endure and remain profitable even when wars or other inter-state conflicts break out.

- ***Chinese investors funnel illicit capital through the host country's regional politicians or local firms into illegal or controversial operations in strategic or extraordinarily profitable sectors.*** In this scenario, Chinese investors provide capital while host country actors bargain over political access, so many investments of this type happen in the host country's peripheral and informal economies. Examples of such illicit investments include is the illegal extraction and smuggling of minerals needed by China. But illicit capital flows – from China or other countries – do not only involve the extractive sector. Foreign investors also fund illicit capital ventures in logging, agriculture, and many other sectors of developing economies.

Strengthening the Developing World

Many studies have established that foreign investment is not, in and of itself, bad for development. Problematic outcomes happen when developing countries mainly depend on a few investors for foreign capital because the absence of competition among foreign investors can render states in the Global South incapable of resisting demands from developed countries in bilateral or multilateral settings. With the rising prevalence of China as an alternative investor in the world, many developing countries are finally able to reduce one-sided reliance on the West for investments and markets, improving their bargaining position in negotiations. (To the degree that the new U.S. Trump administration advances protectionist policies, however, the developing world could lose leverage to bargain with multiple foreign investment sources.)

In specific instances, the impact of Chinese investment – or any foreign investment – in a developing country depends, not just on the type of transnational investor in question, but also on the effectiveness of the recipient nation's state capacities and political institutions. Although China's rise as an alternative investor on the world stage has, for the most part, created more favorable bargaining conditions for developing country, China has its own geopolitical and territorial ambitions. Developing nations can drive better bargains with Chinese and other foreign investors if they get assistance – from the United States and other advanced nations or from multinational sources – to strengthen the capacities of their bureaucracies. Public institutions and officials who follow legal rules not only help recipient countries redirect tax revenues to social expenditures, but also allow them to screen out exploitative foreign investments. Effective public institutions help developing countries maximize the new leverage they can enjoy in a global economy where China has joined other capital-exporting nations.

Read more in Alvin A. Camba, "Inter-State Relations and State Capacity: the Rise and Fall of Chinese Foreign Direct Investment in the Philippines" *Palgrave Communications* 3, no. 41 (2017): 1-19.