Red Trojan Horses?
A New Look at Chinese SOEs’ Outward Investment

Yang Jiang*

Abstract: How dangerous is Chinese outward foreign direct investment (OFDI) because of the state’s influence over business, particularly state-owned enterprises (SOEs)? To what extent are business and politics interwoven in Chinese investment decisions? Crucial knowledge is lacking on the relationship between the state and companies in China’s OFDI. This study does not claim to completely refute the conventional view that Chinese companies, particularly SOEs, are controlled by the state in their OFDI activities. However, it tries to provide some evidence that suggests the need for a revised look at them. It argues that although Chinese SOEs are supported by Chinese diplomacy and loans in their OFDI and have a tacit understanding of certain strategic goals of the state, they enjoy autonomy to make business decisions and have prioritized maximizing their own business interests. Importantly, this is enabled by the state’s view that the profit of SOEs is consistent with national interests.

Introduction

How dangerous is Chinese outward foreign direct investment (OFDI) because of the state’s influence over business, particularly state-owned enterprises (SOEs)? To what extent are business and politics interwoven in Chinese investment decisions?

China’s outward investment is growing rapidly, changing the picture of regional and global political economy and attracting a great deal of controversy. According to the State Assets Supervision and Administration Commission (SASAC), by the end of 2009, 108 central SOEs have invested overseas with a total asset of over 4 trillion RMB (about 600 billion USD) (http://ccnews.people.com.cn/GB/15203184.html). The Chinese state-run oil company China National Offshore Oil Corporation’s (CNOOC) attempted takeover of Unocal in the USA in 2005 triggered Congressmen to call it a “Trojan horse” that would enable China to conduct secret nuclear tests underground, as well as to obtain control of energy assets of the USA (Pelosi, 2005). Other countries remain concerned that China’s sovereign wealth funds and SOEs will continue to buy large stakes in publicly listed American companies. Apart from national economic security,
many democratic countries are also concerned that China’s state-owned companies, while claiming non-interference in domestic affairs of other countries, support regimes guilty of gross violations of human rights, such as Iran, Sudan, Zimbabwe, Myanmar, and Venezuela, by investing heavily in and possibly providing military assistance to those countries. Some observe that China may be trying to challenge the dominance of liberal democracy in the world by showcasing the merits of China’s liberal economic and authoritarian political model to other developing countries, or by trying to establish a “Beijing Consensus” (Jian, 2011). Still others suspect that China tries to establish a global “Chinese empire” (Terrill, 2004). At the same time, there is concern that China is in a desperate global scramble for control over sources of energy and raw materials, thereby posing a threat to international energy security. China’s thirst for energy and resources has also caused resource nationalism in other countries, fearing that their governments would give up too many resources or resource sovereignty to China so that local development would be affected (Burgess and Beilstein, 2013). The preference of Chinese companies to use Chinese employees in their overseas projects has been a sensitive political issue to the host countries, and China’s pursuit of free movement of labour into the host country has been regarded as an attempt of serious intrusion upon national sovereignty (Drysdale and Findlay, 2009). The alleged overseas practices of some Chinese companies in corruption, labour exploitation, environmental damage and forging have also undermined the reputation of the Chinese government. Chinese investment in developing countries has been described as self-interested, exploitative and colonial (Alden, 2005; Halff, 2007).

However, crucial knowledge is lacking on the relationship between the state and companies in OFDI in general and that of China in particular. This study does not claim to completely refute the conventional view that Chinese companies, particularly SOEs, are controlled by the state in their OFDI activities. However, it tries to provide some evidence that suggests the need for a revised look at them. It argues that although Chinese SOEs are supported by Chinese diplomacy and loans in their OFDI and have a tacit understanding of certain strategic goals of the state, they enjoy autonomy to make business decisions and have prioritized maximizing their own business interests. Importantly, this is enabled by the state’s view that the profit of SOEs is consistent with national interests. This view may stem from a combination of reasons, including the government’s lack of a coherent long-term OFDI strategy and the fact that the state has been captured by big businesses. The failure of some investment decisions in the
past and the demand from the companies have led the Chinese government to adopt measures that are more market driven and also to bundle together more aid programmes with business projects. The rest of the article will review the existing studies, describe the methodology, provide a brief background of Chinese policy, and present some empirical findings before a tentative conclusion is drawn.

**Existing Studies**

It has been pointed out in the existing literature of multinational corporations (MNCs) that knowledge is needed on the interplay between home country institutions and firm strategies (Dunning and Lundan, 2008; Child and Rodrigues, 2005). The knowledge gap on state-business relations is especially critical regarding Chinese OFDI. Existing literature mainly describes Chinese business activities and speculates about the relations with the state (e.g. Cai, 1999; Holslag, 2008; Luo and Tung, 2007; Wu and Chen, 2001; Yang, 2005). A few studies have tried to fill this gap, but they focus on China’s national policies and the overseas investment behaviour of companies (Xue and Han, 2010; Rasiah et al., 2010), rather than the relationship between state and business *per se*.

In both political-economic theories and business studies on foreign investments, there are debates about the significance of nationality (Encarnation, 1999). Is there anything distinctive about Chinese investment? The answer is inconclusive among existing studies. Some business studies argue that China has developed along the five-stage investment development path as modelled by Dunning and Narula (1996), or that it is still at an early stage marked by low transnationality and little usage of international financing channels (Xue et al., 2011: 86), while others argue that China skipped the first two stages. A more important question, however, is whether the investments have been driven entirely in accordance with the comparative advantage of the domestic industry. Some argue that traditional explanations for FDIs by developed countries apply to China as well, including market seeking, natural resources seeking and, in recent years, strategic assets seeking (for technology, brand and distribution channels) (Wong and Chan, 2003; Xue et al., 2011). Besides, the rationale of emerging country multinationals also applies to China - to avoid domestic competitive disadvantages (Child and Rodrigues, 2005). Others argue that Chinese investments are unique. Overseas Chinese businesses depend largely on the availability of overseas personal relationship networks and invest in culturally proximate
countries (Cai, 1999; Deng, 2004; Yang, 2005; Buckley et al., 2007). They seem to perceive political and business risks differently from industrialised country firms, which may reflect government influence (Buckley et al., 2007; *The Economist*, 2010). Or simply, it is asserted or assumed that they are driven by the government’s political motivations (for example, Cai, 1999; Filipov and Saebi, 2008; Forney, 2005; Friedberg, 2006; Zweig and Bi, 2005). However, reliance on personal networks or cultural proximity is a feature of Chinese small and medium enterprises, or its early stage of internationalisation; it does not apply to OFDI by SOEs in the 21st century. Neither does downplay of local political risk mean being driven by state diplomacy with weak or autocratic states.

The perceptions of state control over SOEs and thus the dominance of political-strategic goals behind OFDI are generally based on the following grounds (see for example, *The Economist*, 2010). First, the top management of SOEs is appointed by the Party. The SASAC is charged with appointing leadership positions of the 117 national SOEs, and the Central Organization Department of the CCP manages 53 of them through a nomenklatura system. The system also enables the Party to rotate leaders between companies and between business and state institutions (Brødsgaard, 2012). Second, the state is the largest shareholder in many companies (Hemerling et al., 2006). Third, OFDI of SOEs is financially supported by state commercial and policy banks. Fourth, aid and investment are often packaged together (Gill and Reilly, 2007). There are loopholes in such reasoning; as it is unclear which criteria the Party uses to evaluate managers, which objectives the state as a shareholder pursues through SOEs, or how SOEs become qualified for bank loans or participation in aid projects. For example, Brødsgaard (2012) acknowledges that it is unknown how decisions are made on the transfer of business leaders and state officials; in particular, very little is known about how leaders of SOEs are selected.

Some studies have casted doubt on the conviction of the state’s control over China’s OFDI, although their voices remain a minority in academic and public opinion. Gill and Reilly (2007) characterise state-business relations in China’s investment in Africa as a principal-agent dilemma - increasing tensions between the aims of the government and companies. Houser (2008) emphasizes the same tension between the state and national oil companies in OFDI. Some underline the facts that the commercial pressures on Chinese companies are growing rapidly, and that corporate governance in SOEs is increasingly subject to market disciplines (Rosen and Hanemann, 2009; Hurst and Wang, 2012; Drysdale and Findlay, 2009). This makes it difficult for
the state to directly administer company investment decisions and increasingly defer them to professional firm management. Freemantle and Stevens (2012: 3) underline that “more and more Chinese activity in Africa has little direct support”. Drysdale and Findlay (2009) underline that the terms of Chinese banks when lending to SOEs are increasingly commercially based. Armony and Strauss (2012: 8) argue that instead of a “standard view” that Chinese mining companies deviate from western ones in their preference to operate in non-democratic contexts, they prefer “mature and developed mining economies, geographic proximity and direct dealings with other transnational mining companies in lieu of national governments”. Gonzalez-Vicente (2012) concurs that Chinese mining companies’ preference for specific countries in Latin America are best explained by the strategies and experience of firms rather than by a national strategy dictated by the central government. By mapping the formal institutions of Chinese OFDI, Xue and Han (2010) argue that the Chinese government changed its role in OFDI from strict control to encouragement, approval and supervision.

Little is established, however, about the nature of state involvement in OFDI by Chinese SOEs, in particular the direct interaction between government and companies as well as the informal institutions - working mechanisms, decision making, tacit understandings and unwritten rules. This gap is acknowledged, and further empirical research from a political economy perspective is regarded crucial by existing studies (for example, Armony and Strauss, 2012; Child and Rodrigues, 2005; Buckley et al., 2007, Downs, 2007, Kumar and Chadha, 2009; Xue and Han, 2010). To be more specific, more knowledge is needed on the extent of state interference in company governance and strategic decisions, leniency of bank loans, the reliance of business on diplomacy, and business lobbying over China’s OFDI policy and institutions. Moreover, there is limited knowledge on whether Chinese OFDI policy consists of a development strategy for host developing countries or an agenda to challenge dominant powers and the liberal democratic norm (Brautigam, 2009; Jiang, 2011b).

**Policy Background**

China’s overall policy towards OFDI has changed from restriction to promotion. From 1979 to 2000, directed by a national economic strategy that relied on inward FDI and export, and constrained by limited foreign reserves, the government did not actively encourage outward investment. Although in 1992, the 14th CCP’s Congress laid down the policy to expand Chinese
outward investment and international business, in the 1990s only a few domestic companies ventured overseas, mainly in the energy and resources sector. For instance, the government took little notice of CNPC’s first forays into Peru, Sudan and Kazakhstan until the mid-1990s (Xu 2007). At the same time, a number of large SOEs were granted greater autonomy over their foreign operations (De Beule and Van Den Bulcke, 2010; Xue and Han, 2010).

The scale and nature of China’s outward investment have changed significantly in the 21st century. In 2001, encouraging outward investment became part of the 10th Five Year Plan. “Going out” officially became a national strategy in 2002 at the 16th CCP Congress, which was described as “concerning comprehensive development and future of national development” in the Party’s work report. The supportive measures, however, were found to be inadequate by the Development Research Center of the State Council, compared with other countries (Wong and Chan, 2003). More substantial measures were taken in 2004, when the National Development and Reforms Commission (NDRC), with the support of other government agencies, issued a series of policy notices on the measures to support “important projects encouraged by the government” to investment overseas. They listed four categories of projects that the government would support: first, those that help to obtain important energy and resources; second, those that help to export labour and machinery; third, those that help to obtain advanced technology and management experiences; and finally, those that help China to participate in the restructuring of global production. The measures of support include giving preference in granting licences by the NDRC, as well as providing loans and financial insurance, financing support, and establishing risk security mechanisms through the China Import & Export Bank, the China Export & Credit Insurance Corporation (SinoSure), and the China Development Bank. It was the most determined and specific step that the Chinese government had taken to support outward investment.

Several policy objectives are prominent in the government’s push for outward investment: to reduce low-return foreign exchange reserves, to secure a “stable” - long-term and stably priced - supply of energy and resources, to obtain advanced technology, to promote Chinese “global champions” as a component of national competitiveness and great power status, to circumvent trade barriers and reduce competitive and employment pressures in the domestic market, and to pursue diplomatic relations with destination countries. The government’s encouragement of overseas investment was a response to changing domestic and international conditions. Domestically, the development model of the past two decades resulted in problems such as
energy shortages, inflationary pressure because huge foreign reserves accumulated from trade surpluses, over-capacity in production and an increasingly saturated domestic market, rising unemployment and risk of political instability, and slow progress of technology advancement. Internationally, the policy to boost overseas investment is a reflection of a more competitive international environment, as well as China’s more proactive embrace of globalization and its determination to play a major role in the global political economy through “corporate representatives” and investment diplomacy. Encouraged by government policy, China’s OFDI has since flourished.

In the global financial crisis, Beijing launched another push for OFDI. The China Banking Regulatory Commission (CBRC) allowed commercial banks to lend money to fund the transaction price of M&As. To simplify the approval procedures, the Ministry of Commerce (MOFCOM) published “Administration of Overseas Investment” and NDRC published “Working Approval Procedure of Overseas Investment” in 2009. By 1 June 2011, China had signed 130 bilateral investment treaties and 121 double taxation agreements.

Methodology
Because there is little documentary data of the state’s role in Chinese OFDI, this study tries to break the ground by using case studies and interviews. It focuses on SOEs (majority or entirely state-owned) for three reasons. First, they have led the international expansion of Chinese companies, entering new territories and carrying out big projects. Second, they rank high in China’s top MNEs by foreign assets (Xue et al., 2011). Out of the top 18 MNEs, 16 are SOEs; SOEs account for 69 per cent of total Chinese OFDI stock by the end of 2009, and central SOEs account for 67.6 per cent of total OFDI flow in 2009. Third, it is a fact that most private enterprises are not controlled by the state and operate according to their business interests. In other words, SOEs constitute the hard case here in arguing for business autonomy.

Two rounds of fieldwork were carried out in July 2009 and September 2010, consisting of interviews with involved persons in a few big companies (one of the biggest companies in each of the following sectors: telecommunications, construction and petrol), state institutions (NDRC), as well as government think tanks (DRC, CICIR, CPS, CASS, CAITEC) and academic institutions (UIBE). Therefore, this study is case based, supplemented with anecdotal information, and contains the risk of personal or institutional biases. It would also have been
advantageous had there been more cases of companies. However, even scant evidence is here considered useful for challenging the conventional wisdom mentioned above.

The questions asked to interviewees mainly contain the following aspects:

1. To what extent is the state involved in the management of Chinese MNCs?
   1a. How large a share does the government hold in the company, and what are the ownership as well as the governance structures of the company in general?
   1b. Where do companies get funding for OFDI? How do state banks examine loans applications for OFDI?
   1c. To what extent does the government control the personnel and other management decisions of the company?

2. To what extent are Chinese OFDI driven by strategic purposes of the state or by pure commercial goals of the companies?
   2a. To what extent does the company rely on government diplomatic relations to establish or expand business?
   2b. What is the proportion of natural resources that the company sells in the global market instead of bringing back to China (in the case of a resource company)?
   2c. To what extent does the company take into account state strategic demands in investment decisions?

3. To what extent can companies influence the government’s policy or even induce change in the domestic institutions related to OFDI?
   3a. How do companies try to lobby the government in granting them favourable policies for OFDI or even change the regulations?
   3b. What do companies think that the Chinese government should change?

**Empirical Findings**

*Application procedures of OFDI*

Only applications of projects with the usage of foreign currency of above 10 million USD, or 30 million USD in resource projects, need central government approval (see Figure 1). The application system is also changing from one of approval to one of registration.
A few characteristics can be noted from the OFDI application procedure before going into more detailed discussions of individual elements.

First, The Ministry of Foreign Affairs (MFA) does not play a formal role in the approval process of OFDI. As will be discussed later, MFA supports business through building business connections, providing local information and sometimes diplomatic pressure on the host country government or companies.

Second, the Organization Department of the Party and the SASAC are not directly involved in the approval process. As will be discussed in the next section, SASAC prioritizes the increase of value of state assets, and it only tries to strengthen supervision when companies make substantial losses. In June 2011, in response to scandalous losses that some central SOEs have made in their overseas investment in recent years, SASAC came up with two policy documents to strengthen supervision and reduce the risk of state asset losses (http://www.cssn.cn/news/379081.htm).

Third, the most decisive agencies in the procedure are NDRC and MOFCOM, both of which are mainly concerned with national economic interests rather than foreign policy interests.
NDRC checks proposals of OFDI projects that are worth above 10 million USD to see if they are consistent with the national development plan (interview at NDRC). MOFCOM checks the contract to make sure it does not conflict with domestic law or China’s international treaties and that it does not harm bilateral relations. However, as Gill and Reilly (2007) point out, MOFCOM does not have direct authority over either SOEs or their overseas operations. Although SASAC is the “owner” of SOEs, as mentioned above, it only supervises SOEs to prevent serious loss after investment has been made. Therefore, NDRC plays a stronger role in vetting proposals from strategic sectors where many SOEs operate. As a “super-ministry” overseeing national development, it has a few concerns within national security broadly defined - energy security and food security. This certainly translates into an encouraging policy for overseas scrambles for commodities, but there does not seem to exist any specific policy on the choice of investment destination or quota of how many resources the companies have to bring home.

The State Administration of Foreign Exchange (SAFE) has ample foreign reserve and puts little constraint on its usage in OFDI.

Fourth, big mergers or acquisitions often start with companies negotiating between themselves, and only when they have come to an agreement do they apply for government approval, as was the case with CNOOC and Unacol (interview at NDRC). SOEs usually conduct a feasibility study, sometimes hiring external consulting firms, to examine the profitability of the potential investment. One problem is that consulting firms sometimes collude with the target company (interview at a telecom company).

The State’s Control over SOEs in general

In contrast to a general belief that the Chinese party state controls SOEs by appointing top managers and granting financial support (The Economist, 2010; Gill and Reilly, 2007; Brødsgaard, 2012), it is argued here that the state has been captured by business interests. In today’s China, the government and regulators are captured by the big SOEs. Their perceived role in managing state assets and providing employment is extremely important to the state, and they have successfully stalled reform in major areas of China’s economic life in the past decade.

The political power of SOEs rose together with their economic positions in the past decade - their profitability is questionable, but their sheer size bespeaks their weight. After its accession to the World Trade Organization (WTO), China gave up earlier unilateral liberalisation
and adopted a strong industrial policy with the ostensible aim of developing national industries and global champions, just as the model of the developmental state prescribes. Under the Hu-Wen government, thanks to industrial policy, fiscal subsidy, preferential bank loans and the restructuring of SOEs as large oligarchs, the state’s monopoly over some sectors has intensified.

Indeed the top managers of central SOEs are appointed by the Department of Organisation of the Party. The Department of Organisation and SASAC, however, consider the size, assets and especially the profitability of the enterprise when they evaluate and appoint top SOE managers (author’s various interviews in Beijing in 2011). A major mechanism of state control over SOEs is the annual evaluation of enterprises and their managers by SASAC. The SASAC’s power in the Chinese political system has risen significantly in recent years, particularly in relation to their overseeing authority over SOEs. According to various interviewees, the main criterion for said evaluation is their ability to keep and increase the value of state assets, as stated in the Mission of SASAC.7 The same goal applies to SOE’s overseas investment. In other words, profitability, or at least the ability to earn profit, is an extremely important goal for SOEs (also see Gill and Reilly, 2007). The manager of China Steel, Huang Tianwen, had to resign because of losses made in excessive overseas expansion. SASAC used this case to warn other SOEs in the same sector (MinMetals and China Railway Materials) against similar business behaviour (interview at DRC, also see http://finance.591hx.com/article/2011-07-04/0000044495s.shtml). Chen Jiulin of China National Aviation Fuel and Rong Zhijian of CITIC Pacific were also penalized for their loss-making speculation in overseas financial derivatives (http://www.sinotf.com/GB/News/1001/2011-07-27/2NMDAwMDA3MjU2Nw.html).

Among the CEOs of central SOEs, a significant portion have risen up the ladders in the same sector, accumulated technical and business knowledge, and demonstrated their business capabilities. Among the 122 selected appointees from 2003 to 2011, 51 came from the same enterprise or the same sector, 57 came from other SOEs, and only 4 were rotated from a government position (Beijing News, 2011). In 2013, 56.7 per cent or 64 of CEOs of 113 central SOEs were chosen from within the company. Among them, vice-ministerial rank SOEs have a higher proportion of CEOs from the same enterprise (59.6 per cent) or enterprises in the same sector (21.2 per cent) (Xinwenhua, 2013). 42 per cent of 122 open-hiring positions of executive

11
managers at SOEs from 2003 to 2011 were taken by candidates in the same enterprise, and 47 per cent from other SOEs (Beijing News, 2011).

Even when managers are selected to change to political positions, the choice has been based on their performance. According to SASAC, parachuting some top SOE managers to take leadership of local governments is a trend and experiment in Chinese politics. The managerial skills and market perspectives of those managers are considered complementary to traditional government administrators (China Times, 2011). Only in extraordinary conditions are SOE managers’ “political loyalty” questioned, for instance if they are involved in scandals or have shown inability to deal with labour unrest.8

A number of studies have shown the increasing independence and political clout that SOEs enjoy in Chinese domestic politics, thanks to government institutional reform, the perceived role they play in employment and the national economy, and the informal political ranking of SOE managers (see, for example, Lieberthal and Oksenberg, 1988; Nolan, 2001; Downs, 2008). In recent years, major initiatives of reform were stalled or pushed back because of resistance from SOEs and state commercial banks, including recent efforts of financial reform, reform of income distribution and legislation to curtail monopolies. Financial suppression — heavy taxation on savers and subsidies to SOEs and state commercial banks — has been a cornerstone of the development model, and “2009 marked the end of banking reform as advanced since 1998” (Lardy 2008, Walter and Howie 2011: 76). Initiatives to reform income distribution have been thwarted repeatedly because of resistance from vested interests, in particular from SOEs to a proposal to break up monopolies, according to people involved in the internal discussions. In response to public criticism, SASAC claimed that they did not have control over this matter (Chen, 2013). Similarly, the Anti-Monopoly Law, which entered into force in 2008, exempted sectors monopolised by SOEs. Explaining such phenomena, Gao Shangquan, former Director of the State Commission for Restructuring the Economic System that existed from 1982 to 1998, was quoted as saying that, compared with current conditions for reform, reform in the 1980s had a lot of momentum and few objections, and the leadership had authority then (Teng, 2013).

Anecdotal evidence also suggests that SOEs enjoy significant autonomy in their business decisions, sometimes in defiance of the government’s orders during the financial crisis, for example, to stop risky financial derivatives businesses, to allow non-property companies to exit
the real estate market, to allow more room for private businesses and to limit the salaries of SOE managers (see, for example, Jiang, 2009; Zheng, 2010; Zhong, 2011). Such defiant behaviour demonstrates that the pursuit of profit is extremely important for SOE managers, not only for their business careers or potential political careers, but also for their short-term personal wealth.

Some SOEs are also under the supervision of the relevant industrial ministries (for example, telecommunications, construction, transportation, and railways until March 2013), which have their own interest, and local SOEs are managed or supported by local governments. Industrial ministries and local governments are certainly interested in maintaining their regulatory power over SOEs, as this produces leverage and rent. At the same time, the ministries try to maintain state oligopolies, their shares in the domestic market provide guidance on pricing and ensure the state’s tax revenue. For instance, Unicom and China Mobile have been the two biggest telecom oligopolies, and when one pushes the other too much in domestic market competition, the Ministry of Industry and Information Technology (MIIT) would intervene and stop the winner from predacious activities (interview at a telecom SOE). However, the effectiveness of such intervention is questionable. Since government units rely on their SOEs for revenue, employment and performance in political competition, they are sometimes taken hostage by SOEs and act as their representatives. The two telecom companies engaged in price wars in 2001 despite a ban by MIIT and the State Planning Agency in 1999 (http://book.sina.com.cn/2003-04-24/3/5274.shtml). Similar competition is seen between Sinopec and CNPC, only these two compete to buy oil and result in price hikes in the domestic market (http://book.sina.com.cn/2003-04-24/3/5275.shtml). The capacity of ministries to supervise or intervene in companies’ overseas business activities is even weaker.

In short, the criteria for evaluating SOE managers reflect the overall strategic purpose of the Chinese state for its overseas investment, which will be discussed later. Rather than the widely held assumption that China uses FDI to, first of all, challenge a neoliberal world order and build diplomatic alliances with enemies of the West, the pursuit of economic benefits (based on China’s comparative advantage) is more important. It also shows that the state currently does not distinguish SOE’s interests from the state’s interest and presumes that profitability of SOEs is of interest to the nation.
Funding

State financial support – subsidies and easy access to loans – is one of the major reasons for the widely held argument that SOEs are foreign policy tools and do not play by market rules in OFDI. Indeed, the state is the biggest investor and shareholder in SOEs, and the success of zhengqi fenkai (separation of the government as investor from the management of enterprises) in SOE reform has been questioned. However, as mentioned earlier, SASAC and a few industrial ministries represent the state to invest in SOEs and they pursue economic gains above all. Two other qualifications should be added to that line of argument.

First, SOEs often use their own funding for OFDI activities, without applying for loans for each project. It may come from overseas listing of a subsidiary, direct support from the domestic headquarters, or money that the company earned overseas by way of reinvestment. For instance, Chinese oil companies, in most cases, do not need external capital to finance their overseas investment (Houser, 2008).

Second, state commercial banks have their own set of rules for loans and they are quite strict. They understand the general policy of the state to encourage “going out” in several categories of activities, but they also have much autonomy in carrying out commercial assessment. The China Banking Regulatory Commission requires banks to have strict rules for OFDI loans, and loans are given to projects with good business prospects, although lack of experience and local information is considered the reason for the losses of many projects (interviews at CAITEC, a telecom company and a construction company).

The state policy banks – the China Development Bank (CDB) and Ex-Im Bank – naturally support state strategic goals. CDB states that it supports enterprises in going out to obtain oil, natural gas, metal and mineral resources, as well as in diplomacy -- it supports infrastructure and agricultural-forestry projects in countries with important diplomatic relations, mainly in Asia, Africa and Latin America. At the same time, the CDB emphasizes its success in business terms and its bringing profit to the shareholders (Ministry of Finance and Central Huijin Investment Company Ltd).9

Third, it is not only SOEs that receive state support. Private companies followed SOEs in the wave of overseas investment, and they received little government support initially. But the government is beginning to redress the matter by supporting successful companies such as Huawei and ZTE. These successful private Chinese companies, particularly those figuring on the
Fortune 500 list, are considered “national champions”, and receive government support in the form of R&D, funding, and help with market exploration. Business success is an important consideration in the government and banks’ decision of giving support (interview at CPS, DRC).

The Role of Diplomacy and Foreign Policy

Without doubt, China’s push for going out has political strategic considerations. Some regions such as Asia and Africa are considered important targets for diplomacy and therefore investment is encouraged there.

When China initiated its “going out” policy in the late 1990s, the state selectively pushed a few SOEs to invest overseas. For instance, former CEO of CNOOC, Fu Chengyu, was often called upon by the State Council to discuss acquiring mines overseas, including in Indonesia (interview at CCPS, 2011).

When Wu Jianmin was Ambassador to France (1998-2003), he found that Chinese companies there needed support and resources from the government, because local nationalism and unfamiliarity with laws hindered their success. For example, when the negotiation between a French airplane parts manufacturer and a Chinese company were in a deadlock over price, Wu met with the manager of the French company and told him not to focus only on this bill of business. Rather, he should have a long-term view and give some concessions this time for future benefits. Then the French company gave concessions. Wu was inspired by Henry Kissinger who, after retirement from diplomacy, started a consulting company to help companies. Wu visited the consulting company in the 1980s (interview at CCPS).

Partly thanks to Wu’s advocacy of diplomatic support to Chinese companies, the government started to implement a strategy of going out in different regions of the world around 2002, including Africa, Asia, Western Asia, the Middle East, Eastern Europe, Russia and developed countries. As going out was considered part of economic diplomacy, Chinese embassies started to actively study existing opportunities in the host countries, especially if the country is an important target for going out or economic diplomacy. They provide information and legal consultation to Chinese companies, and use their local government and business networks to facilitate business (interview at CCPS).

Apart from supporting company initiatives, embassies would come up with proposals of sectors in the host country that would constitute an investment potential for Chinese companies,
and then invite domestic companies in those sectors to consider the opportunities. MOFCOM also leads “shopping delegations” to other countries in the same fashion whereby MOFCOM plans sectors and invite companies. Then MOFCOM obtains agreement from the MFA and submits the proposal of delegation to the State Council for approval (interview at CCPS).

The Chinese government cannot monitor the local behaviour of all Chinese companies including SOEs. Therefore poor labour and safety standards, exploitation of natural resources and the tendency to hire Chinese workers are amongst the reasons that China is labelled as neo-imperialist or neo-colonialist. As Downs (2007) reports, MFA often struggles to keep abreast of investments that have already occurred. The Chinese government became aware of this criticism in 2005, and at the 2006 Central Working Meeting on Foreign Affairs, it was stated that China should consider the partner countries’ interests while pursuing economic benefits. The government can only pick examples for occasional review and correction of such image, such as in Africa. One indirect way is to alleviate debt of those countries, and another way is through the investigation by Chinese embassies over Chinese companies there (interview at CCPS). Over the past three years, MOFCOM and MFA have formed working groups, which have dealt with many cases of irresponsible local behaviour of Chinese companies (interview at UIBE, 2011).

In short, with regards to the extent of state strategic influence over business, SOEs’ OFDI is seen by the government as part of economic diplomacy, and SOEs in strategic sectors receive diplomatic support to pursue business interests, as the latter are seen as being consistent with the state’s interest. In particular, overseas investment of all central SOEs can get support from the State Council because they are in strategic sectors. It should be noted, however, that the state largely plays a supportive role rather than being a mastermind that directs business decisions, as will be discussed in the next subsection.

**Business Decisions**

The search for investment opportunities and choice of destination are normally carried out by enterprises, as the government is not considered as having adequate information about local business environment, and companies are responsible for their own profit or loss (interview at CASS, DRC, a construction company and a petrol company). Contact with the target host country or company is also usually initiated by companies. There are two exceptions. First, as mentioned earlier, MFA investigates local business opportunities and invite domestic companies
to consider. Second, MOFCOM invites domestic bidders to participate in official aid programmes. In any case, MFA and MOFCOM play a supportive role in providing local information and leading shopping delegations, but the main actor to forge business relations is the actual enterprises.

Competition is not rare between SOEs in foreign markets, either in bidding or market share. They also compete for the “preferred bidder” status with officials at home (The Economist, 2010). Sometimes one Chinese SOE cooperates with foreign companies to compete with another Chinese SOE. For instance, China Railway Construction, together with CITIC and a Japanese company, beat China Construction in an Algeria project, although the latter had had long-term presence in Algeria. CNPC, together with a Malaysian and an American company, beat Sinopec in a Sudan oil pipe project bid in 2005 in a vicious price war, although Sinopec had cultivated the market for ten years (Ren and Wang, 2004). Sometimes competition between Chinese companies becomes so vicious that the local diplomatic mission tries to interfere to stop their malicious competition.

It is a foreign policy concern amongst western countries that China’s is actively investing in “problematic” countries — countries with high political risk, anti-West, or “rogue states”. Chinese companies and academics claim that this is because a market exists in places that the West has not occupied. It is argued in scholarly work that technology is another determining factor behind Chinese oil companies’ preference of onshore locations. Besides, failed M&A attempts in western countries, such as CNOOC’s failed bid for Unocal, have had a significant impact on the psyche of SOEs (Houser, 2008). However, dangers posed by local conflict to Chinese personnel and properties in unstable states such as Sudan and Libya, as well as crimes such as kidnappings and attacks on oil fields in Nigeria and Ethiopia, have taught the Chinese to reassess and distribute risk. In fact, MOFCOM discourages companies from investing in Sudan. The government tries not to be especially close to one side but seeks cooperation with both sides (interview at CASS).

China’s tendency to sign long-term contracts of upstream resource exploration is also an international concern as it disturbs the global commodities market and may trigger similar mercantilist behaviour in other countries, thus brewing great power conflicts. That tendency is explained by the frustration that the price of what China buys in the global market would be
pushed up by western financial institutions. In order to obtain stable, relatively cheap supplies, Chinese companies pursue upstream contracts.

Interviews with various academics and companies show that the government advises companies to sell resources back to China, but there is no such formal rule, and it allows them to pursue profits too on the international market, as it is considered good for government revenue. It is understood by resource SOEs that they should bring resources back in compliance with the national energy and resource strategy. However, it is often more profitable to sell domestically at a managed price or large demand. When the domestic price is lower than the international price, SOEs would sell more internationally, which in turn would force the government to raise the price of petrol. Otherwise, SOEs would demand subsidy from the state for them to sell domestically (interview at UIBE, DRC, NDRC). SOEs also have the freedom to sell their overseas production on the international market instead of bringing it home. For example, most of the equity oil produced by the three national oil companies was sold on the open market to the highest bidder. Despite the criticism over China’s support of Sudan, CNPC sold most of its Sudanese oil to Japan in 2006 (Houser 2008). A debate among the Chinese leadership, therefore, has been whether it is effective to rely on Chinese companies’ overseas production for energy security (Downs, 2004; Jakobson, 2007).

**Business Lobbying**

The influence of SOEs on government has increased dramatically in the past decade, and they have started to try to gain favourable policy for OFDI, though on a limited scale. One channel of influence is the “rotating door” between business and political circles, and the administrative ranks that some SOE managers enjoy. At present, 14 business groups are represented in the Central Committee of the CCP and they try to influence national policy within their fields of expertise (Brødsgaard, 2012). SOEs may also fund research projects at academic institutions to indirectly influence government policy, or organize their own research and send their findings to the government (interview at CICIR).

In general, SOEs and academics feel that the government does not have systematic support or monitoring mechanisms, or a strategy, for outward investment in the government. To SOEs, it implies both great freedom to make business decisions and carry out business activities, and also a source of frustration as they expect more diplomatic and information support. It is
widely felt that the government’s policy and management of overseas investment are short-term oriented and lack strategy. Japan is often cited as an opposite example, whose government strategically and discretely used aid to pave way for investment, and helped companies avoid many costs.

**Concluding Remarks**

It is not the purpose of the paper to argue conclusively that Chinese SOEs are not controlled or influenced by the state in their overseas investment decisions. However, evidence suggests that this generally held assumption should not be taken for granted. SOEs’ profits or market share are often the most important consideration in their overseas activities, and usually the state regards it consistent with national interest. Whether it embodies the capture of the state by business interests, state corporatism, state capitalism or crony capitalism is beyond the scope of this paper and deserves further empirical research of state-business relations in China.

Moreover, as a number of studies have suggested, developed countries have adopted similar measures to enhance firm competitiveness and promote national interests, for instance as regards natural resources supply, industrial restructuring, and foreign market access. The measures included financial, fiscal, information and technical support, industrial policy and official aid (Buckley et al., 2010; De Beule and Van Den Bulcke, 2010; UNCTAD, 2001; Solis, 2003). Except in the case of countries under sanctions, such as Sudan, there are almost no strings attached by the West to its companies’ trade or investment, or to its commercial banks loans in Africa. China’s use of commodity-secured lines of export buyers’ credit are similar to commercial instruments that have been used by Japan and western banks for a long time (Brautigam, 2011). To gain a deeper understanding of China’s international investment, it is more helpful to investigate state-business relations, as that would help explain the where, how and why questions of China’s “going out”.

**Acknowledgements**

I would like to thank Kjeld Erik Brødsgaard, Peter Ping Li, Ari Kokko, Niels Mygind, Jens Gammelgaard, Peter Gammeltoft, Nis Grunberg, Xin Li, Minghua Li, Sanjay Peters and Anthony D’Costa for their comments on various versions of the paper.
Notes

1 For studies on China’s outward investment, see Luo et al., 1993; Zhan, 1995: 72; Cai, 1999; Wu and Chen, 2001; Xue and Han, 2010; Yang, 2005. For broader discussions on outward investment of developing countries, see for example, UNCTAD, 2005; Sauvant, 2008.


3 The policy notices include “jingwai touzi xiangmu hezhun zanxing guanli banfa (Interim Management Procedures for the Approval of Overseas Investment Projects)”, issued by the NDRC; “guanyu dui guojia guli de jingwai touzi zhongdian xiangmu geiyu xindai zhichi de tongzhi (Notice of Giving Credit Insurance to Overseas Investment in Important Projects Encouraged by the Government)” issued by the NDRC and China ExIm Bank; “guanyu kuaguo gongsi waihui zijin neibu yunying guanli youguan wenti de tongzhi (Notice of Internal Operation and Management of Foreign Exchange in International Companies)”, issued by the State Administration of Foreign Exchange.


8 For instance, the 2002 case of Ma Fucai of PetroChina/CNPC Daqing and Li Yizhong of Sinopec Shengli, in Downs, 2008.


References


