



Tomas Dudas

Ph.D. (Economics), Associate Professor, Faculty of International Relations,
University of Economics in Bratislava
1/B Dolnozemska cesta Str., Bratislava, 85235, Slovak Republic
tomas.dudas@euba.sk



Marianna Dudasova

Ph.D. Student (Economics), Faculty of International Relations,
University of Economics in Bratislava, Slovakia
1/B Dolnozemska cesta Str., Bratislava, 85235, Slovak Republic
marianna.dudasova@euba.sk

Growth of Chinese investments in Europe after the global economic crisis of 2008-2009

Abstract. For a long time China was viewed as a typical host country in international capital flows. Long-term rapid economic growth and trade surpluses produced quick accumulation of capital in China which has led to increasing capital flows abroad from public and private companies. When amid the global economic crisis of 2008-2009 domestic investment declined in many economically developed countries, Chinese investments stepped into their domestic investment markets to fill the void. The aim of this paper is to document the growth of Chinese investment in Europe, and to identify the main factors behind this growth. The paper also analyses geographical distribution of Chinese investments in Europe with particular emphasis on Central Europe.

Keywords: China; Europe; Sovereign Wealth Fund; Investments; Foreign Direct Investments; Central Europe; Slovakia

JEL Classification: F21

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Дудаш Т.

кандидат економічних наук, доцент, факультет міжнародних відносин,
Економічний університет у Братиславі, Словаччина

Дудашова М.

аспірант, факультет міжнародних відносин, Економічний університет у Братиславі, Словаччина

Зростання китайських інвестицій у Європі після світової економічної кризи 2008–2009 рр.

Анотація. Тривалий час КНР виступала в якості типової країни-реципієнта інвестицій на світовому ринку капіталів. Однак тривале стрімке економічне зростання Китаю та значний профіцит торговельного балансу призвели до значного накопичення капіталу й зростання китайських державних та приватних інвестицій за кордоном. Коли світова криза 2008–2009 рр. призвела до скорочення внутрішніх інвестицій у багатьох економічно розвинених державах, їх місце на відповідних національних ринках часто займали саме китайські інвестиції. Метою представленої статті є визначення масштабів китайських інвестицій у Європі та факторів зростання їх обсягів. У статті також проаналізовано географічний розподіл інвестицій КНР у Європі.

Ключові слова: Китай; Європа; Суверенні фонди; інвестиції; прямі іноземні інвестиції; Центральна Європа; Словаччина.

Дудаш Т.

кандидат экономических наук, доцент, факультет международных отношений,
Экономический университет в Братиславе, Словакия

Дудашова М.

аспірант, факультет международных отношений, Экономический университет в Братиславе, Словакия

Рост китайских инвестиций в Европе после мирового экономического кризиса 2008–2009 гг.

Анотация. Долгое время Китай воспринимался на мировом рынке капитала исключительно как типичная страна-реципиент инвестиций. Однако стремительный экономический рост и значительный профицит торгового баланса обеспечили накопление в КНР значительных финансовых средств и сделали возможным рост государственных и частных инвестиций за рубежом. Когда мировой финансовый кризис 2008–2009 гг. привел к сокращению объема внутренних инвестиций во многих экономически развитых странах, китайские инвестиции стали массово приходить в эти страны. Целью статьи является определение масштабов китайских инвестиций после мирового экономического кризиса и факторов, сделавших возможным значительный рост инвестиционной активности КНР. В статье также проанализировано географическое распределение китайских инвестиций в Европе, особое внимание уделено центральноевропейскому региону.

Ключевые слова: Китай; Европа; Суверенные фонды; инвестиции; прямые иностранные инвестиции; Центральная Европа; Словакия.

1. Introduction

The rise of China as a global economic superpower is one of the most important stories in the global economy at the beginning of the 21st century. During the first fifteen years of the new millennium, China became the largest exporter of goods and the second-largest economy in the world. After the start of economic reforms in late 1970s China belonged to the largest capital importers in the world economy for several decades, but position of China in the global capital flows started to shift significantly during last decade. Steady economic growth of China and country's growing trade surplus led to a quick accumulation of capital and the amount of disposable capital started

to outgrow ability by Chinese economy to absorb capital. This inevitably led to an increase of Chinese portfolio investments in the global financial markets. In the same time, Chinese economy started to produce strong domestic corporations that started to internationalize their business activities. This process led to growth of the outward foreign direct investments (OFDI) from China. This trend let China to join the ranks of major capital exporting countries.

The global economic crisis of 2008-2009, culminating in the recession of most key economies in its aftermath, is one of the most important turning points in the global economy in the last decades. All economically developed countries have

been severely hit by this crisis. Although most developed countries returned to economic growth fairly quickly, quite a few European economies entered a protracted phase of economic, social and public debt crisis. As a result, confidence in the European economy decreased after the global crisis, leading to decrease in public and private investment. Therefore, many European governments started to search for an alternative investment source to fill the gap left by missing domestic investments. China became one of the obvious sources of investment, as it started to amass record levels of capital in the same time period.

2. Brief Literature Review

After the establishment of People's Republic of China in 1949, the economic policies of China changed dramatically. The communist government of Mao Zedong isolated China from the world economy and up until the 1980s PRC played only a marginal role in global trade and investment flows. The situation started to change after the death of Mao Zedong in 1976 when a group of more pragmatic leaders seized power under the leadership of Deng Xiaoping. The gradual opening of Chinese economy was one of the main pillars of the economic reforms and over time China became an important host country for foreign direct investments (FDI). This process is well documented in the economic literature. Kleinberg (1990) gives a detailed account of the early (but crucial) phases of opening up Chinese economy [13] and Wall provides a description of the role played by special economic zones in this process [26].

After the year 2000, the rising outward FDI flows started to change the investment dynamics in China. Yao and Wang (2014) provide a detailed analysis of the growing FDI outflows from China and analyze its impact on the global economy [27]. Yao, Wang, Zhang and Ou (2016) continued this analysis in 2016, when they researched dynamic relationship between China's inward and outward FDI and tried to identify the key determinants of China's outward FDI (OFDI) in 172 host countries [28].

As for the geographic distribution of Chinese outward FDI, Chinese corporations preferred investing in Southeast Asia (dominated by Hong Kong) and into resource-rich countries in Latin America or Africa (see Szikorova, 2012; or Szikorova and Grancay, 2014) [21; 22]. The role of Chinese FDI in Africa is especially well-documented (see Busse, Erdogan, & Muhlen, 2016) [4]. Kolstad and Wiig (2012) found out that Chinese outward FDI is attracted to large markets, and to countries with a combination of large natural resources and poor institutions [14]. This meant that European countries did not play an important role in Chinese FDI decisions until the global economic crisis of 2008-09.

The growing number of ambitious Chinese corporations started to rapidly increase in the 21st century. Many corporations realized that they are ready to compete on the global markets and that global expansion gives them a competitive edge in comparison with companies focusing only on the domestic markets. Tian, Yu and Zhang (2016) show that Chinese manufacturing companies that engage in outward FDI (OFDI) have better economic performance than non-OFDI manufacturing companies [23]. The increase of FDI flows to Europe is documented by Blomkvist and Drogendijk (2016) who claim that the main motives for Chinese investment in Europe are market seeking and strategic asset seeking, and that there are large differences among European countries in attracting Chinese investments [3].

3. Purpose

The goal of this article is to describe the changing nature of Chinese investments in Europe after the global crisis of 2008/09. The article focuses on the analysis of Chinese capital flows to Europe - with an emphasis on EU member states. Our goal is to identify the main underlying factors behind the growing Chinese investments to Europe and to document its geographical and sectoral distribution. We also examine the position of Visegrad Group countries (Czech Republic, Poland, Hungary, and Slovakia) in Chinese investment strategies with a special emphasis on Slovakia.

4. Results

The export successes of Chinese economy created long-term trade surpluses (see Figure 1). Chinese trade surplus became especially significant after 2003, and China was able to retain its (albeit shrinking) trade surplus even in the years of the global economic crisis of 2008 and 2009. Chinese export revival after 2010 led to new growth of trade surplus that reached pre-crisis levels in 2012, 2013 and 2014.

China as an Investor Country

With the help of long-term trade surpluses, China started to accumulate foreign currency reserves at an increasingly fast rate. The spectacular rise of Chinese foreign currency reserves is closely intertwined with the country's export successes after the year 2000 (see Figure 1 and 2). Today, China owns the largest foreign currency reserves in the global economy as it holds approximately one-third of all currency reserves in the world. According to the data of the State Administration of Foreign Exchange (SAFE) that is part of the People's Bank of China, China's foreign currency reserves reached approximately 3.2 trillion USD in June 2016 [19].

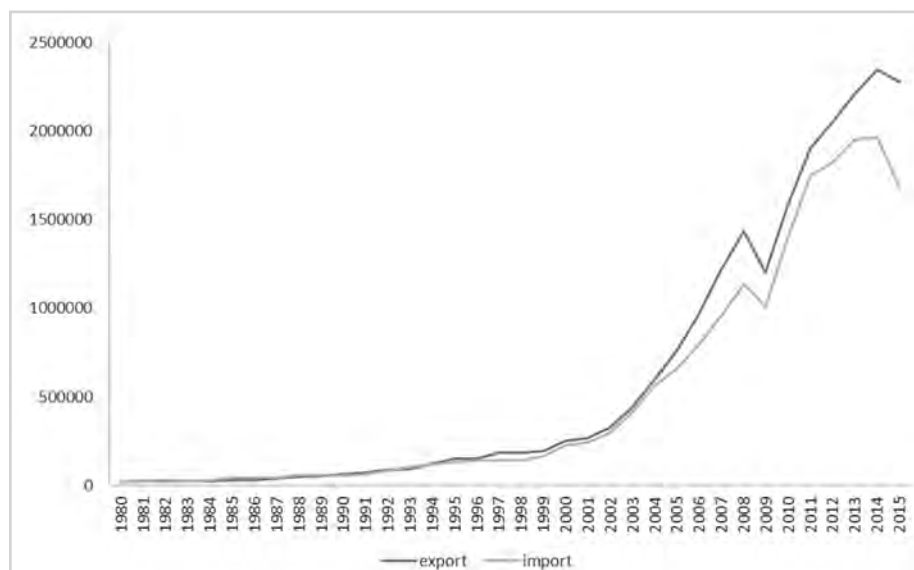


Fig. 1: Foreign Trade of China in 1980-2015 (millions USD)
Source: WTO online statistical database (stat.wto.org)

Foreign currency reserves on the level of 3.2 trillion USD are not only a great asset for China but also an investment challenge. As the level of currency reserves exceeds the needs and absorption possibilities of Chinese economy, most of the free resources are invested in the global financial markets. The aforementioned SAFE is responsible for the management of the currency reserves. As the investment strategy of Chinese currency reserves is a closely guarded state secret, it is hard to create a complete picture of China's investment portfolio. Using data from external sources we know that approximately two-thirds of the currency reserves are denominated in USD and are invested in a portfolio of bonds. According to the data of US Department of Treasury, China is the largest foreign holder of treasury securities on the level of 1.244 trillion USD [25]. Except for government treasuries, China also holds Fannie Mae and Freddie Mac bonds and in smaller extent stocks of American companies [20].

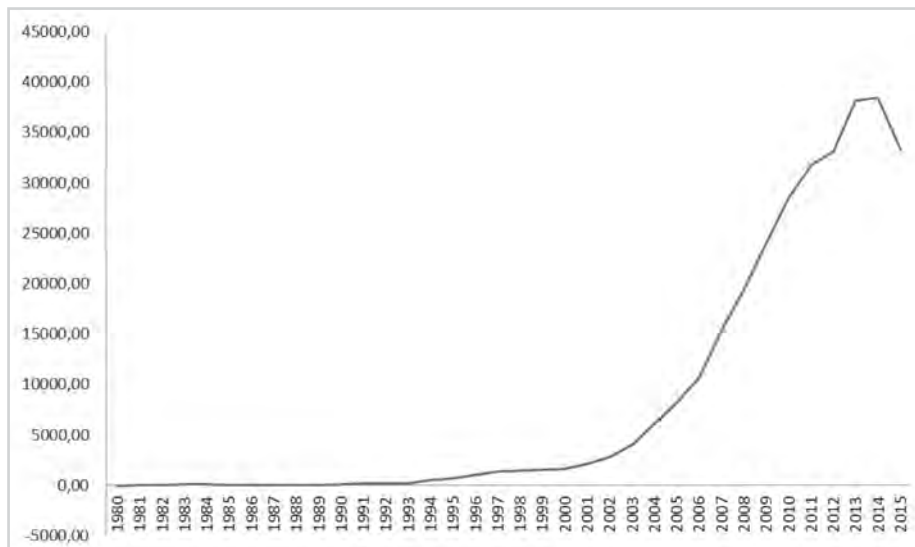


Fig. 2: Chinese Foreign Currency Reserves in 1980-2015 (millions USD)
Source: State Administration of Foreign Exchange database [19]

Although China invests its foreign currency reserves conservatively, the high level of reserves forced Chinese government to look into more active investment strategies. To increase the returns of the investments, China created a sovereign wealth fund called China Investment Corporation (CIC) with the goal to invest a part of its currency reserves. According to the 2015 annual report of CIC, the total assets of this fund reached 810 billion USD at the end of the year, what makes CIC one of the largest sovereign wealth funds in the world [5]. The investment strategy of CIC focuses on investment in international financial markets in the form of bonds and stocks what gives a significant boost to Chinese capital export.

Other than portfolio investments, Chinese capital export incorporates a gradually strengthening component of foreign direct investments (FDI). Steady economic growth in China led to the emergence of strong Chinese corporations with an appetite for international expansion (ex. Lenovo, SAIC Motors or Huawei). After the year 2000, Chinese government actively promoted Chinese OFDI, granting direct support to investments by large state-owned enterprises like China National Petroleum or Sinopec. During last decade significant number of Chinese corporations grew strong globally, and this trend is well documented in the Fortune Global 500 list of the largest global corporations. There was a record number of 103 Chinese corporations in the 2016 edition of the list, turning China into the second most important corporate center in the world after the USA (131 companies) [8].

The expanding internationalization of Chinese corporations results in an increasing export of FDI from China. At the beginning of the 21st century, Chinese OFDI fluctuated at the level of 5-10 billion USD annually, but now they grew relatively quickly to an annual level of 100 billion USD. According to UNCTAD data, Chinese corporations invested 128 billion USD abroad in 2015 alone, what made another record year. In 2015, China was the third most important investor country in the area of FDI behind USA and Japan [24].

The parallel growth of portfolio and outward foreign direct investments catapulted China into the group of the largest capital exporters in the world. According to IMF data China was second largest capital exporter in 2012 already with a 12.1% share of the total global capital exports [12]. The total foreign assets of China reached the level of 6.4 trillion USD and the growth to 20 trillion USD until 2020 is predicted [9]. The growing economic power of China and Chinese corporations is a guarantee of prolonged strong Chinese capital exports in the short to medium term. So it is not surprising that many EU member states see China as a very promising source of capital for the future.

Chinese Investments in Europe after the Global Economic Crisis of 2008-2009

Europe became an interesting FDI target region around the year 2000 when rapidly internationalizing Chinese corporations started to target also markets of traditional developed countries. Despite the rising interest of Chinese corporations, FDI inflows into Europe were still dominated by other developed countries (mainly the USA) and China did not belong to the top 10 investors in Europe [6]. This state of affairs was caused by the dominance of mergers and acquisitions (M&A) the in FDI inflows in Europe, and the majority of M&A deals were done by transnational corporations from developed countries. The growth of the global economy between 2002 and 2007

led to an M&A boom in economically developed countries as many global companies wanted to improve competitive position in their key markets.

The global crisis of 2008-2009 dramatically changed the investment landscape in Europe. The global financial markets dried up in the second half of 2008 and this development led to the cancellation or postponement of many investment projects (mostly cross-border M&As). Global FDI flows declined, dropping from 1,489 billion USD in 2008 to 1,186 billion USD in 2009 (according to UNCTAD data). Europe was perhaps the region most severely hit by the crisis, as FDI inflows to EU member states felt from 793 billion USD in 2007 to 302 billion USD in 2008 (Fabus and Kotuhar, 2010) [7]. FDI flows to EU member states did not recover even several years after the global crisis and they reached only 504 billion USD in 2015 [24].

After the global crisis, general decline in the investment resulted in staggering economic situation in Europe. Economic uncertainty and prolonged issues of the Eurozone decreased confidence in the private sector. The result was a steep decline in gross fixed capital formation in most EU member states (Figure 3). This decline is clearly visible in all countries depicted in Figure 3, but countries most severely affected by the European debt crisis (like Greece, Spain or Portugal) recorded the largest drop in gross fixed capital formation.

The global crisis of 2008-2009 produced an investment vacuum in Europe and that is why most European governments greeted the increased Chinese investment activity. Thanks to a massive public investment stimulus, Chinese economy was able to retain a dynamic GDP growth even in the worst year of the global economic crisis (2009) and large capital reserves of Chinese state and big corporations enabled them to increase investment activity in a time other governments and transnationals halted their investment activities.

Chinese corporations did not hesitate to use the investment possibilities in Europe and increased their FDI activities considerably after 2010. As there are large discrepancies between the official Chinese FDI statistical data (MOFCOM) and the data from Eurostat, we use the database of global think tank Rhodium to document Chinese FDI activities in the EU after the year 2000. According to the Rhodium Group database, Chinese companies completed 1,047 investment projects between 2000 and 2014 in the EU member states with a total value of 46 billion USD [9].

Chinese investors preferred greenfield projects (726), but the average value of the M&A projects was higher. The trends of Chinese FDI inflows to EU countries are documented in Figure 4, which shows a 15-fold increase between 2008 and 2014. The growth of Chinese FDI flows to Europe continued also in 2015, when FDI from China reached a new record level - 20 billion USD [10].

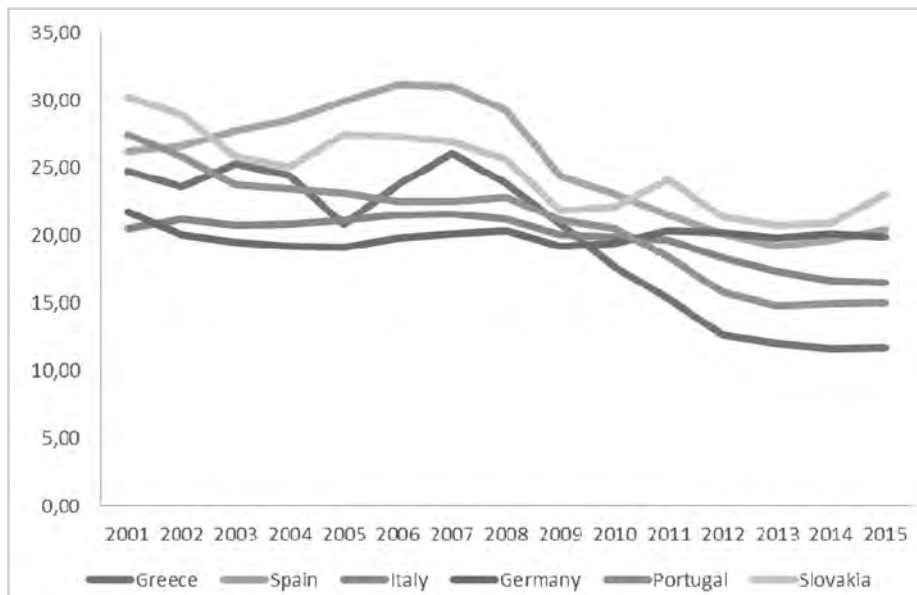


Fig. 3: Gross fixed capital formation in selected EU member states in 2001-2015 (% of GDP) Source: Eurostat online database

As for the geographical distribution of Chinese FDI in Europe, Chinese companies prefer the big European economies. Between 2000 and 2014, the three biggest European economies (Germany, United Kingdom, and France) attracted more than 50% of the total FDI inflows from China. This is not a surprising trend, as these economies offer the most interesting investment possibilities for foreign corporations. On the other hand, the geographical diversity of Chinese FDI started to increase after 2012, with southern EU countries playing a prominent role. The share of these countries (Italy, Spain, Portugal or Greece) in Chinese FDI inflows reached more than 30% in 2015. We can identify two main factors behind this trend.

Firstly, some of the southern EU member states engaged in privatization deals in order to bolster public finances. This resulted in some interesting investment possibilities for Chinese investors (the privatization of Piraeus port by Chinese logistics giant COSCO is an example of these activities) [11].

Secondly, long-term economic weakness in the southern EU countries created interesting M&A possibilities in the private sector. The big Chinese corporations are cash-rich and can make interesting offers to the shareholders of European companies. In 2015, Chinese state-owned chemical giant ChemChina took over the Italian Pirelli (5th largest tire maker in the world) for 7.7 billion USD [1]. In the same year, the Portuguese bank Novo Banco (created from the failing Banco Espírito Santo) sold its investment banking unit to China's Haitong Securities for 423 million USD [18].

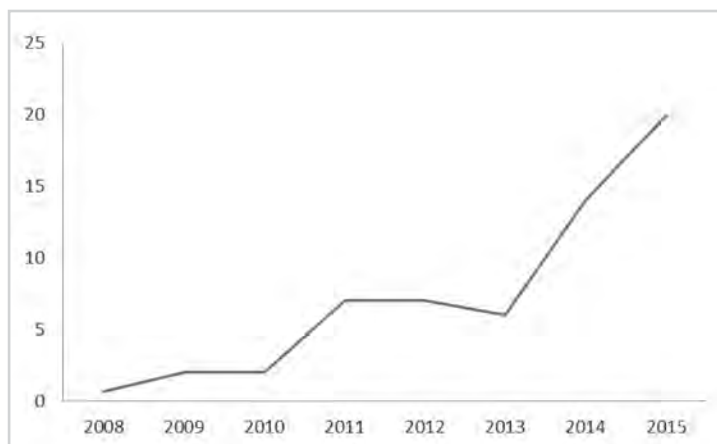


Fig. 4: Chinese FDI Inflows to EU Countries in 2008-2015 (billion USD) Source: Rhodium Group database [9]

The sectoral distribution of Chinese FDI in Europe is more heterogeneous comparing to the geographical distribution. Most FDI from China targets industrial sector. According to Rhodium Group, Chinese companies invested 13 billion USD into energy industry between 2000 and 2014, making it by far the most popular destination for Chinese FDI in the EU. It was followed by the automotive industry (6 billion USD), machinery (4 billion USD), and information and telecommunication technology (3 billion USD). Services sector of economy attracted smaller portion of investments with logistics (3 billion USD) and financial services (2 billion USD) being the most attractive [9]. In 2015, Chinese FDI further shifted towards a more diverse mix of sectors including technology, advanced services, and consumer-related industries. The

automotive sector took the top spot, followed by real estate, information and telecommunication technology, and financial services [10].

Visegrad group (V4) countries are not key destinations for Chinese investors. The V4 countries are deeply integrated into the European economy with companies from other EU member states being the most important investors here. The top positions in FDI inflows into V4 countries are dominated by countries from Western Europe (Germany, Austria, France, Italy or the Netherlands), and Southeast Asia is usually represented by the Republic of Korea (Samsung, Hyundai/Kia, LG, Hankook or Nexen Tire).

At the end of 2013, Hungary had the highest level of FDI stock originating from China on the level of 1.89 billion USD. However, most of this amount (1.66 billion USD) results from one cross-border acquisition of the Hungarian Borsodchem chemical factory by Chinese state-owned giant Wanhua Industrial Group [15]. In the same time, the Czech Republic and Slovakia had the lowest FDI stock from China in the V4 group. However, in the last years there is an obvious increase of interest from Chinese investors in these countries - especially the Czech Republic. In 2015 Chinese industrial conglomerate China Energy Company Limited (CEFC) purchased a minority interest (5%) in the Czech/Slovak investment group J&T Finance Group [16]. In 2016, CEFC increased its stake to 50% [17]. In 2015 CEFC also bought control in one of the most popular Czech football clubs Slavia Praha. In the same time, state-owned energy producer China National Nuclear Corporation was one of the main contenders for the purchase of Slovak energy producer Slovenske Elektrarne. This deal did not happen eventually, but it proved that central Europe is on the investment map of Chinese corporations.

In 2015 an interesting Chinese investment was announced in Slovakia in the information and telecommunication technology sector. ZTE, one of the leading Chinese telecommunication equipment and systems companies, invested 20 million USD with the goal to create a research laboratory in Bratislava [2].

5. Conclusion

FDI from China are welcomed in EU member states as they appeared in a time of scarce investment resources at the market. Nonetheless, we cannot regard Chinese investment as a panacea to investment problems in Europe as Chinese economic growth is slowing down continuously in the last quarters and that can increase the volatility of Chinese FDI in the short- to medium term. On the other hand, a domestic slowdown will force Chinese companies to strengthen

their competitive position in the foreign markets - an obvious case for further increase in FDI outflows from China.

However, EU member states have to be careful regarding Chinese FDI for another reasons. As China is a home to many giant state-owned enterprises and investment funds, it is not a surprise that they play also an important role in investment activities abroad. The corporate takeover by a state-owned Chinese corporation can raise political issues, as China is actively trying to increase its influence in the global economy. As Chinese corporations often suffer from transparency problems, this can lead to a political backlash in the EU member countries. Greece can serve as a good example, as the takeover of Piraeus port was not accepted here as universally positive. Chinese investments in high-tech sectors can also cause problems in the future. There are serious concerns

that Chinese corporations use cross-border M&As in Europe to acquire technologies that would be unobtainable for them through other channels.

Available data suggest that Chinese FDI will play even more important role in Europe in the coming years. China is on the verge of becoming the largest economy in the world and Chinese companies will compete with established transnational companies from developed countries for the domination at the global markets. This will lead to increased outcome of FDI flows from China. On the other hand, governments in EU member states realize the potential of Chinese FDI and are increasingly promoting their countries as potential investment markets for China. This trend is also visible in the V4 region where all four countries try to position themselves as the best investment location for Chinese investments.

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