*International Journal of China Studies*
Vol. 8, No. 2, August 2017, pp. 183-197

# The Impact of China's Economic Restructuring on Southeast Asia: An Investment Perspective

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**Abstract**

China's economic growth in 2015 has fallen to 6.9% from an unrivalled average of 10% between 2002 and 2014. While the global economy is feeling the impact of China's economic restructuring, a change of such a magnitude in China has created a great impact on Southeast Asia, which is intensively involved in trade and investment with China. By analyzing macroeconomic data, we find no indication that China's outward investment in Southeast Asia was immediately shocked by China's New Normal. Instead, in an economically challenging era after 2007, Chinese OFDI in ASEAN has increased significantly. Though Chinese OFDI in Southeast Asia is distributed unevenly in geographical and industrial terms, the analysis of regional and sectorial distribution has reflected a paradigm shift of China's economy from an export oriented to an investment driven growth. The rising wave of Chinese investment in ASEAN can be understood by China's dilemma of over-capacity in some manufacturing sectors. Given the increasing production cost which has significantly reduced cost advantages of Chinese manufacturing, the rapid growth of Chinese outward investment is not only a result of a single firm's strategic shift to relocate to seek higher returns. It is rather a collective reaction of Chinese firms to the challenging business environment in China's domestic market.

***Keywords***: *Outward investment, China, Southeast Asia*

## 1. Introduction

China's economic growth in 2015 has fallen to 6.9% from an unrivalled average of 10% between 2002 and 2014. The global economy is feeling the impact of China's re-imbalance. It has spawned competing theories of what is happening to China's economy previously featured by miraculous growth since its economic reforms in 1978 (Rasiah et al., 2013). The heated debates can be divided into two schools, one of which believes the slowdown to be a result of a deliberate attempt by the government to restructure its economy, whereas the other predicts the economy has slid into a hard landing which sees China entering a lost decade of stagnation or recession *à la* Japan (Powell, 2009; Lai, 2015). Whatever the explanation, a change of such magnitude in China will undoubtedly impact the rest of the world, including Southeast Asia, which is intensively involved in trade and investment with China in the past decades.

Understanding this impact requires knowledge of the nature and structure of China's investment in the region. Although a number of studies have examined a series of issues regarding China's outward FDI in general, including the trend and driving forces of China's outward FDI (Morck et al., 2008; Rui and Yip, 2008), the major focus of the previous research was the determinants and motivations of Chinese companies' in investing overseas (e.g. Buckley et al., 2007), FDI location choice of Chinese firms (Kang and Jiang, 2012) and FDI entry mode decisions of Chinese multinational enterprises (Cui and Jiang, 2009). Nevertheless, the growth in China's outward FDI in Southeast Asia has so far attracted little attention from scholars in mainstream research publications. There is still a dearth of regional studies on what attracts Chinese capital, especially to Southeast Asia which has received a great deal of investment from Chinese investors in recent years. Further, the impact of China's economic slowdown on its overseas investing activities in the region has not received sufficient attention.

Therefore, this paper aims to examine the impact of China's economic rebalancing on its outward investment to Southeast Asia. More specifically, this paper considers two sets of issues. Firstly, what impact has China's economic slowdown created on its outward investment in Southeast Asia? China has witnessed an unprecedented leap forward in investing in Southeast Asia since the 2008 global financial crisis despite its real GDP growth having undergone a significant slowdown. Whether this inverse relation between GDP growth and outward investment in Southeast Asia signifies China' transition from an export-oriented economy to an investment-led model remains as a core topic that we aim to address in the first part of this paper. Secondly, what is the nature and feature of Chinese investment in Southeast Asia as a whole as well as in specific individual sectors and countries in the region? To answer this question, we aim to capture the changes of regional and sectoral distribution of the investment in the face of the Chinese government's call for supply-side restructure reforms. We explored further on whether such an investment pattern shift is reflective of overall economic rebalancing, especially when the comparative advantages used to leverage rapid growth in the past (e.g. by relying on vast amounts of relatively low-wage labour and massive inflow of foreign direct investment) are viewed as lacking the power to sustain future growth.

The paper is organized as follows. After the introduction, section two presents methodology and analytical framework underpinning the analysis of this paper. Section three analyses the impact of China's economic slowdown on the pattern of its outward investment in Southeast Asia. Section four examines the nature and features of Chinese investment in Southeast Asia. Emphasis would be given to the changes of investment pattern in the face of China's recent economic restructuring. The paper ends with conclusions in section five.

## 2. Methodology

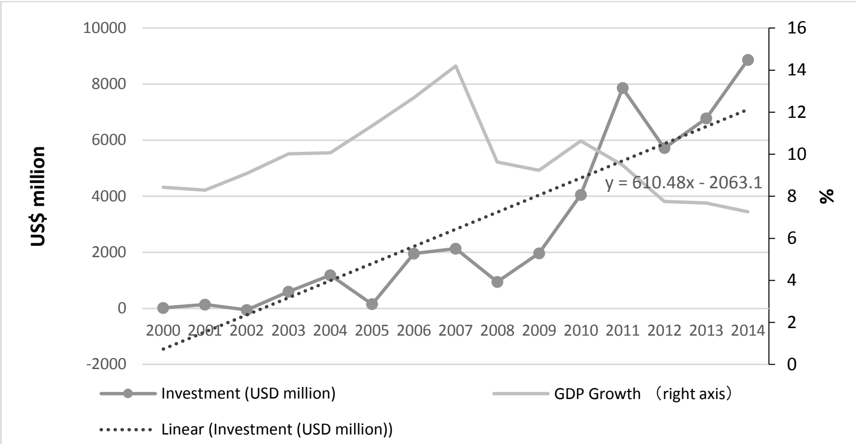
This research adopts a mix mode methodology. Complemented by descriptive quantitative analysis, qualitative evidences are collected from interviews and secondary sources such as government documentaries (Patton, 1990; Johnson et al., 2007). The combined use of qualitative and quantitative techniques enables the benefits of both approaches in research which offers greater validity to the results and analysis. By leveraging on the strengths of both approaches, corroborative results from mixed methodologies strengthen the robustness of research. By using contextual analysis of typical events in certain policy environments, the case study is used when necessary to interpret how firms' choice is influenced by government policy direction. An analysis of institutional players' behaviour is also necessary to reflect the role of specific institutional frameworks.

The quantitative data is extracted from various secondary sources, including the ASEAN Secretariat, China Global Investment Tracker and Global Investment Report by UNIDO. Specifically, investment data from the ASEAN Secretariat provides a sufficiently long time period which enables analysis of the investment from 2000 to 2014. While the China Global Investment Tracker covers a shorter period from 2005 to 2015, its strength lies in its featuring project-based data which allow sector-specific and region-specific analysis of China's investment in ASEAN. Out of 1,761 Chinese mega investment projects across the world from 2005 to 2015, we identified 238 projects in ASEAN. Despite the presence of established local partners, all projects have Chinese multinational corporations (MNCs) as major shareholders (over 50% ownership), and hence serve as a good indicator of MNC's investment in the region.

## 3. Chinese investment in Southeast Asia in an Economic Slowdown

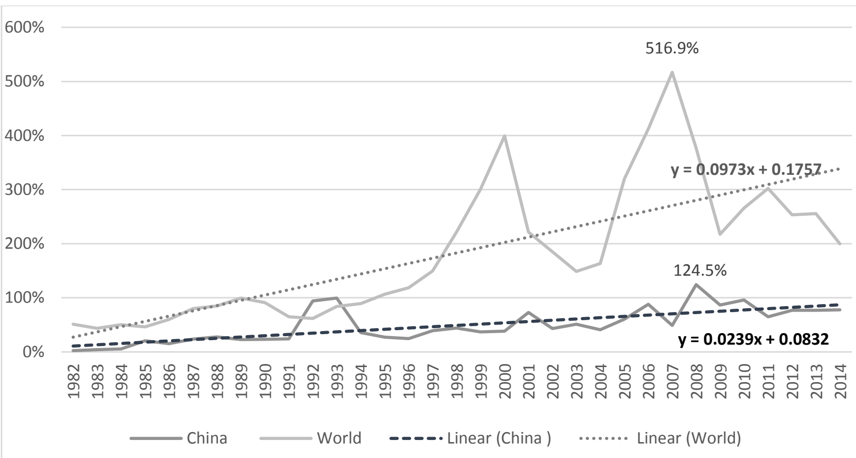
Although the share of outward investment in GDP of China has grown dramatically from 2.2% in 1982 to 77.7% in 2014, China's outward investment by and large remains much lower than the average share of the world (Figure 2). The exceptions in 1992 and 1993 whereby the share of

**Figure 1** China's Investment Flow to ASEAN, 2000-2014




Source: ASEAN Secretariat (2015).

**Figure 2** Outward Investment over GDP, China & World, 1982-2014 (%)




Source: World Bank (2015).

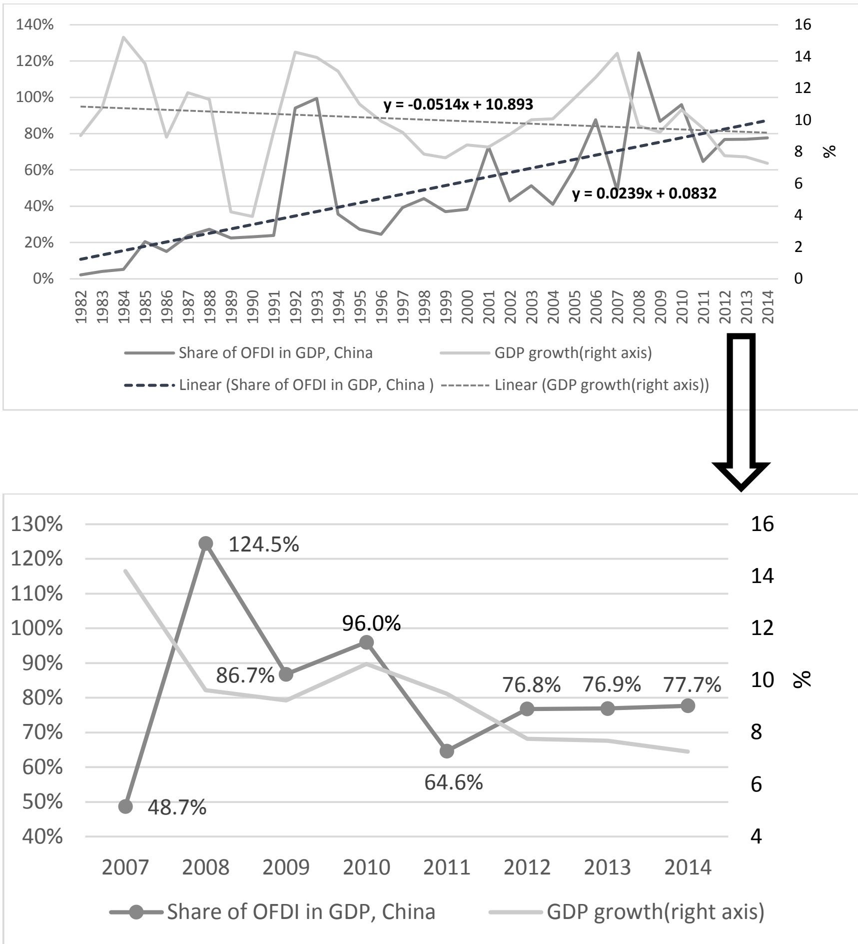
China's outward investment exceeded the world average is largely due to a jump in absolute value (from US$913 million in 1991 to US$4 billion in 1992, and US$4.4 billion in 1993 before returning to US$2 billion in 1994 and afterwards). The world share peaked at 516% in 2007 when investors' confidence gained from strong economic growth drove capital flow worldwide before the Global Financial Crisis struck in 2008. In 2007, China's share of outward investment in total GDP remains at a low 48%. Ironically, when crisis hit the world economy in 2008, China saw a surge of outward investment level to 124% whereas the world level drops significantly to 376% in 2008 from 516% in previous year. In general, while the world share of OFDI in GDP grows at an annual average of 9.7% from 1982 to 2014, China grew at a slower pace of 2.3% every year. Therefore, China's early outward foreign direct investment fell behind world average in terms of growth and level (Morck et al., 2008).

Though the scale of China's OFDI is quite small, a continuous growth trajectory from 1982 to 2014 indicates a promising outlook. Unlike international trade which is rather sensitive to economic turbulence in nature, the growth of China's outward investment demonstrates an inverse relation with its economic growth rate over the period of 1982 to 2014 (Figure 3). Over the last three decades, the share of outward investment in GDP saw a rather steady rise at 23% annually on average, whereas the country's GDP growth shows a general decline from 1982 to 2014. Nevertheless, when China's miraculous two-digit GDP growth slows down from 14% in 2007 to 7% in 2014, the investment share in GDP ranged between 64% in 2011 and 215% in 2008. Admittedly, the contraction could be partly understood as a consequence of the decelerating economic growth since 2007. It is, however, problematic to conclude that there existed a linear relation between the two, as the limited data of only seven years does not allow a decent period for proper statistical calculations.

In fact, China's outward foreign direct investment, despite occurring in an economically challenging era after 2007, is biased towards Southeast Asian countries. China's investment flow to ASEAN rose from US$948 million in 2008 to US$8.9 billion in 2014, while the same period saw China experienced a continuous growth deceleration from 9.6% to 7.2%. In contrast with general investment to the world, China's investment to ASEAN records a robust growth at 45% annually on average during 2008 to 2014 when its economy enters a "New Normal" period.

China's investment in Southeast Asia growing rapidly during this economically challenging period could be explained by the long-lasting close trade relations between the two. China-ASEAN bilateral trade volume recorded an average annual growth rate of 19.8% from 1994 to 2013. China has been ASEAN's largest trading partner since 2009, while ASEAN has been the third-largest trading partner of China since 2011, largely thanks to the complementary role of each in product structure and resource composition which enables an interdependence relationship between the two. Hence, Zhang and Daly's (2011) argument that China's outward FDI is largely attracted to countries with high volumes of exports from China is confirmed in Southeast Asia. In addition, the natural endowment and large market size enjoyed by ASEAN member states collectively attracts China's investment

**Figure 3** China: GDP Growth and Share of OFDI in GDP, 1982-2014




Source: World Bank (2015).

which is both market-seeking and resource-seeking in nature (Kolstad and Wiig, 2012; Ramasamy et al., 2012).

In addition, the growing OFDI is echoed by China's transition from an FDI absorbing country to a global capital giver actively promoting its investment activities across the borders. Apart from the "Going-out" policy in 2001, the newly launched "Belt and Road Initiative" with a series of favourable measures has significantly boosted Chinese investment overseas. Previous studies have shown that institutional factors play a significant, complex and diversified role in determining FDI location choice in comparison with economic factors, while both types of factors influence the FDI location choice of Chinese multinational firms (Kang and Jiang, 2012).

Indeed, China has seen a boost in outward FDI in the region in the past decade, making use of its large foreign exchange reserves and seeking to solve its domestic problem of overcapacity. The fact that most MNCs have state ownership or control has given Chinese SOE access to cheap credit from state-controlled banks for overseas expansion. Adding to it is the highest enterprise savings rate that Chinese SOE having achieved which further propelled it overseas expansion (Morck et al., 2009). Though this surge is also due, in part, to increasingly favourable measures introduced by the host governments in emerging economies, such as Malaysia, it is by a larger extent of the push factor from China that act as a main driver shaping international expansion behaviour of most Chinese firms in Southeast Asia (Cheung and Qian, 2009).

## 4. Chinese FDI in ASEAN

### *4.1 Regional Distribution*

Although Chinese investment in ASEAN remains still relatively low with projects of limited economic scale[1], the past few years have seen a robust growth in Chinese FDI in the region. FDI flow to ASEAN has recorded a 61% average annual growth from US$157 million in 2005 to US$7.27 billion in 2013 (Table 1). Growing capital inflow raised the Chinese FDI stock from US$1.2 billion in 2005 to US$35 billion in 2013, achieving a promising average growth of 51% annually.

Among the ten ASEAN member states, Singapore remains the hottest destination for Chinese outward FDI in 2013. Its share in total Chinese investment in ASEAN grew from 25% in 2005 to its highest 51% in 2008. Despite a slight decline to 41% in 2013, the city-state is still far ahead of the other ASEAN member states as the No. 1 recipient of Chinese investment from 2005 to 2013 (Figure 4). Indonesia maintains a relatively stable position in receiving Chinese investment, as indicated by its share stabilizing around 11% throughout the entire period. While Malaysia has become less attractive to Chinese investors as its share dropped from 15% in 2005 to 4% in 2013, Myanmar headed in the opposite direction, receiving 13% of Chinese FDI in the region in 2013 from a very low level of 2% in 2005, recording an impressive average annual growth of 10% during the period.

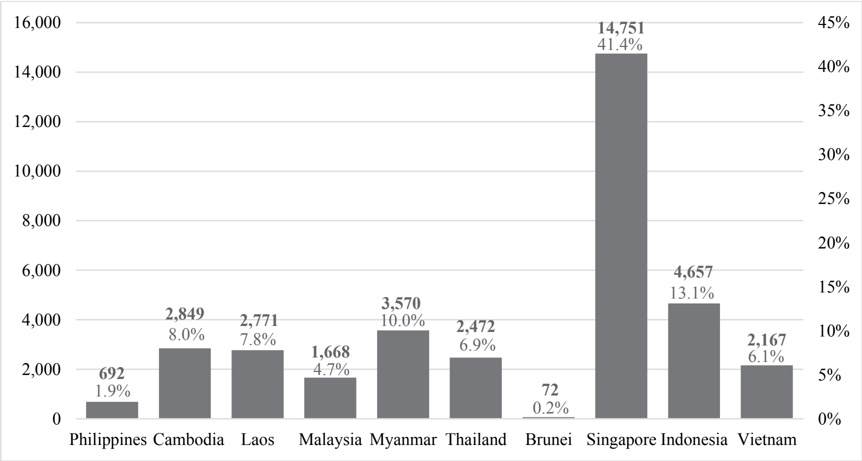
Coupled with encouraging investment stock growth, net investment flow to ASEAN witnessed a promising increase from US$157 million in 2005 to US$7.27 billion in 2013 with a 61% annual growth on average (Table 1). Singapore and Indonesia are still the major destinations for Chinese investment, accounting for about half (49%) of the total investment flow in

**Table 1** China's Outward FDI Flows to ASEAN Countries, 2005-2013 (US$ million)

| *Country/Region* | *2005* | *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* | *Average Annual Growth Rate (%)* |
|---|---|---|---|---|---|---|---|---|---|---|
| Brunei | 0.02 | – | 1.18 | 1.82 | 5.81 | 16.53 | 20.11 | 0.99 | 8.52 | 113.15 |
| Cambodia | 5.15 | 9.81 | 64.45 | 204.64 | 215.83 | 466.51 | 566.02 | 559.66 | 499.33 | 77.14 |
| Indonesia | 11.84 | 56.94 | 99.09 | 173.98 | 226.09 | 201.31 | 592.19 | 1,361.29 | 1,563.38 | 84.11 |
| Lao PDR | 20.58 | 48.04 | 154.35 | 87 | 203.24 | 313.55 | 458.52 | 808.82 | 781.48 | 57.56 |
| Malaysia | 56.72 | 7.51 | -32.82 | 34.43 | 53.78 | 163.54 | 95.13 | 199.04 | 616.38 | 34.75 |
| Myanmar | 11.54 | 12.64 | 92.31 | 232.53 | 376.7 | 875.61 | 217.82 | 748.96 | 475.33 | 59.17 |
| Philippines | 4.51 | 9.3 | 4.5 | 33.69 | 40.24 | 244.09 | 267.19 | 74.9 | 54.4 | 36.51 |
| Singapore | 20.33 | 132.15 | 397.73 | 1,550.95 | 1,414.25 | 1,118.50 | 3,268.96 | 1,518.75 | 2,032.67 | 77.82 |
| Thailand | 4.77 | 15.84 | 76.41 | 45.47 | 49.77 | 699.87 | 230.11 | 478.6 | 755.19 | 88.34 |
| Vietnam | 20.77 | 43.52 | 110.88 | 119.84 | 112.39 | 305.13 | 189.19 | 349.43 | 480.5 | 48.09 |
| ASEAN | 157.71 | 335.75 | 968.08 | 2,484.35 | 2,698.10 | 4,404.64 | 5,905.24 | 6,100.44 | 7,267.18 | 61.41 |

Source: Statistical Bulletin of China's Outward Foreign Direct Investment (2013).

**Figure 4** China's Outward FDI Stock in ASEAN by Countries, 2005-2013 (US$ million)




Source: Statistical Bulletin of China's Outward Foreign Direct Investment (2013).

2013. With a small economies of scale, Brunei recorded a high growth rate of 113% over the period despite the fact the investment amount still remained very low at US$8.5 million in 2013. Overall, Chinese outward FDI net flow into ASEAN grew rapidly with all member states recording a two-digit average annual growth from 2005 to 2013.

Compared to inward FDI, outward investment has just started its engine. Those less developed provinces in China have also benefited from some capital that might have gone abroad. The national campaign such as "West's Great Development" and "The Rise of the Central" have made policy towards central and western China more attractive than ASEAN in attracting the capital. Although Chinese MNCs have taken first steps to invest in the ASEAN market, China's transition from an FDI recipient to investor requires a while before it can become an important international capital exporter such as the US and Japan. Meanwhile, an uneven distribution of outward investment exists among provinces of China. Richer coastal urban provinces and municipalities in the Eastern region report much larger investment stocks aboard than those in the Central and the West. This internal heterogeneity has made economic cooperation between China and ASEAN challenging but complementary. While divergent local policies towards FDI are different from one another, the variation in economic structure and socio-economic development level among eastern, central and western China and among different ASEAN countries requires greater attention for policy formulation to meet different stakeholder demands.

**Table 2** China's Investment* in ASEAN by Sectors until 2015 (US$ million)

| *Sector* | *Value* | *Share of total (%)* |
|---|---|---|
| Energy | 17490 | 33.87 |
| Basic metals manufacturing | 12910 | 25.00 |
| Real Estate | 9730 | 18.84 |
| Transport Sector^ | 3870 | 7.49 |
| Technology product and services | 2750 | 5.33 |
| Finance | 2030 | 3.93 |
| Others | 2860 | 5.54 |
| Total | 51640 | 100.00 |

Notes: * Only those projects valued above US$100 million.
^ Including aircraft lending and shipping.
Source: The China Global Investment Tracker (2015).

### *4.2 Sectorial Distribution*

The analysis in this section is based on the data of 83 mega projects[2] with Chinese investment in the ASEAN region. The total investment for the 83 projects is valued at US$51.64 billion, taking up 95% of the total Chinese FDI stock in ASEAN by 2015 (US$54.32 billion). The fact that these 83 Chinese investors are MNCs reinforces the view that MNCs have taken the lead in investing in ASEAN.

By disaggregating the investment by sector, we found that Chinese investment is largely concentrated in the energy- and metal-related sectors which together absorbed two-thirds of total Chinese investment from 2005 to 2015 (Table 2). The pattern in ASEAN has not been very much different from that in other economies (Kolstad and Wiig, 2012). As ASEAN is rich in natural resource such as iron ore and petroleum, investing in natural and energy resources helps China hedge against future increases in commodity prices. Following the energy sector (33.87%) and metal-related industry (25%), lucrative real estate business becomes increasingly appealing to Chinese investors, attracting the third largest investment amounting US$9,730 million in ASEAN by 2015. Ranking as the fourth largest, transport equipment manufacturing has received US$3.87 billion in investment, accounting for 7.49% of total investment by 2015. In general, except for the real estate sector, Chinese MNCs' FDI in ASEAN has shown a strong tendency towards heavy industry.

In the manufacturing sector, Chinese investment has totalled US$15.2 billion by 2015, taking up 29.4% of total investment in ASEAN (Table

**Table 3** Accumulated Investment in Manufacturing Sector from China to ASEAN, 2005-2015 (US$ million)

| *Sector* | *Value* | *Share of total investment (%)* |
|---|---|---|
| Metals | 12910 | 84.93 |
| Transport Equipment* | 1560 | 10.26 |
| Textiles | 420 | 2.76 |
| Paper and Paper Product | 200 | 1.32 |
| Chemicals and chemical products | 110 | 0.72 |
| Total | 15200 | 100.00 |

Note: * Excluding shipping and aircraft lending.
Source: The China Global Investment Tracker (2015).

3). The bulk of the investment in manufacturing went to sectors where China has comparative advantages, such as metal and transport equipment manufacturing. Among all the manufacturing activities, metal manufacturing accounts for 89.3% of total investment in ASEAN's manufacturing. Following metal fabrication, the transport equipment manufacturing sector attracted 10.2% of the total investment in manufacturing. In a nutshell, Chinese enterprises are investing heavily in producing heavy industrial products, such as steel and copper making, whereas the manufacture of light industrial products takes up only approximately 5% of the total by 2015.

The low investment level of textile and paper product manufacturing is possibly caused by the absence of data on small-scale investment which the current database is unable to capture. Due to the fact that light industry is not capital-intensive in nature (e.g. metal fabrication and energy industry), the sample has limited capability to capture the investment in light industry. Despite this shortcoming, the analysis using 83 mega investment projects provides considerable insights into Chinese MNC investment in ASEAN, as the strong capital capacity of most MNCs have made their investment large-scaled in nature.

Notably, over half (53%) of Chinese MNCs in ASEAN reported incorporating local partnerships. With an eye on developing markets where Chinese investors have to face challenges in understanding different policies, consumption behaviour and socio-cultural background, Chinese MNCs were inclined to collaborate with local partners to overcome difficulties and hurdles in local culture and market conditions. While they continued to forge joint ventures (some to establish wholly-owned overseas entities), Chinese MNC managers tend to launch local businesses through mergers and acquisitions (M&A), which offer the investors a quicker access to dealership and local business networks. The strategy of having a local partner helps MNCs to adapt to the local environment quickly by not only managing good relationships with government and media, but also to quickly integrate with the local business community. Among these, collaboration with host country businessmen provides a feasible solution to engage local buyers and suppliers.

Both greenfield (establishment of new factory or plant) and brownfield (cross-border merger and acquisition) investments can be found as forms of China's OFDI in ASEAN. According to the report of China Global Investment Tracker from January 2005 to December 2015, 37% of the number of total investments (40 out of the 83 China-funded mega projects) was recorded as Greenfield. In general, China's greenfield investment in ASEAN is found mostly in the energy-related sector and infrastructure projects, in both of which China has a competitive advantage and which also helps to reduce its over-capacity in steel and concrete production. Singapore is perhaps the only exception where out of the 18 China-funded projects, only 1 project (taking up 0.8% of total value) was considered as greenfield investment while the remaining are all brown-field in nature. China's strategic intent of going global to acquire technology and know-how has driven China's capital into sectors which China does not have advantages in. Also, the expensive labour and land costs in Singapore has turned out to be a deterrent for Chinese SOEs who are also conscious of profit-maximizing.

## 5. Conclusion

China's economic growth in 2015 has fallen to 6.9% from an unrivalled average of 10% between 2002 and 2014. While the global economy is feeling the impact of China's economic restructuring, a change of such a magnitude in China has created a great impact on Southeast Asia, which is intensively involved in trade and investment with China.

By analyzing data from the China Global Investment Tracker, we find that China's investment in ASEAN has witnessed a significant growth in defiance of China's economic slowdown. Unlike international trade which is rather sensitive to economic turbulence, China's outward investment shows no immediate shock from the country's economic slowdown. Instead, in an economically challenging era after 2007, Chinese OFDI in Southeast Asian countries has increased significantly.

An analysis of regional and sectoral distribution of China's investment has captured a changing pattern of Chinese OFDI in Southeast Asia which reflects the paradigm shift of China's economy from an export-oriented to an investment driven growth. Chinese OFDI in Southeast Asia is distributed unevenly in geographical and industrial terms. While Singapore, Indonesia and Malaysia remain hot destinations for Chinese OFDI, CLMV countries have caught up quickly in attracting Chinese capital especially in those sectors where Chinese companies have comparative advantage such as infrastructure, energy- and metal-related sectors. Though Chinese FDI in the region has shown a strong tendency to be in heavy industry by 2015, the lucrative real estate business has become increasingly attractive to Chinese investors buying overseas houses in the region.

The rising wave of Chinese investment in Southeast Asia can also be understood through the dilemma facing China's manufacturing which is heavily crippled by its redundant capacity. The strong currency in addition to increasing production costs, such as land and labour, has significantly reduced cost advantages of Chinese manufacturing in the international market. Therefore, the decelerating return rate in domestic China has driven a growing number of enterprises to move their domestic production overseas in search of higher returns. Southeast Asia, especially the CLMV countries with the advantages of having cheap labour with favourable policies towards foreign investment, has thus attracted large Chinese investment. The overall increase of Chinese OFDI is not only the result of a firm's strategic shift to relocate to seek higher returns, but also a necessary choice of Chinese firms to be adaptive to the worsening business environment in China's domestic market. Policy makers have to be cautious about the latter development, if not addressed, the Chinese economy may lose its glamour to not only domestic but also international investors. Necessary capital controls should be considered as an option, as uncontrolled capital outflow may eventually generate a disastrous impact on the domestic economy given the massive scale of capital which has been in place in the global market.

As with most studies, this study is not bereft of limitations. As argued by evolutionary economists, location, timing and sectors matter in institutional change (Nelson, 2008). Given the existence of huge diversity in socio-economic conditions among different ASEAN countries, in-depth country studies on a specific sector should be undertaken to better understand the intricacies faced by Chinese OFDI much better than the broad review undertaken in this paper. While a concrete regional study by using quantitative data should shed light on the overall development of Chinese OFDI in the region, qualitative in-depth studies should be conducted in future to garner deeper understanding on the impact of China's economic slowdown on firms' decision to relocate in Southeast Asia. Finally, the very nature of Chinese OFDI and ASEAN host country conditions are evolving. Down the road, the story of China-ASEAN investment links may well look different from what has been described in this paper.

## Notes

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1. Compared to other major investors, China still remains a latecomer in investing in ASEAN. With a total investment of US$8,869 million flowing to ASEAN in 2014, China apparently has a long way ahead to compete with other leading investors in the region, such as the European Union ($29,268 million), Japan ($13,381 million) and the US ($13,042 million).
2. Mega projects refers to projects with investment above USD100 million.

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