Outward Foreign Direct Investment: A Novel Dimension of China’s Integration into the Regional and Global Economy*

Kevin G. Cai

It is now receiving wide attention that since the adoption of the open-door policy at the end of the 1970s China has been extremely successful in attracting foreign direct investment (FDI). Particularly, according to UNCTAD’s World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy, China has become the second largest recipient of FDI in the world since 1993, after the United States. On the other hand, however, it seems less noticed that China has also become a growingly important FDI exporting country. According to UNCTAD’s same report, China now ranks as one of the largest outward investors among developing economies in the 1990s. By the end of 1996, the cumulative stock of Chinese outward FDI had reached over $18 billion, next only to Hong Kong ($112 billion), Singapore ($37 billion) and Taiwan ($27 billion). Consequently, China increased its share in

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1. According to United Nations Conference on Trade and Development (UNCTAD), foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (that is, foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. FDI comprises three components: equity capital, reinvested earnings and intra-company loans. (UNCTAD, World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy (New York & Geneva: United Nations, 1997), p. 295) This definition of FDI is adopted in this article.


3. UNCTAD, World Investment Report 1997, pp. 319–324. According to James Xiaoning Zhan, there are two main sources of data on Chinese outward FDI, the IMF and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). However, the data-collection and estimation methods adopted by these institutions are so different that there are large discrepancies in the values reported. The MOFTEC data are based on official approval figures for initial outflows rather than actual investment, thus excluding reinvested earnings by Chinese foreign affiliates that have passed the original screening process. MOFTEC also does not screen many other outward FDI projects. Furthermore, numerous small investment projects have simply escaped the screening process. Hence the MOFTEC data significantly underestimate China’s actual FDI outflows. The IMF estimates are based on sample data collected by the State Administration of Foreign Exchange Control of China (SAFE) from its offices in various provinces. They represent actual capital movements and cover equity capital, reinvested earnings and inter-company loans. For this reason, the IMF data are adopted by UNCTAD’s report, on which this article relies. For a detailed discussion on the issue, see James Xiaoning Zhan, “Transnationalization and outward investment: the case of Chinese firms,” Transnational Corporations, Vol. 4, No. 3 (December 1995), p.72.

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world-wide FDI outflows from less than 0.5 per cent until 1991 to an average of 1.3 percent in 1991–95.\footnote{UNCTAD, \textit{Sharing Asia’s Dynamism: Asian Direct Investment in the European Union} (New York & Geneva: United Nations, 1996), p.11.} As China is rapidly rising as a new economic power, its deepening participation in the regional and global economy, through both inward and outward FDI as well as trade, will inevitably bring about significant implications in the international political economy. This article attempts to explore the development of Chinese outward FDI, its characteristics and motives, the outward FDI regime, the government’s policies and existing problems, and the prospects for the future trend of Chinese outward FDI.

Before beginning, there are two important points that require clarification. First, it is useful to define the scope of the study. Precisely speaking, this article deals solely with the foreign direct investment that flows out of China \textit{legally}, that is, the purchase of productive assets abroad by Chinese enterprises with official approval from the Chinese government. In other words, this article does not cover other phenomenal capital outflows from China that have also been on the rise in recent years, specifically, overseas portfolio investment and illegal capital outflows for whatever reasons from various channels.

The recent years have witnessed a drastic increase in China’s overseas portfolio investment. According to one source, in the period 1991–94 this reached $9.4 billion, as compared to $1.0 billion in the period 1987–90.\footnote{Wang Jun, “An analysis of the total amount and structure of the capital outflows from China,” \textit{Reform}, No. 5 (1996), p. 94.} However, overseas portfolio investment refers to the purchase of financial instruments abroad, such as foreign stocks and bonds. As this type of capital export is very different from outward FDI, it will not be covered in this article.

It is also important to note that there have also been increasing illegal outflows of capital (capital flight) from China through various channels in recent years. The amount involved (primarily public funds embezzled into private account and/or private investment projects abroad) has been estimated as even greater than the amount of legal capital outflows. According to Long Guoqiang, for example, since the initiation of economic reform and the adoption of the open-door policy in the late 1970s there has been an accumulated amount of $80–100 billion of Chinese capital outflows, of which only $15 billion is approved by the Chinese government.\footnote{Long Guoqiang, “How to prevent capital flight,” \textit{China Economic Times}, 14 May 1997, p.4.} In Wang Jun’s estimation, the total amount of capital flight from China in the period 1982–94 was between $54.7 billion and $120.0 billion.\footnote{Wang Jun, “An analysis,” p. 93.} These illegal capital outflows are primarily a result of the various loopholes that existed during the nation’s transition period from the previous planned economy to a market economy, thus constituting an important part of the corruption that is now so prevalent in China.
Nevertheless, this article will not discuss the issue of China’s illegal capital outflows, a topic that deserves a separate article.8

The second important point that requires clarification concerns the status of China’s direct investment in Hong Kong since 1997. While the data quoted in this article primarily cover the pre-1997 period, the discussion of China’s outward FDI does go beyond 1997. Consequently, there arises the important issue of how to identify properly the status of China’s direct investment in Hong Kong in the post-1997 era, as Beijing has now regained sovereignty over this former British colony. This issue is important, particularly because China’s direct investment in Hong Kong accounts for a major chunk of its total outflows of direct investment.

While it may be theoretically right to say that the Chinese direct investment in Hong Kong can no longer be seen as “foreign” because the territory is now part of China, it is obviously very difficult to identify it as purely “domestic” as the term is usually understood. Mainland China and Hong Kong actually remain independent economic entities with their own respective currencies under the framework of “one country two systems.” Hong Kong still keeps its status as a separate custom territory as stipulated by the Basic Law regarding the territory. As a consequence, both Beijing and Hong Kong continue to treat the movements of capital and goods between them as “foreign,” and compile statistics of these economic activities accordingly. As such, Chinese direct investment in Hong Kong in the post-1997 period still assumes the nature of “foreign” direct investment.

To pursue the argument further, there is also an intractable technical problem. If investment movements between China and Hong Kong are treated as domestic after 1997, it would then be necessary to conclude that their FDI outflows combined, excluding those between them, should be considered as being of the same origin. A similar measure should also apply to trade, balance of payments, foreign exchange reserves and so on. Obviously this picture is too far away from reality.

Probably because of this very fact, International Monetary Fund (IMF), World Trade Organization (WTO) and other relevant international organizations continue to treat China and Hong Kong as two independent economic entities, seeing investment and trade between them as “foreign” rather than “domestic” in compilation of relevant post-1997 statistics. This is also the understanding of other governments, which, while now seeing Hong Kong as part of China, still treat China and Hong Kong as two separate economies.9

Given all this reasoning, this article will continue to use the term foreign direct investment (FDI) to refer to China’s post-1997 outbound

8. For a detailed discussion of illegal outflows of Chinese capital, see ibid. and Long Guoqiang, “How to prevent capital flight.”

9. It is interesting to note that while it is now becoming possible to have a growingly unified economic entity among multiple sovereign states – as is happening in European Union – it may also be acceptable to have two or more independent economic entities under one sovereignty – as now in the China-Hong Kong relationship.
FDI as a whole, including Chinese investment in Hong Kong, though this investment in Hong Kong may be more accurately described as “Hong Kong-directed” rather than “foreign” under the current political framework of the China–Hong Kong relationship. This measure of convenience applies to Macau as well after the territory is turned over to Chinese sovereignty at the end of 1999.

Development of Chinese Outward FDI

Before the late 1970s, China’s outward FDI was minimal and the only activities were largely trade-servicing in nature. According to a Chinese official source, for example, the Chinese outward FDI for 1979 was a negligible amount of 0.8 million yuan (equivalent to about $0.5 million at the current official foreign exchange rate). It was after the Chinese government initiated its open-door policy at the end of the 1970s that Chinese outward FDI began to develop. Even so, in the early years of the open-door policy, China’s outward FDI was insignificant as a foreign economic activity, which reflected the priority during the initial stage of reform of the nation’s domestic economic restructuring. Both market and capital conditions did not yet necessitate a strategy of investing abroad. Thus, China’s annual FDI outflow made a relatively modest increase from $35 million in 1980 to $134 million in 1984, an increase of four times in four years (see Table 1). From 1979 to 1985, China established 185 non-trading foreign affiliates, mostly in the form of joint ventures. These overseas enterprises spread over 45 countries and economies, primarily in the developing world. Most of the investment projects were in such industries as catering, engineering, finance/insurance and consultation, with very few in manufacturing.

These early outward FDI activities were mainly conducted by centrally controlled state-owned enterprises, that is, various long-established specialized foreign trade corporations (FTCs) and newly created foreign business oriented corporations (FBOCs). On the other hand, it is important to note that many of these early investment activities were to a great extent motivated by the government’s political rather than commercial interests. This was particularly evident in China’s heavy investment in Hong Kong and, to a lesser extent, in some strategically and/or politically important Third World countries.

Starting in the mid-1980s, however, there was a big jump in China’s

Table 1: China’s FDI Outflows, 1979–1996 (US$ million)

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<tbody>
<tr>
<td>Value</td>
<td>0.5</td>
<td>35</td>
<td>9</td>
<td>44</td>
<td>93</td>
<td>134</td>
<td>628</td>
<td>450</td>
<td>645</td>
<td>850</td>
<td>830</td>
<td>913</td>
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<td>4,400</td>
<td>2,000</td>
<td>2,000</td>
<td>2,200</td>
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Sources:
Outward Foreign Direct Investment

FDI outflow. In 1985 it reached $628 million, almost five times that of the previous year, and by 1990 it increased to $830 million (see Table 1). From 1985 to 1990, a total of 577 Chinese foreign affiliates (non-trading) were established, a figure which was over three times that for the period 1979–85. The Chinese foreign affiliates, covering over 90 countries and economies (including many developed countries), were now involved in a much wider range of industries, such as metallurgy/minerals, petrochemicals/chemicals, electronics/light industry, transportation, finance/insurance, medicine and tourism. More and more Chinese companies, including manufacturing enterprises, were involved in outward FDI activities in this period, which had previously been the monopolized domain of FTCs and FBOCs. As a result, Chinese transnational corporations (TNCs) became more diverse and numerous, and some big TNCs emerged during this period, such as the China National Metals and Minerals Import and Export Corporation, and China National Chemical Import and Export Corporation. The former established 49 foreign affiliates and offices in 23 countries with an annual business turnover of $7 billion (of which $2.6 billion was from overseas transactions), and the latter set up 62 foreign affiliates in Asia, Europe, the United States and Australia with an annual turnover of $12.8 billion (of which $4.8 billion was from its foreign affiliates).14

Entering into the 1990s, Chinese outward FDI experienced booming development. In particular, the annual outflows reached records of $4 billion in 1992 and $4.4 billion in 1993 (see Table 1). As a result, the annual average of China’s FDI outflow substantially increased from $54 million in 1984–89 to $2,429 million in 1990–94, surpassing other major developing economies except Taiwan (see Figure 1). China has thus become one of the top FDI exporters among developing economies. While in 1985 the cumulative stock of China’s outward FDI was $131 million, well behind the $526 million of South Korea and even further behind the $1,361 million of Brazil, it increased to $2.5 billion in 1990 and $15.8 billion in 1995. By the end of 1996, the total stock of China’s outward FDI reached $18.0 billion, surpassing the $13.8 billion of South Korea and the $7.4 billion of Brazil, behind only Singapore, Taiwan and Hong Kong (see Table 2).15 In the process, China’s share in the total outward FDI stock originating from developing economies has increased substantially (see Figure 2).

footnote continued


15. Taiwan is another economy that has experienced very rapid development of outward FDI around the same period, largely due to the economic restructuring on the island. On the other hand, the rapid increase of Hong Kong’s FDI outflows in the first half of the 1990s was at least partly due to the effects of the prospective handover of sovereignty over the territory from Britain to China (see Table 2). It is interesting to note that the three constituencies of what is now widely called the Greater Chinese Community (China, Taiwan and Hong Kong) have now held the lion’s share of outward FDI originating from the developing world, although a large sum of their FDI is directed among these economies themselves. If Singapore is also considered as a member of this Chinese community, the share is even larger.
To match the rapidly growing volume of Chinese FDI outflows, there has been a corresponding drastic increase in the number of Chinese TNCs and their affiliates abroad. While in 1983 there were only 61 Chinese foreign affiliates in about 30 countries, by the end of 1994 over 900 Chinese TNCs had established over 4,600 foreign affiliates in 130 countries. The current number of Chinese foreign affiliates is estimated

Table 2: Outward FDI Stock of Selected Developing Economies, 1985, 1990, 1995 and 1996 (US$ million)

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<tbody>
<tr>
<td>China</td>
<td>131</td>
<td>2,489</td>
<td>15,802</td>
<td>18,002</td>
</tr>
<tr>
<td>South Korea</td>
<td>526</td>
<td>2,301</td>
<td>10,227</td>
<td>13,757</td>
</tr>
<tr>
<td>Singapore</td>
<td>6,254</td>
<td>9,675</td>
<td>32,695</td>
<td>37,495</td>
</tr>
<tr>
<td>Taiwan</td>
<td>204</td>
<td>12,888</td>
<td>24,200</td>
<td>27,296</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2,345</td>
<td>13,242</td>
<td>85,156</td>
<td>112,156</td>
</tr>
<tr>
<td>Brazil</td>
<td>1,361</td>
<td>2,397</td>
<td>6,460</td>
<td>7,431</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>7,243</td>
<td>12,689</td>
<td>25,004</td>
<td>28,854</td>
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</tbody>
</table>

Source:

Outward Foreign Direct Investment

Figure 2: China's Share in Total Outward FDI Stock Originating from Developing Economies, 1985 and 1996

1985 China 0.5% All Other Developing Economies 99.5%
1996 China 6.4% All Other Developing Economies 93.6%

Source:

to be over 6,000,17 spreading over 180 countries and economies.18 By 1995, seven TNCs from China were among the top 50 TNCs of developing economies origin, ranked by foreign assets, compared with nine from Hong Kong and seven from South Korea.19 It is estimated that the total foreign assets owned by Chinese TNCs are between $190 billion and $195 billion, including the lion's share of $156 billion owned by the Bank of China.20

This rapid development of Chinese outward FDI after the mid-1980s has reflected not only that the Chinese economy is becoming increasingly integrated with the regional and global economy but also that the country needs to invest abroad to keep the development momentum of the domestic economy. The growing economic strength, particularly the growing foreign exchange reserves of the nation, has made the rapid growth of outward FDI possible.21 In this process, the provincial and municipal governments, following the decentralization of the economic system after 1984, have played an important role in pushing a large number of local FTCs and FBOCs into overseas investment activities in order to obtain capital, technology and trade support for their respective local development strategies. A large number of trade companies which were set up by various ministries, provincial governments and municipalities in the special economic zone (SEZ) of Shenzhen in the early 1980s have also joined this process by expanding their business operations.

abroad to pursue their own strategic objectives. Consequently, outward FDI has increasingly become an important part of China’s integration into the world economy.

Characteristics of Chinese Outward FDI

An analysis of the data reveals that Chinese outward FDI has the following characteristics with respect to the geographical distribution, sector distribution, form of outward FDI, and capital-raising channels.

Geographical distribution. Chinese outward FDI now spreads over 180 countries and economies. However, the largest part is concentrated in the neighbouring economies, particularly in Hong Kong. From 1979 to 1993, Hong Kong and Macau accounted for 61 per cent of China’s total FDI outflows, followed by North America (15 per cent), Oceania (8 per cent), Asia Pacific excluding Hong Kong and Macau (5 per cent), Central and Eastern Europe (5 per cent), and Africa, Latin America and Western Europe (2 per cent each). Generally speaking, Chinese outward FDI in the services sector is primarily located in developed countries, while that in the natural resources sector is concentrated in a few resource-rich countries in North America, Australia and Latin America. North America accounts for the largest regional share (32 per cent) in the non-trade sector. While Chinese outward FDI in developed countries has hitherto been concentrated in North America, more recently that in the European Union has gathered momentum.

The orientation of Chinese FDI towards other economies in the region is largely because of greater familiarity with business conditions, low costs and cultural similarity within the region. In particular, ethnic ties play an important role. In any analysis of Chinese outward FDI, it is important to note that the Chinese government, for both political and economic considerations, has especially promoted FDI to Hong Kong. As a result, Hong Kong has become the single largest host economy receiving Chinese outward FDI. By 1993, Chinese investment in Hong Kong reached about $20 billion. In turn, China became the largest investor in Hong Kong (excluding the United Kingdom), well ahead of Japan and the United States.

Sector distribution. In general, Chinese outward FDI involves various business areas, including trade, turnkey projects, labour services, resources exploration and extraction, processing, manufacturing, transport and communications, finance and insurance, medical and health services, consultation, hotels, and so on.28 However, a detailed analysis of the sector distribution of Chinese outward FDI suggests an outward investment pattern that reflects the existing structure of Chinese domestic economy and the country’s comparative advantage.

Investment in the services sector has accounted for over 60 per cent of China’s total FDI outflows. However, the dominant chunk of this investment is related to trading, which has accounted for over 50 per cent of total Chinese FDI outflows. Although large in total value, the average size of Chinese foreign affiliates in trade and other services is small.29 Currently there are over 3,000 Chinese foreign affiliates in the services sector world-wide.30 The high percentage of China’s FDI outflows in the trading sector reflects that Chinese outward FDI is largely used to serve and promote the export of commodities.

Chinese outward FDI in the natural resources sector accounted for approximately 25 per cent of total FDI outflows up to 1994. Chinese foreign affiliates in this sector are fewer in number but larger in scale, primarily in minerals and forestry in the western hemisphere and Australia, and ocean fisheries in Africa and Latin America.31 Examples of large FDI projects in this sector include China Metallurgical Import & Export Corporation’s $180 million investment in Channar Mine in Australia (with an average annual output of around ten million tons of iron ore over 20 years), China International Trust and Investment Corporation (CITIC) and China National Non-ferrous Metal Industrial Corporation’s $120 million investment in the Portland Aluminium Smelter in Australia, Shougang Corporation’s acquisition of Hierro Peru Mining Ltd, China Petroleum and Natural Gas Corporation’s investment in the exploration and exploitation of oil in Papua New Guinea, and CITIC’s investment in forestry in the state of Washington in the United States. There are also over 60 joint ventures in ocean fishery in over 20 countries.32 The growing percentage of Chinese outward FDI in the natural resources sector indicates that the country’s rapid economic development requires resource consumption that domestic supplies can hardly satisfy.

The manufacturing sector has accounted for a relatively small share of Chinese outward FDI, approximately 15 per cent, and this investment is

29. The figure of over 60% for the services sector as a whole is taken from Zhan, “Transnationalization,” p. 74; the figure of over 50% for trading is from UNCTAD, *World Investment Report 1995*, p. 56.
directed mainly to Africa, Asia and the Pacific. Chinese investment in this sector is usually characterized by relatively small-scale projects; labour-intensive production techniques and processes; and relatively simple and adapted technologies; and production of undifferentiated and low-value-added goods. Manufactures such as textile and clothing, footwear, bicycles, simple electrical appliances and electronic products are industries where Chinese companies possess a competitive edge. A few large conglomerates in technology-intensive industries such as aviation, astronautics and electronics have established foreign affiliates, but such advanced technology-seeking projects have been few in number. The relatively low percentage of Chinese outward FDI in the manufacturing sector well indicates the current development stage of the Chinese economy, which is not yet in a position to export technology-oriented capital.

Form of Chinese outward FDI. While almost all Chinese FDI ventures in banking and trade-supporting areas are wholly Chinese-owned, TNCs in other sectors have a preference for joint ventures or various cooperative projects with local partners (about 80 per cent of the Chinese non-trade enterprises abroad taking this form). Within the joint ventures, however, Chinese TNCs are generally inclined to hold a majority equity share (between 40 and 70 per cent) so as to be able to control the operation of ventures. The reasons for this preference — in addition to the government policy of some developing countries of prohibiting wholly foreign-owned enterprises — include limited financial resources, lack of necessary knowledge of local business conditions, minimizing or avoiding various risks, and use of the various existing networks of local partners. On the other hand, the entry mode of Chinese outward FDI projects is largely decided by the financial resources, international experience and technological ability of specific Chinese TNCs. With their expertise in international operations and better business information system, the FBOCs and FTCs prefer to invest in advanced technological firms in industrial countries and large projects in resources extraction through mergers and acquisitions, while the small and middle-sized manufacturing companies tend to establish greenfield investment projects. Of all Chinese outward FDI, 22 per cent is conducted through mergers and acquisitions while 78 per cent is of greenfield nature.

Channels of capital raising. In addition to investments in kind, such as technology, equipment, labour and trade marks valued in monetary terms, there are two major channels of capital raising for Chinese TNCs that invest overseas, from within China and from the local and inter-

34. Zhan, "Transnationalization," p. 76.
national financial markets. However, as China is still a capital-scarce country and the Chinese government is still quite restrictive on outflows of foreign exchange, Chinese TNCs, especially the large ones, have increasingly relied on the funds raised from the local banks in host countries and/or from the international financial markets for their investment and/or reinvestment. Only part of the investment really stems from foreign exchange remitted from China. In the words of two Chinese scholars, this is termed “making money from foreigners with foreigners’ money.”

**Motives for Chinese Outward FDI**

The motives for Chinese outward FDI are generally similar to those for FDI from other developing and developed market economies. Although lingering political considerations in Chinese outward FDI are still visible in some cases (as Chinese TNCs are primarily state-run enterprises, subjected finally to the central government’s foreign policy), it is safe to say that economic considerations have now become the primary engine of Chinese outward FDI. Like TNCs from developed and other developing economies – primarily Asian newly industrialized economies (NIEs) – in this respect Chinese TNCs are becoming more globalized in response to competitive pressures, the domestic liberalization process, and the opening up of new areas for investment.

Specifically, the following major economic motives can be discerned in Chinese outward FDI. First, many Chinese TNCs invest abroad to seek, maintain or expand export markets. Like many developed economies and NIEs that have experienced various stages in their economic development, China has recently undergone a process of structural change and upward mobility in its economic development. Largely because of the saturation of the domestic market, some traditional industries are found to be no longer profitable in China. In the meantime, the growing liberalization of both trade and investment regimes adds to the competition within the domestic market. On the other hand, increasing the export of these products abroad is checked by growing trade barriers in many countries.


40. According to Transnational Corporations and Management Division, Department of Economic and Social Development of the United Nations, there are five primary types of FDI undertaken by TNCs from developing countries, that is, market-seeking FDI, export-oriented FDI, resource-seeking FDI, technology-seeking FDI and efficiency-seeking FDI. UN-TCMD, *Transnational Corporations from Developing Countries: Impact on Their Home Countries* (New York: United Nations, 1993), pp. 11–14.

As a result, the growing competition pressures in China coupled with increasing protectionism in other countries have forced many Chinese companies to establish factories abroad.\textsuperscript{42}

Outward FDI helps the export of Chinese commodities in various ways. First, Chinese outward FDI, largely in the form of joint ventures, directly promotes the export of Chinese capital goods and related materials, especially to developing countries; raw materials, supplementary materials and semi-products, as in many manufacturing and processing projects; and Chinese technology know-how, special techniques, patents, and trade marks, when joint venture projects require such contributions from Chinese TNCs. On the other hand, Chinese foreign affiliates play a uniquely important role in collecting up-to-date information on the international market, which is often crucial for the production and provision of suitable commodities for export. Most importantly, under growing world-wide protectionism Chinese TNCs establish factories particularly in those countries where there is no export quota or where Chinese TNCs could use local export quotas for other markets, thus effectively circumventing trade barriers and helping maintain or increase export share in the markets of many developed countries.\textsuperscript{43}

Secondly, Chinese outward FDI is used to acquire a stable supply of resources, primarily in fisheries, forestry and mining. With its rapid economic development China has now become a net resources importing rather than an exporting country. By 1997, for example, the total value of minerals that China imported reached $13.0 billion while the value for mineral exports was only $8.6 billion.\textsuperscript{44} For the single important item of petroleum, China imported 45.37 million tons while exporting only 26.96 million tons with a deficit of 18.41 million tons in 1996.\textsuperscript{45} Thus, Chinese outward FDI in the resources sector plays a growing role in compensating for the shortages of raw materials in China. For example, since 1985 a number of Chinese TNCs have established either joint ventures or wholly Chinese-owned fishing affiliates in over 20 countries, including Morocco, Senegal, Sierra Leone, Gabon, Nigeria, Iran, the United States, Argentina, CIS countries and Indonesia, and have so far brought back to China hundreds of thousands of fishing products. Some Chinese TNCs have also been involved in the projects on mineral resources in Australia and Brazil. For example, China Metallurgical Import and Export Corporation has been involved in a joint venture project on extraction of iron ore in Australia, holding 40 per cent of the total share of AU$280 million.


\textsuperscript{43} At present, labour and special technique export, which has traditionally been the country’s major sources of earning foreign currency, is particularly important for China because it can help relieve the increasingly serious unemployment burden brought about by the large-scale restructuring of the state-owned enterprises.


\textsuperscript{45} \textit{Ibid.}, p. 254.
Within the 30-year duration of the joint venture there will be a stable shipment of 200 million tons of quality iron ore from Australia to China.46 China Petroleum and Natural Gas Corporation has been involved in the overseas investment in the exploration and exploitation of oil in Peru and Canada since 1992. Since 1996, the company has also obtained oil-related projects in Sudan, Venezuela and Kazakhstan. On 15 September 1997 the first shipment of crude oil obtained from the company's overseas investment was brought back to China.47 On 24 September 1997 China and Kazakhstan signed energy-related agreements on Chinese involvement in three big projects of oil exploration and exploitation in Kazakhstan, totalling $9.5 billion in cost. The agreements provide for the construction of a 3,000 kilometre pipeline from Kazakhstan to western China and another 250 kilometre pipeline crossing the Turkmen border to Iran, and the mining of oil deposits in Kazakhstan.48 In the forestry industry, Chinese TNCs have also invested actively in North America, Latin America, Africa and the South Pacific region.49

Thirdly, outward FDI is used by some Chinese TNCs as an effective channel to obtain foreign technology and management skills. There are several ways of acquiring advanced technology crucial for the renovation of China's own state enterprises through investing abroad: by establishing joint ventures with those foreign companies that possess advanced technology; by purchasing shares in those foreign companies that have advanced technology; by using semi-advanced equipment which is purchased locally in the operation of foreign affiliates; by assimilating advanced technology parts and components from foreign companies into domestically produced equipment; and by acquiring technologically advanced equipment through foreign affiliates at a lower price than otherwise.50 Furthermore, the operation of FDI affiliates abroad encourages the training of management personnel. As these Chinese foreign affiliates operate in an environment where business is conducted according to international standards, personnel are able to receive first-hand training and invaluable experience. The Chinese foreign affiliates also play an important role in collecting up-to-date information on technological development abroad.51 On the other hand, in contrast to most TNCs from Asian NIEs, Chinese TNCs have little incentive for efficiency-seeking outward investment, for China itself has an ample supply of low-cost, productive labour and inexpensive land.52

Fourthly, while some Chinese TNCs rely on the capital raised in the international financial markets for their outward FDI projects, other companies use outward FDI as an efficient channel to raise capital,

46. Jiang and Zou, Foreign Investment, pp. 18–19.
primarily in Hong Kong, for domestic use. They do this by seeking public listing of their shares on the Hong Kong Stock Exchange through either acquisitions or new listings and by the use of various debt instruments. From 1993, many Chinese enterprises have been successfully listed on the Hong Kong Stock Exchange and have often been many times oversubscribed. However, as many Chinese state-owned enterprises do not meet the requirements of the Hong Kong Stock Exchange for listing, especially with respect to international accounting and reporting standards, some of them have acquired Hong Kong companies that are already listed in the exchange, or have acquired non-listed Hong Kong companies that satisfy the requirements and subsequently listed them, or have established holding companies by themselves in Hong Kong that meet the requirements. Some of the funds raised are then used to support investment projects in China, establishing a direct link between outward and inward FDI. Outward FDI, in these cases, is a means for Chinese TNCs to overcome domestic capital scarcity.

In the specific case of Chinese FDI in Hong Kong, Chinese TNCs have also gained a number of additional advantages from direct investment. For instance, Hong Kong is used by some Chinese TNCs as regional headquarters or springboards for their broader strategic objectives of internationalization. Important examples include Fujian Enterprise (Holdings) Ltd, Guangdong Enterprise (Holdings) Ltd and China Resources, all of which have established foreign affiliates in other countries from their Hong Kong affiliates. Hong Kong is also used by many Chinese companies as a window to observe world market trends and develop better information channels. In addition to the economic considerations, Hong Kong is attractive because of its geographical and cultural proximity to China.

In any analysis of Chinese outward FDI, it is also important to point out that political considerations always play an important role. Chinese FDI in Hong Kong is an example of this. Over time, Chinese TNCs have made quite a few high-profile investments in Hong Kong, such as CITIC’s acquisition of the Ka Wah Bank, China Merchants Holdings Ltd’s acquisition of Union Bank, the Bank of China Building ($130 million), the second harbour tunnel ($390 million), and the partial take-over of Cathay Pacific Airways by CITIC (a 12.5 per cent stake for $260 million). Chinese TNCs have also invested in sectors like housing and telecommunications, as well as essential services ranging from waste

53. Some Chinese companies have also raised capital through similar means in other major international financial markets, such as New York, Tokyo, etc.


disposal to power plants. As a result, the number of China-invested companies in Hong Kong has reached over 1,800. Consequently, Chinese TNCs have been playing an increasingly crucial role in the economic life of Hong Kong. They serve as part of Beijing’s strategy of keeping Hong Kong’s economy stable so as to avoid adverse political and economic effects both before and after the Chinese regained sovereignty over the territory.

China’s Outward FDI: The Regime, Policies and Problems

According to UNCTAD’s World Investment Report 1996: Investment, Trade and Investment Policy Arrangements, trade and FDI are mutually supportive. Trade leads eventually to FDI and FDI leads to more trade. The result is an intensification of international economic transactions. The development of China’s foreign trade and FDI (both inward and outward) is illustrative of this phenomenon. In this process, the growing liberalization of the FDI regime by the Chinese government, first in the area of inward FDI and then gradually spilling over into the outward FDI area, has provided a favourable policy environment for a positive interaction between trade and FDI to take place. On the other hand, however, the specific policies of the Chinese government towards outward FDI also reflect the level of national economic development, the country’s factor endowments and the specific developmental objectives of the government. Generally speaking, the Chinese government permits outward FDI primarily within the context of its national objectives and resources availability.

China has undergone a process of gradual liberalization of its outward FDI regime since the early 1980s, in line with the country’s overall economic reform. Like many other open-door measures, outward FDI has been viewed by the Chinese government as an important means of integrating the country into the world economy and strengthening economic relations with neighbouring countries. The more immediate and specific considerations of the Chinese government in promoting outward FDI, however, are to secure a stable supply of raw materials and improve export opportunities. On the other hand, largely as a result of the government’s concerns over avoiding precipitation of capital flight and foreign exchange constraints, the liberalization process of the outward FDI regime is more cautious and slower than that of the inward FDI

57. China Economic Times, 22 May 1997, p. 1. This figure (1,800) represents those that have received formal approval from the relevant authorities of the Chinese government. However, an even larger number of Chinese companies have registered in Hong Kong without obtaining the formal approval of the domestic authorities. Some scholars estimate that the actual figure of Chinese companies in Hong Kong is around 5,000. See Danming Lin, “Hong Kong’s China-invested companies,” p. 167.

regime. In particular, to avoid excessive capital outflows at the expense of domestic investment, government policies generally favour investments in kind, such as equipment, know-how and manufacturing materials. In the meantime, the government limits capital export by encouraging Chinese investors to share fixed investment requirements with local partners and to raise funds in local or international financial markets.

The Chinese government first allowed outward FDI in 1979 as part of its broader open-door policy. Before 1983, however, the approval process of outward FDI was highly centralized. From that time it has been increasingly decentralized. China’s policies with respect to the administration of outward FDI have been codified in specific rules and regulations, which involve the following important documents: the Approval Procedures and Administration of Non-Trade Joint Ventures Set Up Abroad (1985), the Approval Procedures and Administration of Trade-related Organizations Set up Abroad (1988), the Administration of Foreign Exchange for Outward Investment (1989), and the Approval Procedures and Administration of Overseas Investment (1993). Despite these official documents, however, there has been so far no formal law governing outward FDI, which is still being regulated through about ten provisional regulations and administrative procedures.

Under the outward FDI regime thus established, MOFTEC is authorized as the primary government organ responsible for its approval and administration. The other government departments involved in governing outward FDI include local authorities, the State Planning Commission, the State Council, the Ministry of Finance, the Administration of State Assets and the State Foreign Exchange Administration. Depending upon the type, scale and location of non-trade investments being proposed, appropriate approvals are required from different levels of government. Projects worth more than $30 million are subject to approval by the State Council. Approvals from MOFTEC are required for those projects that are valued between $1 million and $30 million, the projects that involve government loans, guarantees for foreign loans or use of the nation’s foreign exchange, the projects that are conducted in Hong Kong and Macau or in those countries with which China has not had diplomatic ties, and the projects that are in some specific investment areas. Projects valued under $1 million are approved by the Commissions of Foreign Trade and Economic Co-operation of provincial or municipal governments or by the ministries responsible for the prospective investor. For trade-related overseas projects, MOFTEC is responsible for the control of overall number of foreign affiliates to be established while the approval power is retained for provincial and municipal governments and relevant ministries. However, although all projects theoretically remain subject

60. Ibid. p. 69; Li Yuesheng et al., A Practical Handbook, pp. 123–130.
61. In practice, many investment projects simply escaped the screening process. Besides, the screening process is largely limited to original investments, so that reinvested earnings by Chinese foreign affiliates that have passed the original screening process are usually not subject to subsequent further screening. Zhan, “Transnationalization,” p. 69.
to screening, smaller projects and projects with Chinese equity in kind are now actually subjected to less strenuous screening procedures. On the other hand, the People’s Bank of China regulates all outward exchange remittances through its State Foreign Exchange Administration.62

Within this general administrative framework, the Chinese government has encouraged and promoted some specific types of outward FDI that would generate benefits for the domestic economy. The country’s priorities primarily revolve around securing access to markets and contributing to foreign exchange earnings, acquiring advanced technology and equipment and management skills, securing stable sources of raw materials that cannot be sourced or are scarce in China, and contributing to stronger economic ties with neighbouring countries and countries included in China’s development assistance programmes.63

Under these priorities, the government has specifically encouraged outward FDI in the manufacturing (processing and assembling) industries in which Chinese companies have a competitive edge, resources exploitation and extraction, high-tech development, turnkey projects, and the tertiary sector (including trade-service, banking, insurance, hotel, tourism, medicine and real estate). The methods adopted by the government to promote these types of outward FDI include tax incentives,64 subsidies, national bank loans with preferential terms,65 and better access to the domestic market for goods produced by Chinese foreign affiliates. In particular, in order to promote outward investment in the electronics and machinery industries, government policy stipulates that if prospective investors in these sectors plan to make their investments in kind, they are exempted from paying a “security deposit” (5 per cent of the value of the proposed investment) to the government, and if proposed investments in these sectors are less than $0.3 million and are of after-sale service in nature, they can be invested freely with the company’s own foreign exchange savings.66

The Chinese government has also sought to link official development assistance (ODA) to outward FDI. It has done so by encouraging recipient governments to use ODA loans to attract Chinese investment in existing projects and by using ODA funds to establish joint ventures involving Chinese companies. Since 1991, ODA-related outward FDI projects have been established in a number of developing countries,

64. In general, all foreign affiliates have been exempted from taxes for the first five years of their existence. After this period, foreign affiliates pay taxes on earnings of 20%.
65. These loans are especially provided to overseas projects of resources extraction and investment projects in the manufacturing/processing which require a large amount of initial capital. For example, those Chinese investment projects in ocean fisheries, forestry and minerals in Western Africa, Alaska, Brazil and Australia rely on such national bank loans sponsored by the government.
especially in Africa. In 1994 China had extended monetary assistance to 46 developing countries and arranged for 350 bilateral aid projects and 25 new construction projects to be implemented in 77 such countries. In the meantime, China has also reformed its foreign aid through adopting two new forms of assistance: the extension of preferential loans at government discount rates and the promotion of joint and co-operative ventures.

Furthermore, as outward investment is much more complex than domestic business, it requires personnel with much broader knowledge and international management skills. However, largely as a result of its long-time isolation from the world economy, China lacks personnel who possess international management skills and who have sufficient knowledge about the market conditions of host countries (including language, business culture, competition policy, political and economic environment, availability of suppliers and distribution networks) and a good understanding of the intricacies of international legal frameworks, international finance, taxation, modern communications, customs regulations and the like. In response to this situation, MOFTEC, in conjunction with UNCTAD’s Division on Transnational Corporations and Investment, initiated a training programme in September 1994. The specific objectives of this programme were to impart formal knowledge about the transnationalization process, especially regarding the establishment and management of foreign affiliates, and to create a forum in which over 60 senior and mid-level managers from leading Chinese companies could exchange information on their experiences with respect to outward investment activities. Though a small step, this programme is an important move in a process of preparing personnel for the country’s deeper integration into the world economy through outward FDI.

In order to promote outward (and inward) FDI and protect the interests of Chinese TNCs in their overseas investment, China signed its first bilateral investment treaty with Sweden on 29 March 1982. By 1 January 1997 China had concluded such treaties with a total of 80 countries.

Despite the efforts of the Chinese government to liberalize and rationalize its policies towards outward FDI, liberalization has only been partial and quite limited so far. Some major limitations remain. Moreover, some existing policies towards outward FDI are obsolete, adversely affecting the efficient management and business expansion of many Chinese foreign affiliates. For example, under the current foreign exchange administrative system, all the profit obtained from overseas must be sent back to China and a very strict 1:1 mortgage system applies to

68. BBC, SWB, 2623, cited from The China Quarterly, No. 147 (September 1996), p. 1024.
those production enterprises that raise capital abroad. In addition, the current screening procedures of outward FDI projects are, generally speaking, still too complicated and too strict with project plans, feasibility study, contracts and other relevant documents having to go through various approval procedures at different governmental levels. Individual Chinese companies are still not authorized to have the independent right to sign contracts with foreign counterparts on overseas investment projects, the right to send relevant personnel abroad freely, and the right to raise foreign capital and/or use their own reserved foreign currency as they want. The salary level of Chinese personnel in the Chinese foreign affiliates is still kept unreasonably low. All these illiberal policies obviously limit opportunities for Chinese enterprises to increase their competitiveness in international markets.71

Furthermore, while the administrative system of outward FDI has been greatly streamlined in recent years, it is still far from effective and supportive. First, the government lacks a mechanism to conduct the post-approval administration and supervision of Chinese foreign affiliates and their management. Secondly, there is a lack of relevant laws governing finance, taxation, credit, foreign exchange and statistics with respect to Chinese foreign affiliates. Thirdly, the government has not yet had a specific and well-articulated plan or policy regarding China’s outward FDI. Fourthly, the government’s policy guidance with respect to country direction and sector distribution of outward FDI is far from clear. Fifthly, the government’s incentive policies for promoting the export of equipment, technology and materials and for promoting foreign exchange earning with respect to outward FDI are far from clear and effective. Finally, support for Chinese outward FDI is still modest, say, banking, and the like.

These existing policy-related and administrative problems, many of which are largely the legacies of the previous command economy, have in turn brought about various problems regarding Chinese outward FDI. For example, Chinese foreign affiliates, which are primarily state-owned enterprises, are still largely operated within the management mechanism of the command economy, remote-controlled and managed by their parent companies in China like other domestic enterprises. Consequently, as they lack the necessary autonomy with respect to personnel, finance and salary level, they are operated inefficiently without initiative. On the other hand, quite a few parent companies, trading companies in particular, do not have a clear overall strategy with respect to overseas business. Some foreign affiliates of these companies count for their financial survival solely on the fees and/or commissions that are charged on the Chinese companies they represent for import and/or export business; some other Chinese foreign affiliates are actually turned into the reception houses for their parent companies. Moreover, many Chinese TNCs do not have an effective evaluation and supervision system for their foreign affiliates.

71. Jiang and Zou, Foreign Investment, p. 16.
The overseas investment projects that Chinese companies are involved in are generally small, except for a very few projects that are valued at over $100 million. For example, the average value per Chinese overseas non-trading project is only $0.57 million, compared to $6 million for developed countries, $4.5 million for developing countries, and $1.4 million for CIS and East European countries. The average value per Chinese overseas trading project is even smaller, only $0.2 million in value. As most Chinese overseas projects are generally too small, Chinese foreign affiliates are weak, unable to take aggressive initiatives. This is largely a result of the lingering legacy of the previous command economy, which prohibits industrial companies from doing international business independently and authorizes only a few specialized foreign trade corporations to conduct international business. Consequently, many really powerful industrial enterprises, while having financial and technological resources, are still deprived of the autonomy of conducting international business themselves, lack information on international markets, and lack experience and knowledge of international business. On the other hand, some specialized trading companies, though they have long experience of conducting international business, various channels of marketing and information on international market conditions, are financially weak and technologically impotent, unable to take big initiatives in the face of growing competition in the world market.

Besides, the regional distribution and sector distribution of Chinese outward FDI are heavily biased. Over half Chinese foreign affiliates are located in developed countries with Chinese companies competing between themselves in these countries. Investment projects in developing countries are not only small in number but also weak in scale. As a result, the ability to expand the market of developing countries is greatly limited. With respect to the sector distribution of Chinese outward FDI, too many projects (except resource-exploring projects) are processing in nature while those which require the high content of special technology that China possesses are few. Consequently, the comparative advantage of the country has not been ideally realized.

Furthermore, for quite a few Chinese outward FDI projects, a feasibility study is not accurate without real understanding of the economic conditions and relevant laws and policies of the host country and without a thorough understanding of the credibility of the local partners. Once in operation, many Chinese foreign affiliates fail to keep track of and study the local market, economic conditions, relevant laws and governmental policies, and performance of local partners. Consequently, these Chinese foreign affiliates perform poorly.

Chinese foreign affiliates lack qualified personnel who have international management skills, sufficient knowledge about host country markets and good understanding of international standards, and do not have a long-term strategy of training their personnel. To make the matter

72. Ibid. p. 17.
worse, nepotism is widespread in the selection of personnel for Chinese foreign affiliates, while selection by merit is hardly used.\footnote{Ibid. pp.16–18. For an official study of these problems, see Chen Keqin et al., “On some issues regarding the management of overseas enterprises,” \textit{Foreign Economic Relations and Trade}, No. 21 (27 May 1998), pp. 2–11.}

Finally, it is also important to mention the myopic behaviour of some Chinese-invested companies in Hong Kong. As widely reported, much of the Chinese investment in Hong Kong is undertaken by those so-called “red-chip” companies that have close links with high-ranking officials in China. However, the leadership of these companies is not always secure, frequently decided by the existing domestic political power structure within China. Because of this insecurity, those in control of the companies are easily tempted to have more concern for their individual interests rather than the long-term interests of the companies, a practice that frequently brings about undesirable consequences to the companies. In particular, the companies in this category tend to concentrate their capital on those industries that promise quick returns and to engage in speculative activities, say, in the extraordinarily volatile Hong Kong property market and stock market. While many of these companies were initially established by the Chinese government to help preserve the economic stability of Hong Kong, their speculative activities are in effect contributing to the volatility of property prices and stock prices in Hong Kong, thus undermining Beijing’s objective of stabilizing Hong Kong’s economy.\footnote{Hing Lin Chan, “Chinese investment in Hong Kong,” p. 951.}

In addition, because of mismanagement quite a few big Chinese companies with a foreign footing have now been in trouble, most notably those so-called trust and investment companies which were initially set up in the 1980s to funnel foreign investment into provinces around the country.\footnote{Currently there are 239 such trust and investment companies in China. \textit{Business Week}, 28 December 1998, p. 27.} Many of these companies, especially in the coastal area, were throwing money into speculative real estate and stocks while borrowing ever larger sums at both domestic and foreign financial markets, Hong Kong’s financial market in particular. Poor management coupled with corruption, however, has meant many of these companies are unable to fulfil their debt obligations. The collapse of Guangdong International Trust & Investment Corporation (GITIC) in October 1998 is a most phenomenal case in point, indicating how serious the problem is with these troubled companies now.\footnote{It is widely reported that more troubled companies should be on the waiting list for bankruptcy. However, as Beijing’s refusal of guaranteeing the bankrupt GITIC’s debt severely shook the confidence of the foreign financial community over China, bringing about very negative consequences on future inflow of foreign capital, the Chinese government has now become more cautious over letting companies go bankrupt. Instead, Beijing is currently trying to work out some restructuring plan to help companies in trouble out of the crisis. See \textit{Business Week}, 15 March 1999, pp. 18–19.}
Obviously, all these problems have to be effectively addressed before outward FDI can really help achieve the various objectives that the Chinese government has set for it.

Conclusion

According to John Dunning, countries tend to go through five stages in their investment development path. These stages can be classified according to the propensity of the countries to be outward and/or inward direct investors. This propensity rests on the extent and pattern of the competitive or ownership specific (O) advantages of the domestic companies of the countries concerned, relative to foreign companies; the competitiveness of the location-bound resources and capabilities of that country (the L specific advantages of that country), relative to those of other countries; and the extent to which domestic and foreign companies choose to utilize their O specific advantages jointly with the location-bound endowments of home or foreign countries through internalizing the cross-border market for these advantages. To use this analytical model, China is now in Stage 2 when its inward FDI starts to rise because of improving L advantages (such as low-cost but well-educated and well-trained labour force, inexpensive land, growingly improved infrastructure, huge market size and potential, increasingly liberal policies of the government) while its outward FDI emerges as a result of the growing O advantages of domestic companies, a situation in contrast to Stage 1 when both L and O advantages do not warrant either inward FDI or outward FDI. In this second stage, Chinese outward FDI is both of a market-seeking or trade-related type and of a strategic asset and resources-seeking type in both countries lower in their investment development path than China and countries higher up the path. However, as in many other countries in the same stage, the growth rate of Chinese outward FDI is insufficient to offset the growth rate of inward FDI. Consequently, China is currently experiencing net inward investment, that is, its net outward investment position worsens, although the growth rates of outward FDI and inward FDI would finally begin to converge towards the latter part of the second stage.77

Dunning’s model provides a structural and systematic explanation of Chinese outward FDI that is subject to further growth through various stages, and a more empirical observation may reveal a similar prospect.

77. John Dunning’s investment development path model was first put forward in 1979. It was later modified by John Dunning and Rajneesh Narula. For a summary of this analytical model, see John H. Dunning and Rajneesh Narula, “The investment development path revisited: some emerging issues,” in Dunning and Narula, Foreign Direct Investment and Governments, pp. 1–41. According to this model, countries in Stage 3 are marked by a gradual decrease in the growth rate of inward FDI and an increase in the growth rate of outward FDI that results in improving net outward investment (NOI); Stage 4 is reached when a country’s outward FDI stock equals or exceeds the inward FDI stock and outward FDI continues to grow faster than inward FDI; and finally in Stage 5 the NOI position of a country first falls and later fluctuates around the zero level while at the same time both inward and outward FDI are likely to continue to increase. Developed countries are currently approaching this fifth stage.
Three major factors may warrant the continuing development of Chinese outward FDI in the years to come. First, Chinese economy has performed quite well in the past two decades and will continue to grow at a very high rate. Against this general economic background, it is very likely that the country’s balance of payments will remain favourable and the foreign exchange reserves high. This will create very favourable background conditions for Chinese TNCs to invest abroad. Secondly, with the country’s rapid economic growth in the past two decades, the Chinese industrial structure has been upgraded significantly and Chinese companies have accumulated sizeable indigenous assets, which has substantially increased the competitiveness of Chinese companies in the international market. And thirdly, there is an increasingly strong political commitment on the part of the Chinese government to further liberalization of its economic system and greater integration into the regional and global economy. In particular, outward FDI has increasingly been seen as a strategic option for establishing a presence in foreign markets, getting access to foreign resources and increasing the competitiveness of Chinese companies. As such, the government is continuing to liberalize its outward FDI policies and encourage the internationalization of Chinese companies. In this respect, the Chinese government, in order to improve the competitiveness of Chinese companies in the international market, is currently pursuing a strategy of forming what the Chinese call “world-class” industrial-commercial conglomerates by grouping large manufacturing companies and specialized trading corporations together, modelled after Japanese sogo shosha and Korean chaebol. These newly created Chinese conglomerates are authorized to enjoy much more autonomy in international operations than any other enterprises. This strategy will surely be conducive to the further development of Chinese outward FDI.

The recent financial crisis that swept over many economies in East Asia has substantially increased the value of the Chinese yuan against many other currencies in the region. If this situation continues, it would probably be a new catalyst for Chinese TNCs to invest abroad, functioning from two directions. On the one hand, the decreasing competitiveness of Chinese goods in the world markets as a result of the high value of the Chinese yuan would push more Chinese companies to establish factories abroad for the manufacture of their products; on the other hand, the lower value of the currencies of some economies in the region would pull some other Chinese companies to invest in those economies to take advantage of the low costs of investment there in terms of the Chinese yuan.

As FDI is one of the major driving forces behind the globalization of national economies, the rapid growth of Chinese outward FDI has been establishing another important link between the Chinese economy and the

78. For both geopolitical and geoconomic considerations the Chinese government has repeatedly pledged not to devalue the Chinese yuan. These considerations are clearly expressed in a column article, “Play well the card of RMB,” in China Economic Times, 26 June 1998, p. 7.
world economy, thus making the country even more completely and irreversibly integrated into the global community. However, current Chinese outward FDI flows are still quite small in absolute terms, and therefore their implications on the world economy, except in Hong Kong where Chinese FDI exerts a crucial influence on the local economy, remain quite modest. With the continuing rapid growth of Chinese outward FDI, it could well be expected that China will soon pass Dunning’s Stage 3, which witnesses a gradual decrease in the growth rate of inward FDI and an increase in the growth rate of outward FDI, thus substantially improving the country’s net outward investment position. What will be really significant is when China finally moves into Stage 4, when its outward FDI stock equals or exceeds its inward FDI stock. Even if China’s current inward FDI stock of $169 billion (1996) is taken as the basis, an outward FDI stock of $169 billion will surely equip China with significant power to exert great impact on the world economy in one way or another. In the meantime, Chinese TNCs will become an important and formidable force in the regional and global economy. All this will inevitably create both new conflicts and new opportunities along with pressures for change in prevailing international structures.

79. The modern history of the world economy shows that later comers usually complete various development stages much faster than their predecessors.