IMPORTANCE OF FOREIGN DIRECT INVESTMENT BY DEVELOPING COUNTRIES

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An important aspect of economic globalization is the rapid growth of direct investment between various countries. From 1986 to 1991, the average annual FDI outflows in the world was $US180.5 billion. In 1997, the figure rose to $US475 billion. By 1998, it grew further to $US649 billion, an increase of 36.6 percent over the previous year. The average annual growth rate from 1986 to 1998 was 21.1 percent (UNCTAD, *The World Investment Report*).

What deserves attention is that since the 1970s, the outflow of FDI from the developing countries has been growing at a comparatively fast speed. Its share of total world FDI outflows expanded from 6.7 percent in 1985 to 14.4 percent in 1997. In 1998, the share narrowed to 8.4 percent because the financial crisis in Asia retarded the FDI outflows from the developing countries while FDI by the developed countries grew substantially.

Compared with other developing countries, FDI outflows from Mainland China are still in a primitive stage of development. Although FDI outflows from Mainland China extended to more than 160 countries or regions around the world by the end of 1998, the sum total of the investment stood at only US$6.33 billion, less than 0.2 percent of the world total and merely 0.8 percent of total FDI outflows from the developing countries ($US805.8 billion). This sum is far from enough when viewed from the angle of China's aggregate economy, its total volume of foreign trade, or the scale of FDI it has absorbed so far.

In terms of investment structure, China's FDI outflows are also at an extremely preliminary stage. Of the $US6.3 billion FDI outflows so far, trade-oriented investment accounts for 61 percent, natural resource-oriented investment accounts for 19.4 percent, and manufacturing investment accounts for only 11.5 percent. Over 90 percent of those FDI projects were below US$1 million in scale, and the average investment in each project was $US1.12 million. In comparison, the FDI by developed countries averaged $US6 million per project and that by developing countries was above $US4.5 million per project. Fifty-eight percent FDI outflows from Mainland China went to Hong Kong and Macao; they were not FDI outflows in the true sense. FDI outflows from Mainland China to North America and Europe accounted for 14.4 and 5.2 percent of the total respectively while Oceania, Asia, Africa, and Latin America accounted for only 7.3%, 6.0%, 5.0%, and 4.1% respectively.

With the approach of China's entry into the WTO, how China's industries will meet the challenge of international competition has become a topic of concern in academic circles, enterprises, governments, and Chinese society as a whole. We believe that WTO entry will create opportunities for Chinese enterprises to play in the international arena and that the development of direct investment in other countries and regions would be a positive measure for China to meet the challenges of international competition. Outward FDI is conducive to the promotion of trade and utilization of international resources, the relaxation of oversupply in the domestic market, and the development of a scale economy. It is also conductive to the effective introduction of advanced technology and management expertise from foreign countries and to the import of talents and information. It is exactly for this reason that on several recent occasions the State leaders of China have made clear-cut calls from a strategic point of view for active development of FDI outflows from China and for the cultivation and development of China's own multinational enterprises.

Determined by the stage of development of the economy, China's FDI outflows will go to both developing and developed countries. For this reason, traditional theories about the MNEs of both developed countries and developing countries can be used to explain China's strategic decision in stepping up outward FDI and to guide the government in its formulating strategies and policies. Such theories include John Dunning's Eclectic Approach analys is of ownership, location, and internalization advantages; Raymond Vernon's theory of the product life cycle of international investment and trade; Japanese scholar Kojima Kei's theory of the marginal expansion of industries; Louis T. Wells' theory of small-scale technology; Sanjaya Lall's theory of localized technological change; and G. L. Reuber's theory of long-term strategies.

China might learn best from the process of FDI development in Japan. In the late 1960s FDI outflows from Japan had two characteristics: a comparatively large proportion oriented to natural resources, and dominance of trade-oriented investment over manufacturing oriented investments. This is just the current situation in China.

A good trend of development has occurred in China's FDI outflows in recent years. This is mainly due to the rapid growth of the demand for natural resource products in China's domestic market, the rapid increase of its foreign trade, and the enhancement of its international competitive capability in certain industries. The international expansion of China's household electric appliance industries is particularly impressive. In spite of this progress, however, China will have to overcome several major obstacles if it hopes to implement its FDI strategy successfully.

1. **Technical obstacles.** On the whole, Chinese enterprises have insufficient technical advantages. There is more to be desired in their digestion and innovation of imported technology, and their advantages in the localization of technology are not so apparent. Even the household electric appliance industry, which has an extremely good prospect at present, still relies upon continuous imports of key technology for many products, especially for top-end products. Lack of technical advantages will remain a long-term factor restricting China's development of MNEs.
2. **System obstacles**. Large enterprises play a major role in the development of FDI. In China, most large enterprises are solely or majority owned by the State. The number of large private enterprises is extremely small, and there are as yet no effective system, policy, or capital market conditions to promote the growth of private enterprises. As the situation stands, China will rely mainly upon existing large State-owned enterprises to develop its FDI for a fairly long period of time. Due to the defective corporate governance in SOEs, such as the distortion of management objectives and behavior and the lack of sufficient means to stimulate and restrict their managers, China's State-owned enterprises have figured poorly in competition in the domestic market, even under government protection. It can hardly be imagined how these enterprises will achieve any success in international operations.
3. **Capital obstacles**. On the one hand, due to their low efficiency, China's State-owned enterprises are short of financial resources to develop FDI by themselves. On the other hand, China's financial system is not yet complete. Capital markets are still underdeveloped, and the dominant State-owned banking system is in need of reform and will be haunted by huge amounts of non-performance assets for a fairly long period of time. For this reason, the financial system can not play an active role in developing China's FDI.
4. **Talent obstacles**. MNE's will need certain expertise to conduct international operations. A deficiency of talent, particularly talent capable of international operations, has already become apparent during the process of rapid development of the Chinese economy. In addition, State-owned enterprises suffer a serious outflow of talent and can not find a satisfactory solution to the shortage of talent capable of international operations.

Given the current realities, it is highly likely that China will implement its FDI strategy mainly by relying upon State-owned enterprises and mobilizing capital through government power and interference without cost-benefit analysis. If we carry out the FDI strategy in the way of the planned economy, however, we may never reach the strategic goal after paying a heavy price. For this reason, successful implementation of China's FDI strategy depends on active reform of the State-owned enterprises and financial system and on vigorous development of the private sector of the national economy.