Transnationalization and outward investment: the case of Chinese firms

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During the past decade, China has emerged as one of the most significant outward investors among developing countries, in terms of both stock and flows. A number of factors explain the transnationalization of Chinese firms, such as the desire to protect and expand export markets, ensure access to natural resources and acquire advanced technology. The characteristics of China's outward investment reflect the country's export-oriented policy, diversified industrial structure and strong government intervention in industrialization and investment flows. Based on an empirical study and an analysis of current economic trends and firms' competitiveness, the author argues for a more liberal regulatory framework and proposes a set of policy options, with a view towards strengthening Chinese firms' international competitiveness and ultimately maximizing the contribution of outward investment to China's economic development.

Introduction

While a great deal of literature has been devoted to China's inward foreign direct investment (FDI) over the past decade, much less academic attention has been given to China's outward investment. In the few existing studies on this subject, China's outward FDI was usually incorrectly depicted as the

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analysis was typically based on significantly underestimated data.[1] In fact, China is not only one of the largest host countries of FDI in the world, but is also emerging as an important developing home country. China's annual average outward FDI reached $2.4 billion during 1990-1994, more than the outward FDI of Latin America and the Caribbean as a whole.

This article examines China's outward FDI[2] and the transnationalization of Chinese TNCs. The first section reviews the evolution of Government policy regarding outward investment and outlines the regulatory framework; section two describes the trends, patterns and characteristics of China's outward investment; section three analyses the process of transnationalization, motivations for outward investment, the strategies of Chinese TNCs and impediments to transnationalization; and the last section discusses policy implications of the analysis, and includes a set of policy measures. The article builds on the relevant parts of the *World Investment Report 1995* (UNCTAD-DTCI, 1995), and applies part of its policy analysis to China.

The regulatory framework

In 1979, the Government of China began encouraging outward FDI, as part of its broader "open policy."[3] Outward investment was viewed as an important means of integrating China into the world economy, securing a stable supply of raw materials, improving export opportunities and strengthening economic relations with neighbouring countries. At the same time, the Government had a number of concerns, especially regarding excessive capital outflows at the expense of domestic investment; a perception that outward FDI did not contribute as much as domestic investment to national development; foreign exchange constraints; the perception that Chinese companies lacked the experience necessary to operate effectively in international markets; and difficulties in monitoring overseas investment, bringing with it a loss of control over state property. Due to these concerns, the Government adopted a cautious approach towards outward FDI. Specifically, it

[1] Most studies on China's outward FDI are based on data published by China's Ministry of Foreign Trade and Economic Cooperation, which significantly underestimate the actual amount of the country's outward FDI.

[2] Outward FDI, throughout this article, refers to whole-, majority- and minority-owned affiliates, as well as a variety of non-equity contractual arrangements, such as licensing, management contracts and turnkey operations.

[3] Before 1979, outward investment was small and concentrated in trade-supporting activities.

favoured investments in kind (equipment, know-how and raw materials) to avoid excessive capital outflows. It also encouraged resource and market-seeking outward FDI that would generate benefits for the domestic economy.

The approval process has been gradually liberalized since the initial reforms were implemented in 1979. Prior to 1983, when the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) became the focal point for the screening of outward FDI, the authority for approval of all outward FDI projects was highly centralized. After 1983, all projects remained subject to screening, but smaller projects and projects with Chinese contribution in kind were subject to less strenuous approval procedures. The liberalization measures were mainly codified in the "Provisional regulation for approval procedures and administration of non-trade-related outward FDI" of 1985, the "Administration of foreign exchange for outward investment" of 1989 and the "Approval procedures and administration of overseas investment" adopted in 1993. However, the regulatory process is far from perfect, and no formal law relating to outward FDI exists. Outward FDI has been regulated through about ten *provisional* regulations and administrative procedures.

The regulatory regime and approval process governing outward FDI involves different levels of Government, depending upon the type, scale and location of investments being proposed. These include local authorities, MOFTEC, the State Planning Commission, the State Council, the Ministry of Finance, the Administration of State Assets and the State Foreign Exchange Administration. Projects worth more than $30 million are still subject to approval by the State Council. Projects valued at between $1 million and $30 million, as well as projects involving Government loans, or guarantees for foreign loans, must submit a feasibility study to the State Planning Commission and the details of the project to MOFTEC. Projects valued at under $1 million are approved by the Commission of Foreign Trade and Economic Cooperation or by the ministries responsible for the prospective investor.

In addition to this gradual liberalization of China's outward FDI regime, the Government began to promote, since the mid-1980s, outward FDI that serves specific objectives, including:

- securing a stable supply of raw materials that cannot be sourced or are scarce in China;

- contributing to foreign exchange earnings and generating export opportunities;
- channeling advanced technology and equipment back to China;
- contributing to stronger economic ties with neighbouring countries and countries included in China's development-assistance programmes.

The methods by which the Government promotes these types of outward FDI include tax incentives, subsidies and privileged access to the domestic market for goods produced abroad by Chinese foreign affiliates. As regards tax incentives, foreign affiliates are exempted from taxes for the first five years after their establishment; after this period, foreign affiliates pay taxes of 20 per cent on earnings. If prospective investors in the electronics and machinery industries 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 industries are less than $1 million, they are exempted from the approval process. The Government has also sought to link official development assistance (ODA) to FDI 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, especially in Africa.

The Government has also promoted FDI in Hong Kong during and after the negotiations about the future of Hong Kong. These investments have helped to build confidence in the economic future of Hong Kong (Bacher *et al.*, 1992).

While the general trend during the 1980s and the early 1990s has been a gradual and limited liberalization of China's outward FDI regime, concern over the lack of Government control beyond the initial screening process and the poor performance of some Chinese foreign affiliates have motivated the Government to strengthen its post-approval monitoring capabilities. Government regulation of outward FDI can, therefore, be expected to remain relatively strict, and controls may even be tightened in the post-approval stage. However, this is not likely to affect China's outward FDI significantly in the long term (although it may have a short-term dampening effect), given the Government's commitment to the internationalization of the Chinese economy and the important role that Chinese TNCs play in this process.

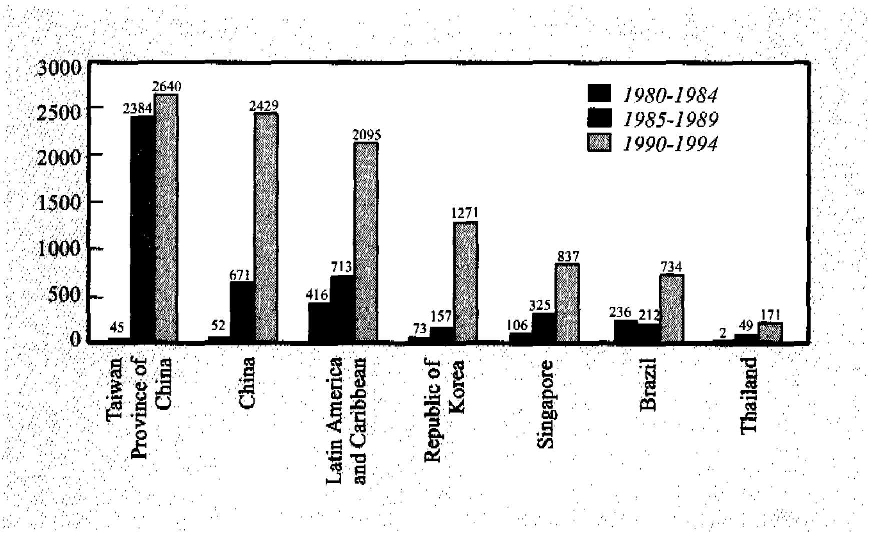
Trends and patterns of outward FDI

General trends

Although the quality of data leaves much to be desired (box 1), it is clear that China's outward FDI has grown rapidly during the past decade and a half. The country is emerging as an important home country, both within South-East Asia and among all developing home countries (figure 1).

Figure 1. Annual average FDI outflows from selected developing countries and regions, 1980-1994

(Millions of dollars)



Source: UNCTAD-DTCI, FDI database. The data on China are based on IMF balance-of-payments tapes.

Although a few outward investment projects existed before the 1970s, the actual process of transnationalization of Chinese enterprises began in the late 1970s.[4] A spurt of Chinese TNC expansion occurred since the late 1980s, driven by the country's fast economic development and structural

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[4] For a detailed historical review, see Zhan (1990).

Box 1. The quality of China's outward FDI data

The two main sources of data on China's outward FDI are the IMF and MOFTEC (the latter is responsible for the administration of China's outward FDI). The data-collection and estimation methods of these two institutions give rise to large discrepancies in the outward FDI values reported (see accompanying table).

MOFTEC data are based upon approval figures for initial outflows rather than actual investment, thus excluding reinvested earnings by Chinese foreign affiliates that have passed the original screening process. In addition, MOFTEC does not screen all outward FDI. Intercompany loans, FDI by Chinese foreign affiliates to third countries,[a] FDI by privately owned firms and foreign affiliates located in China, and FDI in financial services (screened by the People's Bank of China) are not included in MOFTEC's screening process. Furthermore, numerous small investment projects have simply escaped the screening process. As such, the MOFTEC data significantly underestimate outward FDI insofar as they exclude several important sources of such investment.

Comparison of MOFTEC and IMF/SAFEC estimates on Chinese outward FDI flows

(Millions of dollars)

Collecting agency	1992	1993	1994	1979-1994
MOFTEC	220	120	81	5 200
IMF/SAFEC	4 000	4 400	2 000	16 000

The IMF estimates for China are based on sample data collected by the State Administration of Foreign Exchange Control of China (SAFEC) from its offices located in various provinces. The main advantage of the IMF/SAFEC data is that they are meant to represent actual capital movements, and cover equity capital, reinvested earnings and intercompany loans. The main weakness of these estimates is that they are based on a fairly limited sample and do not provide either a sectoral or geographical breakdown.

China's FDI outflow figures are further muddled by its investment in Hong Kong, particularly by the phenomenon of "round-tripping"[b] (which accounted for a notable share of Chinese FDI during 1992-1993). A careful interpretation of outward FDI figures is, therefore, necessary.

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[a] Generally speaking, FDI by foreign affiliates of Chinese TNCs in a third country is outward FDI from the country where that affiliate is based. However, the capital for such investment projects in the third country, in most cases, either originates from the parent firms or from the investment returns and export earnings of the affiliates concerned.

[b] "Round-tripping" refers to the circular flow of capital out of China to Chinese foreign affiliates (mainly in Hong Kong) and the subsequent "re-investment" of the "foreign" capital in China for the purpose of benefiting from fiscal entitlements accorded to foreign investors (see box 7 and Zhan, 1993b).

transformation from a centrally planned to a market-oriented economy. By the end of 1994, the number of Chinese foreign affiliates increased to around 5,500,[5] with a total outward FDI stock of between $15 billion and $18 billion.[6] These firms are affiliated to over 900 firms based in China,[7] which are often part of larger conglomerates themselves. It is estimated that the total foreign assets owned by Chinese TNCs are between $190 billion and $195 billion,[8] of which the Bank of China has the lion's share, accounting for $156 billion. Excluding the Bank of China, the total foreign assets owned by Chinese TNCs is between $34 billion and $39 billion. The total foreign assets owned by the top 10 Chinese TNCs in 1994 reached $22 billion (table 3).

The high growth rate of China's outward FDI has, however, been surpassed by the rate of growth of inward FDI.[9] The outflows/inflows ratio has grown from an average of 1: 3.7 between 1985 and 1990 to 1:17 in 1994. Figure 2 reveals the trends of China's inward and outward investment in parallel, and the country's net FDI position.

Although outward FDI may fluctuate in response to macro-economic and regulatory conditions, the long-term trend indicates continued growth. Several factors suggest that China is likely to remain one of the most important home countries for FDI among developing economies:

- GNP per capita has been growing rapidly, and the balance of payments has improved significantly.[10]

- Chinese industry has been upgraded significantly, including through inward FDI and technology transfer. In addition, Chinese firms have accumulated indigenous assets over a decade of rapid growth. This has increased their competitiveness in the international market.

- The Government has been encouraging enterprise internationalization and is improving its regulatory framework for outward investment.

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[5] By June 1994, MOFTEC had approved and registered 4,557 Chinese overseas affiliates. However, for the reasons discussed in box 1, the actual number of Chinese affiliates abroad is likely to be higher.

[6] Author's estimate, based on various sources.

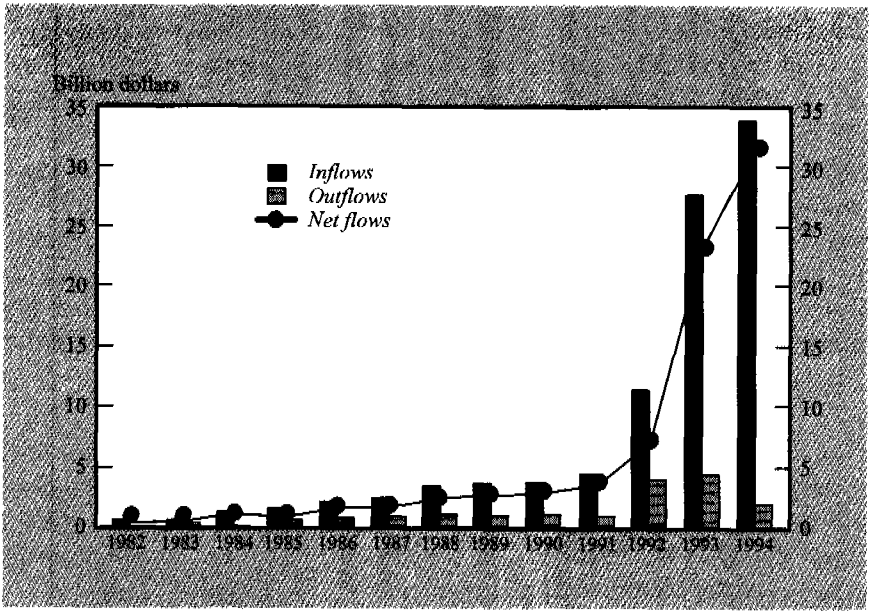
[7] A number of Chinese foreign affiliates belong to central ministries or local governments.

[8] Author's estimate, based on various sources.

[9] For review of China's inward FDI, see Zhan (1993b).

[10] China's foreign exchange reserves reached $51.6 billion at the end of 1994, one of the largest in the world.

Figure 2. Inward and outward FDI and net position



	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Inflows	0.4	0.6	1.3	1.6	1.9	2.3	3.2	3.4	3.5	4.4	11.2	27.5	33.7
Outflows	0.04	0.09	0.14	0.63	0.45	0.65	0.85	0.78	0.83	0.91	4	4.4	2
Net flows	0.36	0.51	1.16	0.97	1.45	1.65	2.35	2.62	2.67	3.49	7.2	23.1	31.7

Source: Based on IMF balance-of-payments tape, retrieved in July 1995; UNCTAD-DTCI, FDI database; and Zhan (1993b).

All this suggests that China is in the second stage of the investment-development path (box 2).

Sectoral and geographical distribution

China's outward FDI is characterized by a dominance of trade-supporting investment:

- ***Services sector.*** Investment in the services sector accounted for over 60 per cent of total outflows. Trade-supporting investment in the form of trading companies, large in number but generally small in scale, makes up a large share of China's total outflows. Unlike trade-supporting investment, investments in the banking industry are smaller in number but larger in value. Although outward investment by the Bank of China accounts for the lion's share in banking (table 1), some other firms have also tried to gain a foreign foothold. For example, in

Box 2. China's investment-development path

The basic idea of the "investment-development path" (Dunning, 1981, 1988, 1994) is that the relationship between inward and outward FDI flows of any country goes through five predictable stages as the economy develops. The net FDI position of China (figure 2) reflects the competitive position of Chinese domestic enterprises, which is determined by their areas of specialization, the country's economic endowments and the nature of Government intervention in international and national transactions. As incomes rise, infrastructure improves, markets grow and human capital is enhanced through education and training, FDI flows into China increase, as its locational advantages prove attractive to TNCs. At the same time, outward FDI from China is growing as well, particularly to exploit natural resources and "buy entry" into foreign markets. Recent evidence suggests that inward FDI may have reached its peak, while outward FDI is gathering momentum.

Hong Kong, China International Trust and Investment Corporation (CITIC) acquired the Ka Wah Bank, and China Merchants Holdings Ltd. acquired the Union Bank. Insurance is another industry in which China's outward FDI has been growing rapidly. In the past few years, Chinese insurance companies have set up more than 60 foreign affiliates, earning more than $300 million in profits in 1994; while they are concentrated on Hong Kong and Macao, they are also operating in Germany, Singapore, the United Kingdom and the United States (Economist Intelligence Unit, 1995). Construction is one of the most important overseas activities of TNCs from China, but this does not involve substantive FDI: like their principal competitors from the Republic of Korea, Chinese construction companies do not have to make large investments abroad in order to carry out their overseas construction activities (ESCAP/UNCTC, 1985). Investment also took place in communication, real estate and the restaurant business; examples are CITIC's partial take-over of Cathay Pacific Airline for $260 million (a 12.5 per cent stake), as well as investments in satellite communication.

- ***Natural resources***. Investment in the natural resources sector accounted for approximately 25 per cent of total outflows. This type of investment, notably in minerals, forestry and ocean fishery, is usually large in scale. Examples include China Metallurgical Imp. & Exp. Corporation's $180 million investment in Channar Mine in Australia, with an average annual output of around 10 million tons of iron ore over 20 years; CITIC and China National Nonferrous Metal Industrial Corporation's $120 million investment in the Portland Aluminum Smelter in Australia; Shougang Corporation's acquisition of Hierro Peru Mining Ltd.; China Petroleum and Natural Gas Corporation's

Table 1. Large Chinese financial corporations abroad, 1992

(Number and millions of dollars)

Name	Date operation started	Location	Assets (Million dollars)	Number of affiliates	Number of employees
Bank of China, Hong Kong	1917	Hong Kong	..	26	1 700
Bank of China, Macao	1950	Macao	..	21	1 000
Kwangfung Province Bank	1929	Hong Kong	7 030	23	1 300
Bank of China, Tokyo	1986	Japan	6 600	1	125
Kinchen Banking	1936	Hong Kong	6 500	31	1 100
Sin Hua Trust, Saving & Commercial Bank Ltd.	1947	Hong Kong	6 450	39	1 700
Bank of China, London	1929	United Kingdom	6 010	4	198
China and South Sea Bank	1945	Hong Kong	3 910	39	1 900
China State Bank	1938	Hong Kong	3 480	19	900
Bank of China, Singapore	1936	Singapore	2 570	3	535
Bank of China, New York	1981	United States	1 920	2	210
Bank of China, Luxembourg	1979	Luxembourg	750	1	31
Xiamean International Bank	1947	Hong Kong	660	19	1 600
Communication Bank, Hong Kong	1929	Hong Kong	110	28	2 000
Bank of China, (Luxembourg) Ltd.	1991	Luxembourg	15	0	6
Hua Chiao Commercial Bank	1962	Hong Kong	..	21	900
Po Sang Bank Ltd.	1964	Hong Kong	..	13	800

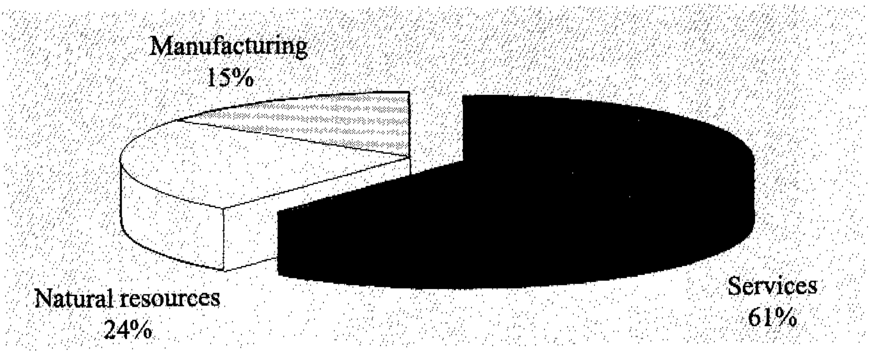
Sources: *Encyclopedia of Contemporary Financial Enterprises in China* (1993); and UNCTC (1992).

investment in the exploration and exploitation of oil in Papua New Guinea; and CITIC's investment in forestry in the state of Washington of the United States. There are also over 60 joint ventures in ocean fishery with over 20 countries (including Argentina, Iran, Mauritius, the United States and 9 West African countries) (Liang, 1995).

- ***Manufacturing sector***. The manufacturing sector accounts for a relatively small share of outward FDI, approximately 15 per cent. Investment taking place 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 TNCs possess a competitive edge. They have established a number of plants to manu-

Figure 3.
Sectoral distribution of China's outward FDI, 1980-1994

(Percentage)



Source: Author's estimates based on various sources.

facture textiles and clothing in developing countries and assemble bicycles in countries such as Algeria, Brazil, Germany, Ghana, Poland, Tanzania and the United Arab Emirates.

China's outward FDI is spread over around 130 countries and territories. Investments in the services sector are scattered over 100 countries (both developed and developing, but more in developed countries), while FDI in natural resources is concentrated in a few resource-rich countries in North America, Australia and Latin America. Hong Kong is the largest host economy for China's outward FDI, followed by North America, Australia and the Asia Pacific region (excluding Hong Kong) (figure 3). Excluding banking and trade-supporting FDI, among the largest recipients are: Canada, Australia, the United States, Peru, the Russian Federation, Thailand and Chile.

Hong Kong and Macao attracted 61 per cent of the total outflows from China, the majority of which took place in the services sector. In the manufacturing sector, China's outflows to Hong Kong make up 22 per cent of total outflows. It has contributed significantly to FDI inflows into Hong Kong, having become the second largest investor there (after the United Kingdom) and the third largest contributor to FDI stock in the manufacturing sector (11 per cent of the total $4 billion by 1994).[11]

[11] Hong Kong Government Industry Department (1994). In Hong Kong's manufacturing, Japan is the largest investor (34 per cent), followed by the United States (28 per cent).

Table 2. Selected large Chinese foreign affiliates, 1994

(Millions of dollars)

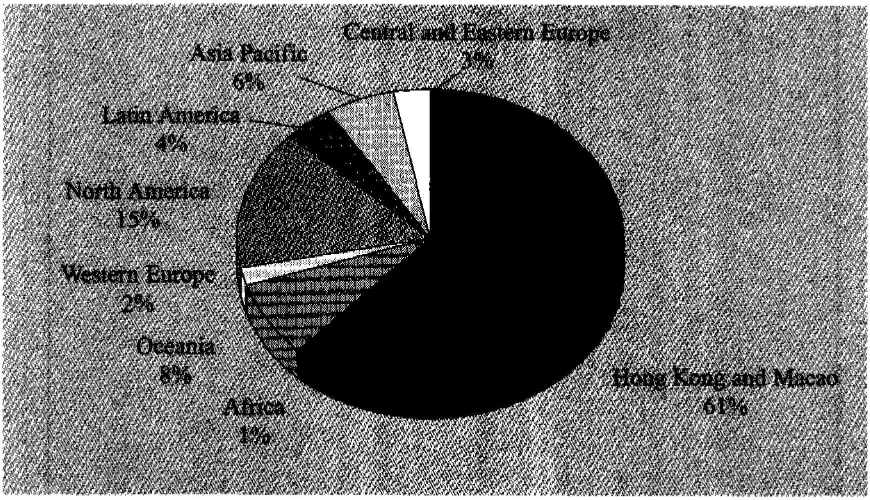
Firm	Amount of equity investment by Chinese	Date operation started	Parent [illegible]	Equity share of parent firm	Location	Industry	[illegible]
China Merchants Ltd.	..	1872	Ministry of Communication	100	Hong Kong	Maritime transport & other	..
China Travel Group Ltd.	..	1960s	State Bureau for Overseas Chinese	100	Hong Kong	Travel & other	..
China Resources	..	1950s	MOFTEC	100	Hong Kong	Trading, real estate & other	..
CITIC, Hong Kong Group	..	1980	CITIC	100	Hong Kong	Telecom, maritime transportation, real estate, etc.	12 000
CITIC, America (Holdings) Ltd.	..	1988	CITIC	100	North America & Chile	Timber, pulp, steel, trading, etc.	250
CITIC, Canada Inc.	302.5	1985	CITIC	0	Canada	Manufacturing	..
Shougang Herro Peru S.A.	118	1993	Shougang Co.	68.4	Peru	Mining & metallurgy	110
CHIEC (Channar) Pty, Ltd.	117	1988	China Metallurgical Industrial Co.	40	Australia	Mining	105
Sinochem American Holdings, Inc.	92	1982	Sinochem	100	United States	Petro-chemical, real estate, trading, etc.	1 415
CITIC, Australia Pty, Ltd.	43	1987	CITIC	100	Australia	Minerals & food processing	430
CMIEC Australia Ltd.	38	1987	China Metallurgical Import & Export	100	Australia	Natural resources	..

Table 2. Selected large Chinese foreign affiliates, 1994 (*continued*)

WENITA Forest Products Ltd.	30	1990	Foreign Trade Transportation Co.	45	New Zealand	Forestry & timber processing	37
CCEC, Overseas Group Ltd.	..	1979	China Civil Engineering Co.	100	Hong Kong	Construction, real estate, trading, etc.	780
Int'l United Shipping and Investment Co.	22.5	1980	China Ship-building Industrial Co.	45	Hong Kong	Communication	..
US AGRI-Chemical Co.	20	1980	Sinochem	100	United States	Agro-chemicals production & trading	546
Sinochem International Oil (Hong Kong) Co.	20	1985	Sinochem	100	Hong Kong	Trading of oil & petro-chemical products	87
CATIC, Chile Co.	20	1989	Agriculture Trust and Investment Co.	100	Chile	Manufacture & natural resources	..
Cheerglory Trades Ltd.	17	1981	MINMETALS	100	Hong Kong	Steel, non-ferrous metals & others	68
Far East Number 1 Oil Depot	16	1995	Foreign Trade Transportation Co.	57	Malaysia	Oil storage	..
MINMETALS, America Inc.	12	1982	MINMETALS	100	United States	Steel, minerals, real estate	116
China Australia Fishing Pty.	10.5	1989	Zhoushan, Ningpo and Fujian Fishery Co.	100	Australia	Fishery	..
Hongan Co. Ltd.	7.5	1987	China Packing Imp. & Exp. Co.	50	Hong Kong	Manufacturing	..
Village Chinois Group S.A.	6.7	1987	Guangdong Shunde Real Estate Co.	34	France	Services	..
Macau Cement Manufacturing Co. Ltd.	5.5	1988	CITIC	48	Macao	Manufacturing	..
Kaihin Enterprises Co. Ltd.	5	1984	China Huajian Co.	50	Hong Kong	Electrical Equipment & others	..
Siderurgica ITAMIN Ltd.	5	1988	MINMETALS	50	Brazil	Mining	..
China-America Reinsurance Co.	5	1981	People's Insurance Co.	50	Bermuda	Insurance	..

Source: Based on responses to questionnaires and annual reports on the respective parent firms/supervisory bodies.

Figure 4.
Geographical distribution of China's outward FDI, 1979-1994
(Percentage)



Source: Author's estimates based on various sources.

The ethnic factor is a crucial determinant in the locational decisions of Chinese TNCs: 67 per cent of the total value of outflows and 56 per cent of the investment projects are located in Hong Kong, Macao and other Asian neighbouring countries. These locations offer an ideal combination of proximity, cultural affinity, and common language. A further examination of individual projects reveals that Chinese TNCs, small ones in particular, have the propensity to establish joint ventures with overseas Chinese enterprises, not only in neighbouring countries, but also in other parts of the world. This certainly reduces the costs of "psychic" distance, since a lack of international experience and the relatively small scale of investors raises perceived risk and costs.

The Government of China has, almost by definition, played a crucial role in shaping the structure of the country's outward investment. In contrast to the Republic of Korea where the role of the Government in the economy is more discreet, to Brazil and Singapore where it is more selective, and to Hong Kong where it is largely absent (Riemens, 1989), China's outward investment has always been part of the Government's development scenario. As discussed earlier, only certain types of outward investment are

Box 3. International financing of Chinese TNCs: an example

A joint venture between CITIC Canada Inc. (a subsidiary established in Canada by the China International Trust and Investment Corporation (CITIC)) and Power Corporation of Canada provides an example for raising funds locally for an FDI project. The two companies bought in 1986 the Canadian Celgar Pulpmill which had an annual output of 180,000 tons of bleached long-stable kraft pulp. Each partner holds a 50 per cent share and is committed to provide half of any required additional investments as well as working capital. The Consolidated Bathurst Inc. (later called Stone Consolidated Inc.) was entrusted with providing expertise for managing the newly purchased factory. As regards the funds required for the acquisition, CITIC Canadian Inc. raised the funds locally. It obtained financing of Canadian $60 million in the form of a syndicate loan through the Royal Bank of Canada, on the condition that half of its share in the pulpmill be mortgaged to the bank and a long-term sales contract be signed with its parent company in China. The business was so successful that, in less than three years, CITIC managed not only to pay off its loan with the profits from the pulpmill, but also to reinvest the balance of the profits (together with Swedish and Hong Kong companies) in a sawmill with an annual processing capacity of 310,000 cubic meters of log, at a value of Canadian $40 million. In addition, CITIC Canada Inc. and Stone Consolidated Inc. also succeeded in 1991 in obtaining a loan of Canadian $700 million from the Royal Bank of Canada and the National Westminster Bank of the United Kingdom to expand the production capacity of the pulpmill to 420,000 tons annually, upgrade its technology and improve its pollution control methods.

Source: Based on MOFTEC (1992/1993).

allowed or promoted, mostly inward-oriented outward investment, geared toward domestic development. As has been reiterated by Government officials, China is a developing country, not a capital-exporting developed country. Future liberalization and promotional measures will most likely take place within the framework of a controlled scenario.

Forms of investment, mode of entry and financing

A review of the forms of investment in categories other than banking and trade shows that Chinese TNCs have a preference for joint ventures with local firms, rather than for fully owning their foreign affiliates. However, they are inclined to exercise control over the business by holding a majority equity share. Equity shares between 40 per cent and 70 per cent are the most common form of Chinese firms' participation, particularly in investments in the natural resource and manufacturing sectors. Among the reasons are scarce financial resources, less ability or willingness to bear risk and lack of knowledge and experience in foreign operations. Furthermore, the local joint venture partners sometimes offer their established distribution network, even their locally established trade marks.[12] As regards trade-supporting investment and investment in banking, almost all ventures are 100 per cent Chinese-owned.

Large investment projects are usually realized through acquisition or partial acquisition, while smaller projects are often of a greenfield nature. A study shows that 78 per cent of all outward investment consisted of greenfield investments, and the balance were mergers and acquisitions (Luo *et al.*, 1993).

Partly due to the lack of hard currency and partly due to the Government's restrictive measures aimed at minimizing outflows of foreign exchange, equity contributions to overseas ventures is often in the form of equipment and machinery. Some Chinese TNCs, particularly large ones, have made efforts to raise capital for large investment projects either in the host country or in international financial markets; CITIC Canada's expansion in Canada is a good example (see box 3).

Portland Aluminum Smelter in Australia is another successful example of the international financing of a Chinese outward investment. In 1986, CITIC Australian Pty. Ltd. purchased a 10 per cent equity share of the Portland Aluminum Smelter, with $120 million financed through a syndicate loan for 12 years from 12 large foreign banks. CITIC was able to pay off the debt in a few years from its investment returns (Li, 1993).

The transnationalization of Chinese TNCs

Emergence of Chinese TNCs

Over the past decades, the competitive strength of Chinese firms has increased through Government-encouraged technology upgrading and the development of support industries clustered around primary industries. Furthermore, the large inflows of FDI and technology over the past 15 years have helped to upgrade the technological and organizational capabilities of individual firms, thereby accelerating the overall pace of China's industrialization (Zhan, 1993b). Production has moved towards semi-skilled and moderately knowledge-intensive consumer goods. These developments have

[12] For example, Suzhou Television Work produces television sets in Thailand, using the locally established brand name "TANIN".

made a number of Chinese firms ready to compete internationally, first through exports, then, gradually, through outward investment.

Although outward investment has not been a priority on its policy agenda, the Government has pursued structural adjustment and reforms in large and medium-sized enterprises, aiming at enhancing their competitiveness in both international and domestic markets. Those reforms include enterprise grouping via domestic mergers and strategic alliances, granting enterprise autonomy, encouraging diversification and introducing a shareholding system. Among the effective policy measures is the promotion of the diversification of large- and medium-sized enterprises via domestic mergers and strategic alliances. This policy can be traced back to mid-1980, when the State Council promulgated *Provisions on Promoting Economic (Enterprise) Alliances*, followed by the State Council's *Provisions on further Promotion of Horizontal Economic (Enterprise) Grouping* (1986), and *Recommendations on Establishing and Developing Enterprise Groups* (1987). Enterprise groups were formed at a rapid pace, some of them of fairly large size. In addition to the 55 state-level enterprise groups, there were about 430 enterprise groups at various levels, and over 1,000 groups in the form of strategic alliances in 1993 (Harrold and Lall, 1993). These reforms strengthened the competitiveness of Chinese firms, paving the way for their internationalization. The resulting groups constituted the main source of China's outward FDI. In fact, the support of the Government gave Chinese TNCs an important competitive advantage not usually available to firms based in developing economies (except for such cases as the Republic of Korea).

In parallel with enterprise reforms, Chinese TNCs expanded internationally. The initial wave of companies going abroad consisted mainly of trading companies together with construction contractors, transport companies and banks, all of which promote exports of goods and services from China. These companies had monopolized China's foreign trade over the past decades in their specific areas of activity, thus gaining experience in international business. They were reorganized domestically and internationally after China embarked on an export-promotion campaign. They also diversified their operations by acquiring a number of manufacturing firms to form industrial-commercial conglomerates modeled along the lines of Japanese *sogo shosha* and Korean *chaebols*, while enjoying more autonomy in international operations (trade and investment) than manufacturing firms. These trading firms are relatively competitive in international markets, and some rank among the world's largest firms in their respective industries. For

Table 3. The top 10 Chinese Transnational Corporations, ranked by foreign assets, 1994

(Millions of dollars)

Rank	Name	Industry	Number of affiliates	Number of foreign affiliates	Foreign assets	Foreign sales[a]
1	China International Trust & Investment Corp.	Diversified	52	8	15 000	..
2	China State Construction Engineering Corp.	Construction & real estate	67	47	2 189	1 010
3	China Chemicals Imp. & Exp. Corp.	Trading & other	90	42	1 915	7 914
4	China Metals & Minerals Imp. & Exp. Corp.	Trading & other	116	47	710	2 270
5	China Harbours Engineering Construction Corp.	Construction, real estate & other	30	20	559	409
6	China Shougang Group	Iron & steel & other	105	26	446	980
7	China Cereals, Oil & Foodstuffs Imp. & Exp. Corp.	Trading & other	50	21	440	6 200
8	China Foreign Trade Transportation Corp.	Transportation & other	79	11	300	300
9	China Iron & Steel Industrial & Trading Group	Iron & steel	83	18	188	257
10	China Textile & Clothing Imp. & Exp. Corp.	Trading & other	43	26	179	1 000

Source: annual reports.

[a] Including both exports and foreign production.

Box 4. Shougang Corporation: going international

Shougang Corporation is one of the largest enterprises in China, with 9 major subsidiary groups in iron and steel, mining, electronics, machinery, construction, ocean-shipping, trade and finance (including banking), stretching over 16 industries and possessing 105 large and medium-sized plants and mines, 41 sino-foreign joint ventures, more than 200,000 employees and domestic fixed assets of more than 30 billion Chinese Yuan (RMB). Shougang Corporation's international operations started in mid-1980, and became full-fledged in 1992. Within a few years, it established over 20 affiliates with overseas fixed assets of $500 million, and a strategic base in Hong Kong through acquiring six listed companies and restructuring them into two large groups (i.e., Shougang Concord International Enterprises Ltd. Co. and Shougang Concord Grand Group Ltd.), with a market value of HK$ 2.35 billion of net assets. In the meantime, it won the international bidding for purchasing Hierro Peru Mining Ltd. in Peru. In addition, the company has formed its own fleet with a capacity of 1.3 million tons in 1993, and is now establishing a South-East Asia regional headquarters in Singapore and a strategic base in Latin America (located in Peru).

instance, Sinochem has been ranked by *Fortune* among the 30 largest service companies of the world for four consecutive years; the Bank of China is among the world's largest transnational banks, with $156 billion of foreign assets in 1994; and five Chinese construction firms are listed among the world's top 250. Taking the list of "the largest TNCs based in developing countries ranked by foreign assets" (UNCTAD-DTCI, 1995) as a benchmark, the top 10 Chinese TNCs can be ranked among the top 40 of the largest TNCs from developing countries, and 8 of them can be among the top 25.

Manufacturing TNCs—such as Shougang (Capital Iron & Steel Co.), China Petro-chemical Co., China North Industrial Corp., China Astronaut Industrial Corp., China Aviation Industrial Corp., and Anshan Iron & Steel Corp.—transnationalized during the mid-1980s, some of them at a fairly rapid pace (box 4). At the end of 1991, the Government formally granted 55 large enterprises autonomy in planning and international trade and investment, and provided fiscal and financial incentives.

In addition to these TNCs, there are also a number of Chinese firms based in Hong Kong that are owned by and report directly to either a central ministry or to provincial or municipal governments. Some of them are fairly large and had been in operation in Hong Kong before the 1970s. For example, China Merchants Ltd. (owned by the Ministry of Communication) which owns businesses in transportation, shipbuilding and repairing, hotel, manufacturing, infrastructure (such as wharf and terminals in Hong Kong), retailing, banking and insurance; and China Resources (owned by

> **Box 5. Export expansion through outward FDI**
>
> In 1992, Shougang Corporation teamed with Cheung Kong (Holdings) Ltd. and the Canadian company CEF Holding to acquire Tung Wing Steel in Hong Kong. Shougang invested $20 million to obtain 51 per cent of the stock. Cheung Kong (Holdings) Ltd. is a financial group jointly managed by Cheung Kong and a Canadian commercial bank. Tung Wing Steel is one of the major suppliers of steel products in Hong Kong, involved, among other things, in trade, storage, transportation and engineering services. It has one third of Hong Kong's steel market. The acquisition of Tung Wing has significantly expanded Shougang's exports of steel products, machinery and electric equipment to South-East Asia and to other parts of the world. The acquisition is also part of Shougang's strategy to cooperate with foreign firms in jointly managing its overseas investment.
>
> *Source:* Based on SIRI (1994).

MOFTEC), one of China's largest service companies. Others were established and supervised by the provincial and municipal governments in the mid- or late-1980s. These firms have served as middle men for the firms of respective provinces and cities in their international business.

Motivation and strategies

There are two major motivating forces behind investments abroad by Chinese companies: access to foreign markets and securing a stable supply of resources. In addition, tapping advanced technology and raising capital are factors behind some investments, particularly in Hong Kong and the United States.

- *Market-seeking*. This is the main motivation for most Chinese outward investment. It is the response of firms to the country's export-oriented policy over the past decade. Firms followed export channels into foreign markets, often establishing a local presence in order to expand market shares and avoid actual or anticipated trade barriers.[13] Trade-supporting investments, the majority of which were established by Chinese services TNCs, have played an important role in helping parent companies to market their products in an effective and efficient manner. In this respect, outward investment has contributed significantly to the rapid growth of China's exports.[14] Trade-supporting af-

[13] Such trade-supporting FDI is also typical for the other developing countries.

[14] According to WTO, China was the eleventh largest exporter in the world in 1993 and 1994. Its exports reached $121 billion in 1994.

filiates, with the advantage of being located in the market, have also served as an antenna for parent companies to monitor international economic developments, including technological changes and changes in customer demand (see box 5).

In a number of manufacturing industries, the domestic market has reached its limits of effective demand, and there is even significant excess production capacity in such industries as textiles and clothing, bicycles, footwear and electrical appliances (e.g., radios, electrical fans). Firms, particularly large ones, are therefore forced to target international markets for their products—and can do this successfully in industries in which they enjoy competitive advantages (Zhan, 1993a).[15] However, these firms are often faced with trade barriers. In certain product categories, in fact, quantitative restrictions are more severe for Chinese export products than for those from other countries, and a number of anti-dumping cases have been filed against Chinese products. This has forced firms to seek possibilities to circumvent trade barriers. Textile and clothing factories in some African and South Asian countries, as well as assembly plants for bicycles in Germany, the United States and Latin America, are examples of the type of investment that results. More FDI of this type can be expected to support or eventually replace exports.

- *Resource-seeking*. Despite the fact that China is well-endowed with natural resources, its per capita availability of national resources is relatively low, particularly for such resources as iron ore, aluminium, copper, timber and fish. There are two incentives for principal manufacturers to invest in natural resource exploitation: one is that a large and growing demand for these resources in the expanding home market guarantees, to some extent, a satisfactory return on investment; the other is that large projects meant to secure natural resources that the country is lacking usually enjoy financial and diplomatic support by the Government. China Metallurgical Import & Export Corporation's $180 million investment in the Channar Mine in Australia in 1988 is a good example. The project was part of a broader bilateral economic cooperation agreement between China and Australia. During the

[15] The market shares and the revealed comparative advantage indices for textile and clothing, travel goods and handbags, footwear and miscellaneous manufactures in the North American market are much higher than the other main suppliers to that market. For details, see the results of the analysis of China's exports contained in Zhan (1993a).

20 years of operation (1990-2010), the total mine output of 200 million tons of iron and ore is shipped back to China.

- *Technology-seeking.* Chinese firms are increasingly interested in acquiring advanced technology and manufacturing know-how in specific industries through FDI. A few large conglomerates in such industries as aviation, space, electronics, petrochemicals and engineering have made attempts to establish an overseas basis to channel back advanced technology to upgrade their domestic manufacturing on the one hand, and to develop new products for international markets on the other hand. Some Chinese TNCs have established research and development bases overseas. Successful examples are Shougang Corporation's acquisition of the United States Masta Engineering Co. (box 6); Sinochem's acquisition of Pacific Refinery of West Coast Corp.; Nanjing Panda Electronics Group's acquisition of an electronic firm in the United States; and China No. 1 Machinery Works' acquisition of an American numerical control company (which became a research-and-development basis and manufactures numerical control systems for China No. 1 Machinery Works' products). However, such investment projects in research and development are few in number and difficult to realize. Examples of failures include Chinese CATIC's acquisition of a Seattle aircraft-parts company serving as a major supplier to the Boeing Company, which ran afoul of United States regulations meant to prevent the acquisition of sensitive technology by foreigners.

In contrast to most TNCs from developed home countries and newly industrializing economies, efficiency-seeking is not a major motivation for Chinese TNCs. There is little incentive for firms to seek efficiency abroad, as China itself has an ample supply of low-cost labour and inexpensive land. Although production costs have been rising rapidly in the coastal areas of China, Chinese firms tend to establish their new production facilities in (or even move the old ones to) lower-cost sites within the country rather than outside of China. In fact, one can observe a kind of "flying geese" locational pattern (UNCTAD-DTCI, 1995) within China. It has been the strategy of a number of large Chinese TNCs to build their manufacturing bases in the middle and western parts of China, to produce products for export markets, with the exports being facilitated by their affiliates in these markets.

Besides the general motives described earlier, there are a number of specific reasons to invest in Hong Kong, an important strategic location for

Box 6. Technology-seeking investment: a success story

In mid-1988, Shougang Corporation spent $3.4 million to purchase a 70 per cent equity share in Masta Engineering Co. in the United States. Founded in 1989, Masta is one of the top international design and manufacturing companies for metallurgical equipment. About half of the hot strip rolling mills in the world are designed by Masta. Through this investment Shougang is able to use Masta's 650 blueprints and microfilms, 46 software packages, 41 technical patents and 2 registered trade marks in well-advanced rolling and continuous casting technologies. Masta became Shougang's research-and-development basis overseas. This investment has significantly strengthened Shougang's abilities to design and manufacture heavy metallurgical equipment and increased the international competitiveness of China's iron and steel industry.

Due to its solid technological know-how and international reputation, Shougang has won, since 1989, a number of important contracts in India, Indonesia, Macao, Malaysia and the Philippines. Masta was responsible for the design of these projects, and Shougang for manufacturing the equipment and accessories. In 1992, for example, Masta won the bid for a hotplate leveller project for Morgan Steel Mills Inc. in Portland, the United States. The leveller was designed by Masta and manufactured by Shougang in China. It was the first time that metallurgical equipment produced in China was exported to a developed country.

In late 1989, Shougang and its subsidiary Masta established a joint venture in Beijing, Masta Engineering Beijing Co. Ltd. With the advanced technology from Masta, the venture undertook a number of large technological renovation projects in China, including one research-and-development project listed as a key one in China's Seventh National Development Plan. Through joint research and development with United States experts and hands-on training in both China and the United States, Chinese engineers soon became familiar with the most advanced technology and know-how in the metallurgical industry.

Source: Based on SIRI (1994).

Chinese TNCs. China has been expanding its investment in Hong Kong significantly since 1983; during 1985-1994, Chinese firms established around 1,790 affiliates in Hong Kong and Macao, an estimated investment of between $9 billion and $11 billion.[16] Based in (or having a foothold in) Hong Kong, Chinese TNCs have been both inward-looking to the mainland and outward-looking to the world.

For some large Chinese TNCs, Hong Kong serves as a springboard for further transnationalization. Geographical proximity makes Hong Kong an ideal place for Chinese firms to familiarize themselves with western business practices and to set up regional headquarters—free of the rigid central Government's administrative control. For example, Fujian Enterprise (Hold-

[16] Author's estimate based on IMF data (excluding possible "round-tripping"). MOFTEC's official figure is US$ 3.2 billion, a figure that clearly underestimates the actual outward FDI to Hong Kong.

ing) Ltd. has used Hong Kong as a base to establish affiliates in Argentina, Australia, Canada, Japan, Peru, Thailand and the United States. Similarly, Guangdong Enterprise (Holdings) Ltd. based in Hong Kong has established 15 ventures in Australia, Canada, France, Germany, Thailand, the United Kingdom and the United States.

Hong Kong also serves as a channel for Chinese TNCs to obtain capital, advanced technology and business. One aspect of this is reverse investment by Chinese TNCs from Hong Kong to the mainland. Reverse investment may well amount to 20 per cent of the total FDI flows from Hong Kong to the mainland during the early 1990s. For instance, in the first nine months of 1993, four Chinese affiliates in Hong Kong invested about $1.5 billion in China, accounting for 14 per cent of China's total FDI inflows during the same period (Lin, 1994). The funding of those investment projects comes usually from one, or a combination of three main sources: funds raised in the Hong Kong financial market and loans from international banks; export earnings and investment returns of overseas affiliates; and "round-tripping"—capital from the mainland, re-routed back to China (see box 7).

Impediments to the transnationalization of Chinese TNCs

Despite the rapid growth of China's outward FDI over the past decade, impediments to the internationalization of Chinese TNCs exist. A sound regulatory framework is lacking, and there are no formal laws and regulations, nor is there monitoring at the post-approval stage. Administrative control by the Government is very rigid, and bureaucratic interference in micro-management is still evident. The decision-making power in investment and personnel management at the firm level is still in the hands of the respective supervisory ministries and municipal governments. Firms have been complaining that the Government's screening and approval process of outward investment is time-consuming, and that procedures are too complicated (Wan, 1995). While policy makers have sound ideas about how to maximize the benefits of inward FDI in the interest of national development, how to nurture Chinese TNCs as a means of promoting the economic development of the country and the international competitiveness of its firms needs careful consideration.

Operating in a different economic, social and cultural system is a great challenge for individual Chinese TNCs, especially also since most are State-

Box 7. Reverse investment by Chinese TNCs

Since the beginning of the 1990s, Hong Kong has become an important investment location for some Chinese TNCs to obtain foreign capital through listing in the Hong Kong Stock Exchange. The accompanying table contains an example of one particular type of fund raised by a few Hong Kong-based Chinese affiliates in the Hong Kong financial market in 1993.

Fund-raising by Chinese affiliates in Hong Kong: convertible bonds, 1993

(Million dollars and percentage)

Company	Value	Date of maturity	Interest rate
Guangdong Enterprises (Holdings) Ltd.	102	1998	4.5
Yue Xiu Enterprises (Holdings) Ltd.	105	1998	4.5
China Travel International Investment Trust	144	1998	4.25
Shougang Concord International Enterprises Ltd. Co.	183	1998	4.5
China Overseas Development	125	2000	5.25
Shougang Concord Grand Group Ltd.	76	1999	1.5
Hai Cheng Holdings	15	1999	1.5
Jin Hui Holdings	32	1997	2.5

Source: Wu (1994).

As many Chinese state-owned enterprises have difficulties to meet the listing requirements of the Hong Kong Stock Exchange, especially as regards international accounting standards and foreign exchange requirements, some have been able to obtain listing through the acquisition of either an already listed company in Hong Kong, or a company that satisfies the listing requirements of the exchange, or through setting up a holding company registered in Hong Kong which owns assets in China. The funds raised at the Hong Kong Stock Exchange are partly used for local business expansion and partly for reinvestment back into China. The acquisition of Congli Investment Co. Ltd. (the largest electronics group in Hong Kong in the 1970s) by China Space Industrial Corp. is a good example. In 1992, China Space Industrial Corp. bought 51 per cent of the shares of Congli (a value of HK$230 million) and renamed it Space Technology International Ltd. The firm grew rapidly, and in 1993 it successfully raised HK$1.4 billion in Hong Kong, a significant portion of which was used in China to acquire a big automobile manufacturer in Guizhou and to invest in a science park in Huizhou and a few large real estate projects in Shanghai[a].

"Round-tripping" is another possible source of capital, i.e., the circular flow of capital out of China to foreign affiliates of Chinese TNCs and the subsequent "reinvestment" of this "foreign" capital in China for the purpose of benefiting from fiscal entitlements accorded to foreign investors. Round-tripping was significant during 1992-1993. One estimate suggested that round-tripping accounted for 25 per cent of China's FDI inflows in 1992, i.e. $2.3 billion out of $9 billion (Harrold and Lall, 1993, p. 24).[b]

Policy reform aimed at equalizing the treatment of domestic and foreign capital is substantially reducing the incentive for round-tripping, in particular the reduction of tax incentives for FDI and, more generally, the gradual movement towards a national treatment-based regulatory regime governing investment. Furthermore, provinces and cities are no longer allowed to provide their own incentives or preferential treatment to foreign investors. That round-tripping has become less common is suggested by the fact that FDI inflows increased from $28 billion in 1993 to $34 billion in 1994, while FDI outflows decreased from $4.4 billion in 1993 to $2 billion in 1994.

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[a] Li, Jian, "The rise of space technology international group", *International Business*, 5 February 1995.

[b] In the author's view, this estimate is too high. There should be a difference between round-tripping and reverse investment carried out by Chinese TNCs. The latter consists of funds raised in the Hong Kong financial market and loans from international banks, and firms' export earnings and investment returns.

owned enterprises. Lack of experience and expertise in international business, and inadequate investment information, are major impediments to their internationalization. The technical and logistic complexities of outward FDI projects require management skills specific to international operations. In addition to detailed knowledge about host country markets in which FDI projects are planned (e.g., language, business culture, competition policy, availability of suppliers, distribution networks, etc.), managers in TNCs also need to have a good understanding of the intricacies of international legal frameworks, international finance, taxation, modern communications, and customs regulations, among a host of other issues.

Policy implications

Dealing with policy concerns

As mentioned earlier, the Government of China has a number of policy concerns with respect to outward FDI, maintaining therefore a fairly cautious approach towards outward FDI. Particularly important is a perceived causal link between capital scarcity (including both a shortage of savings and of foreign exchange) and capital controls over outward FDI. However, a sustained balance-of-payments surplus is a permissive, not a necessary, condition for allowing outward FDI. The availability of substantial foreign exchange reserves facilitates the liberalization of outward FDI policies. But the experience of, for example, the Republic of Korea, Malaysia and Thailand suggests that balance-of-payments concerns do not preclude liberalization, particularly in the face of competitive pressures which require that firms need to have the strategic option for FDI (UNCTAD-DTCI, 1995).

As far as China is concerned, the country enjoys large balance-of-payments surpluses and large reserves of foreign exchange ($69.8 billion at the end of September 1995, among the highest in the world), generated by the export boom over the past decade and large FDI inflows.[17] In fact, the problem that the Government now faces is more one of an overheated domestic economy, as well as inflation, rather than of foreign exchange scarcity. This should ease some of the policy concerns regarding outward FDI, allowing competing policy considerations to gain importance. The most important of these, strongly favouring a liberalization of outward FDI policies, is the need to maintain and increase the competitiveness of Chinese firms in a situation in which the country is increasingly becoming part of a globalized world economy, and internationalization is becoming imperative for Chinese firms.

Several factors have pushed—and will continue to push—Chinese firms in that direction:

- The Chinese economy in general is opening up not only to trade (in connection with the efforts to join the World Trade Organization), but also investment competition in the domestic market is becoming fiercer.

- In a number of manufacturing industries, the domestic market has already reached its limits of effective demand, and there is even significant excess production capacity.

- A number of Chinese export products are faced with trade barriers; this creates the necessity to give domestic firms the option to make the strategic decision to invest abroad in order to serve markets to which access through trade is hindered. If Chinese firms are not allowed to exploit their ownership advantages abroad while having to compete with foreign firms at home, their long-term competitiveness is threatened. In the end, this could damage their very viability. Furthermore, a relative decline in competitiveness of domestic firms increases the possibility that foreign firms acquire the assets of the domestic firms (and subsequently repatriate part of their local earnings). Since prospective domestic TNCs are likely to be one of the sources of growth

[17] Although foreign exchange is needed to service inward FDI, FDI in China itself has generated large amounts of foreign exchange (see Zhan, 1993b).

for the domestic economy, the possibility of their failure needs to be incorporated in the calculation of the social rate of return of outward FDI (UNCTAD-DTCI, 1995).

These considerations should lead Chinese policy makers not only to allow, in the future, outward FDI that is directly geared towards enhancing domestic development (described earlier as inward-looking outward FDI), but also outward FDI that has a more indirect effect on the country's long-term economic performance, namely through increasing the international competitiveness of Chinese firms. In many cases, in addition, FDI of either kind is still likely to have the direct effects desired by policy makers, i.e., to gain access to natural resources, technology, organizational and managerial practices; to serve export markets better; and to monitor international economic developments. The indirect positive effects of outward FDI for economic development will be increasingly recognized by the Government in the future.

One of the main challenges the Government faces as a result of the internationalization of Chinese firms is how the State, as the owner of most of the firms investing abroad, can effectively supervise the operation and management of these assets. As outward investment grows and the number of overseas affiliates increases, State control over the capital account and over its own assets becomes more and more difficult and therefore costly. The matter is further complicated as most outward FDI is in the form of joint ventures with foreign partners. Where possible, the Government needs to perfect its monitoring capabilities, but not at the price of slowing down the transnationalization process of its firms. As a Chinese proverb goes: one should not stop eating for fear of choking. Besides, the Government's ability to impose effective controls on capital outflows is likely to continue to decline as the economy opens up further (Mathieson and Rojas-Suarez, 1992). In fact, the main issue for the Government is how to ensure that its interests as owner are protected without overly resorting to the exercise of bureaucratic power. Any strengthening of monitoring capacities should only be part and parcel of the ongoing overall enterprise reforms of the country.

Policy options

These broad policy considerations warrant a rethinking of the outward FDI policies by the Government of China in the direction of more liberal and supportive policies that enhance the international competitiveness of Chinese firms and maximize the contribution of outward investment to domestic economic development. Some options in this respect are outlined below.

Regulatory recommendations

Most importantly, an appropriate regulatory framework for outward FDI needs to be created. More specifically, it is high time to enact an outward investment law. It should embody a further relaxation of regulatory controls. For the screening and approval process, value thresholds should be gradually raised to have more outward FDI projects exempt from the approval process or subject to less complicated procedures. Sectoral restrictions should also be narrowed. A simplification of the application procedures and a speeding-up of the approval process are highly desirable. As in the case of approval for inward FDI, automatic approval after a certain period of time should be considered. The approval of outward investment projects should be based on a broader and, most importantly, clearly defined list of national-interest criteria. The discretionary character of the present regulatory framework will otherwise remain one of the most important impediments for the transnationalization of Chinese firms, and thus for their efforts to strengthen their competitiveness.

An appropriate institutional set-up is crucial for the success of more forward-looking policies in this area. A Board or a Steering Committee on Outward Investment should be established at the highest level, i.e., the State Council. Its mandate should be to formulate laws and regulations relating to outward FDI and the country's overseas assets; establish a list of priority areas for firms' outward FDI; and formulate guidelines for the gradual liberalization of outward investment. It should have a small research arm, as its brain-trust to analyze foreign market potential, and to encourage linkages between large investment projects and Chinese economic development.

A consolidated database on China's outward FDI should be established in the supervisory organization, MOFTEC. It should cover the most important variables on which information is necessary to monitor the status and performance of outward investment projects. Ad hoc surveys may be helpful in this respect. The results of these surveys can be fed back into the database and serve as a basis for the formulation of policy.

Supportive policies

Liberalization and the improvement of the regulatory framework for outward investment should be accompanied by various supportive measures.

The experience of a number of developing countries shows that governments can adapt financial techniques used in programmes to promote domestic industrial development and/or incentives provided to inward FDI to support firms that need to establish themselves abroad.

Some form of financial support for outward FDI can evolve from trade-based export-promotion programmes, especially where FDI is associated with increased exports. The newly established Import-Export Bank of China could add outward FDI promotion to its objectives.[18] Its programmes could include, in addition to providing import and export credits, financial support to firms engaged in overseas operations, particularly those outward investments aimed at serving foreign markets, increasing the export of equipment and components and securing access to raw materials and technology—the classic motives for encouraging outward investment. The Import-Export Bank should also consider establishing an insurance scheme for outward investment. Chambers of commerce could help identify investment opportunities, conduct feasibility studies, organize investment missions and coordinate with agencies dealing with FDI matters in host countries to China's outward FDI.

The Government of China has adopted an active approach towards bilateral investment protection and promotion treaties: the country has so far concluded 71 such treaties, 46 since January 1990 alone. However, these treaties have been dealt with by the Government mostly from a host country's perspective, in the framework of efforts to improve the environment for inward FDI. Until recently, there were few Chinese firms to benefit from them for their own international operations, and few of them were familiar with the provisions of these treaties. MOFTEC needs to increase awareness about these treaties among Chinese firms. In addition, more importance should be attached to the outward FDI aspects of these treaties, which is particularly important for China since State property is involved.

But more direct assistance is also needed. For this purpose, an Overseas Investment Information Centre should be established, to gather and disseminate information on investment conditions in host countries and investment opportunities in industries, to offer consultation and advisory services and to arrange promotional seminars. Under the supervision of MOFTEC, the Centre should be linked with overseas commercial offices (part of the

[18] Import-Export banks in a number of developing economies such as the Republic of Korea, India, Thailand, and Taiwan Province of China support outward investment.

Chinese diplomatic corps in over 100 countries), through which investment opportunities can be fed back into a database of the Centre on outward FDI opportunities. Seminars should be organized regularly, using staff returned from overseas commercial offices as resource persons to brief interested firms about host countries' business potential and regulatory frameworks.

Lack of management skills related to international production has been an impediment to outward investment. In response to this challenge, MOFTEC, in cooperation with UNCTAD's Division on Transnational Corporations and Investment, initiated a training programme in September 1994 to strengthen management skills relevant to the internationalization of Chinese firms. The specific objectives of this programme were to impart formal knowledge about the transnationalization process of enterprises, especially regarding the establishment and management of foreign affiliates, and to create a forum in which over 60 senior and middle managers from leading Chinese companies could exchange information on their experiences with outward investment. Programmes such as this one are but a small step towards developing the management skills necessary for the successful internationalization of a country's economy through outward FDI. However, the establishment of this programme does underscore the growing recognition within China's policy circles of the importance of human resource development, and the positive role that the Government can play in this regard.

In addition to policy measures directly meant to improve the regulatory framework for outward FDI, other policy measures aimed at strengthening firms' international competitiveness should also be considered by the Government. These include strengthening the country's industrial policies, furthering and deepening enterprise reform and improving the regulatory framework for inward FDI.

Concluding remarks

The past decade has seen a rapid growth of Chinese TNCs and their outward investment. China has emerged as one of the most significant outward investors among developing countries, both in terms of the volume of outflows and the rate of growth. The structure of China's outward FDI and the characteristics of Chinese TNCs' activities reflect a strong role played by the Government.

The rapidly changing domestic economic conditions and the equally rapidly changing global economic environment call for an adjustment by the Government, especially in respect to its policies regarding outward FDI. In fact, Chinese firms have put pressure on the Government to liberalize outward FDI. Furthermore, the rapid progress of firms' transnationalization has made the current regulatory framework far from sufficient. Under these circumstances, the Government of China should consider a further liberalization of its outward FDI policy.

There is no doubt that the Government still needs to approach the question of outward FDI with caution, and take considerable care to align outward investment policies with macroeconomic and balance-of-payment conditions and with other development priorities. Strategies pursued in this respect should certainly mix and match approaches over time within fairly broad parameters reflecting the country's specific factors, such as relative resource endowments, sectoral business configurations and regional and international ties. Nevertheless, policy makers should equally devote their attention to the new issues arising from the country's further integration into the globalizing world economy. And, in this respect, one major issue is the competitiveness of national firms in the face of gradually opening domestic and international markets. Both enterprise competitiveness and national welfare could be harmed by restricting firms to the domestic market (UNCTAD-DTCI, 1995).

A more liberal policy regime than the current one governing outward FDI, complemented by an appropriate promotional programme, would help firms to enhance their competitiveness, which in turn would help increase overall national economic performance. ■

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