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An Assessment of Outward Foreign Direct Investment from China's Transitional Economy

HSIU-LING WU & CHIEN-HSUN CHEN

AS A RESULT OF GRADUAL INSTITUTIONAL TRANSFORMATION, China's economy has been able to grow rapidly since 1978, and China is often cited as the leading example of a successful gradualist approach to institutional changes (Lau *et al.*, 2000; Smyth, 1998). China began to undertake aggressive foreign direct investment (FDI) overseas, with the aim of increasing its influence on the international stage, in both economic and political terms. Before China began its process of economic liberalisation in 1978 the government had adopted an inward-looking policy with emphasis on self-reliance and economic independence; it was therefore strongly opposed to FDI and the establishment of multinational corporations so common in the West. It was felt at that time that the presence of Western multinationals brought no benefits to the host country. However, once China had embarked on the process of economic liberalisation and the Chinese–Foreign Joint Ventures Law was enacted in July 1979, more and more transnational corporations and other foreign enterprises began undertaking production in China, helping to stimulate economic development (Chen, 1992, 1996; Cheng & Kwan, 2000).

As a result, China came to adopt a different attitude towards the importance of FDI, and by the late 1980s not only had the Chinese government continued the process of liberalisation, welcoming foreign capital, technology and management experience with its open door policy, but it was also encouraging the expansion of overseas investment by Chinese enterprises, with outward FDI becoming part of the strategy for economic development based on institutional transformation (Zuo, 1998).

However, whilst China's economy was developing rapidly, considerable amounts of capital were still required for economic development, and it could not afford to spend large amounts of foreign exchange reserves on overseas investment. Seeking out efficient areas for overseas investment therefore became a major concern and several industries were chosen to fulfil this goal, such as those industries in which China lacked its own resources or those already possessing mature technology which could use overseas investment to implement technology transfer to other developing nations, thereby stimulating export growth. In terms of enterprise financing, China expected those enterprises that were capable of doing so to make maximum use of the international capital markets.

In response to the trend towards economic globalisation and regionalisation, along

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with the development of overseas markets, China's enterprises began to undertake aggressive overseas investment at such a rapid pace that it has already attracted widespread attention abroad; in 1995 the United Nations Economic and Trade Development Organisation listed China as one of the developing countries beginning to undertake overseas investment on a large scale.

It remains an important scholarly task to assess the progress and performance of China's outward FDI. Thus the main purpose of this article is to explore and scrutinise the progress of China's outward FDI, with special attention to its motivation, its sector distribution, scale of operation and geographical distribution, its overall benefits and problems, and its future prospects. The article is organised as follows. First we explore the motivation behind Chinese outward FDI, next we examine the evolution of Chinese outward FDI, and then we analyse its sector distribution, scales of operation and geographical pattern. Finally, we appraise the overall benefits and major problems of Chinese FDI and conclude by summarising the article's major findings.

Exploring the motivation for China's FDI

Investing overseas and transferring production plants abroad are methods which are already in extremely widespread use by European, US and Japanese enterprises. The motivation for such investment is usually related to competition, product characteristics or cost factors. In addition, the host nation's investment environment, such as tax incentives, tariff and non-tariff barriers etc., can all influence the inflow and outflow of FDI. Thus the motivation for overseas investment can usually be classified as either expansive or defensive. In the former case a company seeks out overseas bases in order to develop overseas markets or obtain the raw materials needed for production; in the latter case the main reason for moving production overseas is because changes in the investment environment in the home nation make investing at home disadvantageous.[1]

In the case of China, its outward FDI started once economic reforms had been initiated; the amount of capital involved is limited, Chinese firms lack experience, and overseas investment is dominated by state-owned enterprises, unlike the situation in developed countries such as the European nations, the US and Japan, whose overseas investment activities have formed a comprehensive system for the division of labour based on the industrial development structure in the home country.

In the early period of development of Chinese outward FDI the first agencies to begin international operations were the provincial and city level international economic and technical collaboration companies, such as the Shanghai Overseas Economic and Technical Collaboration Company and the Fujian Overseas Economic and Technical Collaboration Company. These companies exploited their respective experience of extensive foreign aid to undertake labour collaboration and contracting, and to establish joint venture companies in developing countries.[2] By the late 1980s not only had China's government opened the country up further to foreign investment, welcoming foreign capital, technology and management experience, but it had also begun to encourage Chinese enterprises to invest overseas and engage in transnational operations, and consequently overseas investment became one of the main elements

in China's economic development strategy for institutional change. Following the government's lead, in the 1990s private enterprises began to participate actively in evaluating the feasibility of overseas investment, and in the actual expansion of such investment (Hou, 1998).

China's overseas investment thus began with state-owned enterprises, with an emphasis on labour collaboration and contracting; gradually, as economic growth began to speed up, overseas investment was expanded to include resource development and transnational investment undertaken by individual enterprises on their own initiative. From 1991 onwards, more and more national and regional business groups began to participate actively in overseas investment activities. Their motivation tended to be more trade-related, with the desire to develop new markets, increase exports, exploit advantageous local conditions and obtain resources or commercial benefits in some other fashion.

Liu (1992) noted that the motivation for outward FDI by Chinese enterprises included the following: (i) development of overseas markets; (ii) procurement of foreign exchange; (iii) achievement of enterprises' overall strategic goals; (iv) stimulation of exports; (v) earning investment profits higher than those obtainable at home; (vi) diversifying production lines or expanding the enterprise's scope of operations, and so on. However, the majority of Chinese enterprises involved in transnational operations are state-owned enterprises, and the government maintains extensive controls over the market operations of its state-owned enterprises—contrary to the situation in other countries—and political and diplomatic motivations are still important factors (Qiao, 1996; Qi, 1999), and the political motivation behind the flood of Chinese investment into Hong Kong prior to Hong Kong's return to China in 1997 was obvious (Bacher, Lorz & Schuknecht, 1992). It can thus be seen that China hopes to make use of overseas investment to develop interaction and collaboration with other countries, thereby enhancing China's international economic and political influence.

Evolution of China's outward FDI

As Table 1 shows, in terms of Chinese government policy and the progress of economic reform, during the past two decades the evolution of China's outward FDI has undergone four stages.

First stage (1979–1983)

During this period a total of 76 projects (including both joint venture companies and wholly owned companies) were set up abroad by Chinese enterprises, with the total investment by China coming to approximately US$50 million. Investment projects took place in 23 countries or regions, but as this was still the early stage of development, the scale of investment projects was relatively small, and investment was mainly concentrated in a limited number of industries, including marine transport, finance and insurance, contracting and Chinese restaurants.

As noted above, the first Chinese enterprises to engage in transnational operations were special foreign trade companies at central and regional government level, as well

TABLE 1

OUTWARD FDI FLOWS FROM CHINA

	Number of projects (1)	*Chinese investment value ($ million) (2)*	*Average Chinese investment value ($ million) (3) = (2)/(1)*	*Total Investment Value ($ million) (4)*	*Chinese equity Share (%) (5) = [(2)/(4)] × 100*
1979	4	0.53	0.13	1.2	44
1980	13	31.87	2.45	68	47
1981	13	2.6	0.20	6.8	38
1982	13	2	0.15	6	33
1983	33	13	0.39	10	130
1984	37	100	2.70	118	85
1985	76	47	0.62	88	53
1986	88	33	0.38	109	30
1987	108	410	3.80	1373	30
1988	141	75	0.53	118	64
1989	119	236	1.98	325	73
1990	156	77	0.49	167	46
1991	207	367	1.77	759	48
1992	355	195	0.55	351	56
1993	294	96	0.33	187	51
1994	106	71	0.67	124	57
1995	119	106	0.89	200	53
1996	103	294	2.85	494	59
1997	158	196	1.24	325	60
1998	266	259	0.97	–	–
Total	2409	2613	1.08	–	–

Note: Data are on an approved basis.
Source: Almanac of China Foreign Economic Relations and Trade, 1991–2000.

as provincial and city government international economic and technical collaboration companies.

The motivation behind overseas investment at this stage was based mainly on China's policy objectives; the establishment of overseas enterprises was thus intended only to expand the area of collaboration with foreign countries, establish international trade relationships and enhance China's international political and economic influence, rather than to maximise profits. Owing to a lack of experience and unsatisfactory supervisory systems, some enterprises were set up without due consideration having gone into their establishment; they were badly managed and made losses year on year. In 1983, on instructions from the State Council, the Ministry of Foreign Trade and Economic Cooperation reorganised these overseas joint venture companies, and after obtaining the agreement of the joint venture partners, those companies which had been mismanaged were wound up. Well-known companies which undertook overseas investment during this period included China Petrochemical Import–Export Corporation, China Wukuang Import–Export Company and Shanghai Machinery Export Company, each of which had established trading companies overseas or established overseas joint-venture companies to undertake their contracting projects.

Second stage (1984–1985)

In the space of 2 years China approved the establishment of 113 overseas enterprises—almost double the number whose establishment had been permitted in the previous 5 years—pushing China's total investment to US$140 million. These enterprises were spread throughout over 40 countries and regions, and were engaged in a wider variety of sectors and industries, including manufacturing, processing and assembly, trade, and so on.

Third stage (1986–1992)

As the pace of economic liberalisation speeded up, and as improvements were made in technical and managerial standards in China, enterprises began to undertake overseas investment on a larger scale, and to participate in international competition. In addition, from 1991 onwards, China's exports, and the country's foreign exchange reserves, increased rapidly. At the same time, however, economic development was restricted by a shortage of resources, and necessary adjustments to the industrial structure meant that mature technologies and industries would have to be transferred overseas. China therefore decided to encourage the development of overseas investment, which could make use of comparative advantage. As a result, China's overseas investment increasingly began to place the emphasis on profit maximisation. The ranks of Chinese enterprises investing overseas were then joined by large and medium-sized manufacturers along with integrated international investment companies such as Capital Iron and Steel, China International Investment and Trust Corporation and Shenzhen Saige Ltd.

During this period there was a major increase in overseas investment activity by China. By the end of 1992 China's overseas investment had extended to over 120 different countries and regions, with more than 1360 overseas enterprises being set up, and total investment by China reaching US$1.591 billion. In 1992 approval was given for 355 enterprises to invest overseas, making this the year with the fastest growth in the number of companies set up overseas.

The total Chinese overseas investment in that year alone came to US$195.3 million, and at the same time, the scale of overseas investment by the various companies was also increasing. There were over 100 companies in which Chinese investment exceeded US$1 million; the largest had an investment of over US$100 million. Although large enterprises accounted for only 8% of the total number of enterprises established overseas, these companies accounted for 76% of the total amount invested.

Overall, therefore, the chief features of this stage were (i) the significant increase in the pace of overseas investment, (ii) the expansion in areas of investment to include industrial and agricultural production, resource development and other service industries, and (iii) the motivation for overseas investment, which included encouragement by central, provincial and city government, not only in terms of policy objectives centred around enhancing China's political and economic influence but also the desire to maximise profits.

Fourth stage (1993 to date)

Beginning in 1993, China's economy began to show signs of overheating, with prices rising, whilst the poor operational efficiency of large and medium-sized state enterprises was abundantly clear. The Chinese government decided to implement economic restructuring, which entailed a period of adjustment for overseas investment. As China tightened up overall control, reduced the money supply and sought to bring inflation under control, sources of funding also became tight, and at the same time, China began to undertake more rigorous screening of overseas investment projects. Review processes implemented by relevant government agencies were tightened up, and re-registration was required of those overseas enterprises already established. As a result, the number of registered overseas investment enterprises, and those being set up, fell drastically.

It was not until 1995 that the number of overseas investment projects started to rise again. In 1996, although the number of Chinese enterprises' overseas projects fell compared with 1995, there was almost a two-fold increase on the 1995 figure in the total amount of investment, indicating that the scale of overseas investment in this particular year was relatively large. In 1997 the scale of overseas investment fell again, whilst in 1998, although both the number of enterprises set up overseas and the total amount of investment had increased, the scale of investment per enterprise fell.

Distribution of Chinese overseas investment by sector

A survey of China's overseas investment over the period 1984–87, reported in the United Nations' *World Investment Directory 1992* (see Table 2), showed three characteristics of Chinese overseas investment by individual sectors in the 1980s.

First, the amount of investment in the agricultural sector fell markedly, whilst investment in mining rose; this is consistent with the trend towards emphasising resource development, which began in the late 1980s.

Second, the proportion of overseas investment in secondary and tertiary industry gradually rose. In 1984 overseas investment in primary industry accounted for 79.3% of total overseas investment, whilst the secondary and tertiary industries accounted for only 7.0% and 13.7% respectively. However, 4 years later the proportion of total overseas investment accounted for by primary industry had fallen to 26.8%, whilst the proportion accounted for by the secondary and tertiary industries had risen to 55.1% and 22.1% respectively.

Third, within the secondary industry sector the most rapid increase in the amount of overseas investment was in metals manufacturing. Other industries with a relatively high rate of growth included textiles and electrical equipment manufacturing.

As Table 3 indicates, Chinese overseas investment can be divided into trade and non-trade investment, with the non-trade category including mainly industrial manufacturing and the agricultural sector, contracting and resource development.

In a comparison of trade investment and non-trade investment, one can see from Table 3 that industrial manufacturing and the agricultural sector accounted for the largest proportion of China's overseas investment, followed by trade. The number of investment enterprises established overseas in the industrial manufacturing and

TABLE 2

SECTOR DISTRIBUTION OF CHINESE OUTWARD FDI FLOWS, 1984–1987 (MILLION YUAN)

	Outward investment value			
Sector and industry	*1984*	*1985*	*1986*	*1987*
1. Primary sector	142.5	10.9	14	281.4
Agriculture	141.0	7.9	13.1	13.5
Mining and quarrying	0.2	–	–	145.5
2. Secondary sector	12.5	59.5	156.8	237.4
Food, beverages and tobacco	–	5.4	9.6	4.3
Textiles, leather and clothing	5.7	9.3	34.7	28.2
Paper	0.9	10.3	–	–
Chemicals	–	3.4	12.9	4.1
Coal and petroleum products	–	0.3	–	2.8
Rubber products	–	4.7	20.7	4.7
Non-metallic mineral products	–	–	2.3	4.9
Metals	1.9	3.3	5.2	198.7
Mechanical equipment	0.1	2	0.7	–
Electrical equipment	2.9	3.9	52.6	9.3
Motor vehicles	–	–	–	0.7
Other transport equipment	0.4	–	–	15.4
Other manufacturing	0.4	0.2	2.6	30.4
3. Tertiary sector	24.6	71.1	90.4	232.3
Construction	3.9	15.6	10.7	9.4
Distributive trade	3.8	19.4	20	32.8
Transport and storage	2.6	2.8	11.2	10.3
Finance and insurance	–	0.1	17.3	–
Other services	14.1	13.1	25.3	78.7
Total	179.6	141.5	261.2	1051.1

Source: United Nations, *World Investment Directory 1992, Vol. 1, Asia and the Pacific*, p. 70.

agricultural sector has consistently been the highest; in both 1993 and 1994 the number of overseas investment enterprises in the industrial and agricultural sector exceeded 50% of the total, and only in 1995 did the number of trade enterprises establishing overseas marginally exceed those establishing in the industrial manufacturing and agricultural sector. In the Chinese definition, the industries which are classified as falling within the industrial manufacturing and agricultural sector include heavy industry, light industry, textiles, wood processing, agriculture, fisheries, pastoral farming, machinery, construction, assembly and repair, mineral exploration and mining, water and electricity, petrochemicals and so on. Overseas investment in these industries involves mainly the Chinese enterprise providing equipment and technology, and participating in technical guidance and operational management.

Analysis of the total amount of investment reveals that resource development is an area where there has been significant growth in Chinese overseas investment; the proportion of total overseas investment accounted for by resource development increased from 1.1% in 1993 to 11.1% in 1995. This was a result of the average level of resources per inhabitant being too low in China because of its large population.

TABLE 3

DISTRIBUTION OF CHINESE OUTWARD TRADE AND NON-TRADE FDI FLOWS, 1993–1995 (US$ MILLION)

	1993	*1994*	*1995*	*Average size (1995)*
1. Number of projects	380	145	197	
Trade	85	39	78	
Manufacturing and agricultural sector	175	81	73	
Contracting projects	14	9	15	
Resources exploration	4	4	5	
Others	102	12	26	
2. Signed outward FDI contracts value	119.75	80.39	130.98	
Trade	23.71	9.77	24.55	(0.3147)
Manufacturing and agricultural sector	59.55	58.10	64.34	(0.881)
Contracting projects	7.56	3.33	4.99	(0.3326)
Resources exploration	1.38	1.43	14.86	(2.972)
Others	27.55	7.76	22.24	(0.8553)

Source: Lin (1997).

China's rapid economic growth requires resource consumption, and thus, to solve the shortage of certain resources, China has to collaborate on resource development with other countries, including collaboration on the establishment of logging, pulp and paper plant with countries in North America, South America, the South Pacific and Africa that have extensive timber reserves. In addition, China is collaborating with over 20 developing nations in the development of fishery resources, and in the mining of iron ore and precious metals. One prominent example is the purchase of a Peruvian iron-mining company by China's Capital Iron and Steel. Since relatively little of China's iron ore is actually usable, and mining equipment and production costs are high, assuming that the current rate of extraction is maintained, domestic sources can provide a stable supply of iron ore for only a little over 20 years. Furthermore, even if mining technology is improved, domestic reserves will not last more than 40 years, far lower than the global 150-year guarantee of reserves. Under these circumstances, on 5 November 1992 China's Capital Iron and Steel purchased the Peruvian iron mining company in order to make use of that country's high-quality, plentiful supply of iron ore in the development of China's iron and steel industry.[3]

The data in Table 3 also reveal that contracting projects have consistently accounted for a significant proportion of China's overseas investment. These projects represent one of the fundamental aspects of China's overseas development strategy, involving mainly the construction of buildings, railways, highways, bridges and harbours, and land reclamation in the developing nations. Table 4 shows that the operating revenue derived from overseas contracting work by China was increasing significantly over the period 1976–98.

Poor labour quality and low technical standards in the developing nations have greatly encouraged the development of the contracting market, and China has been able to move into this market on the basis of its experience, through the provision of foreign aid, in undertaking basic infrastructure construction.

TABLE 4

TOTAL VALUE OF CONTRACTS AND OPERATING REVENUE OF CHINA'S FOREIGN CONTRACTING PROJECTS, 1970–1998 ($ MILLION AND %)

	Contracts signed		*Operating revenue*	
	Total value	*Growth rate (%)*	*Total value*	*Growth rate (%)*
1976–1981	451.97	–	123.36	–
1982	345.86	–	188.65	–
1983	798.62	130.91	315.64	67.32
1984	1538.13	92.60	494.31	56.61
1985	1115.74	−27.46	662.76	34.08
1986	1188.70	6.54	818.89	23.56
1987	1492.58	25.56	1073.41	31.08
1988	1812.53	21.44	1253.00	16.73
1989	1781.05	−1.74	1484.30	18.46
1990	2125.35	19.33	1644.14	10.77
1991	2524.09	18.76	1969.73	19.80
1992	5250.51	108.02	2402.86	21.99
1993	5188.70	−1.18	3668.54	52.67
1994	6027.53	16.17	4882.71	33.10
1995	7483.54	24.16	5107.81	4.61
1996	7728.34	3.27	5820.51	13.95
1997	8516.46	10.20	6036.18	3.71
1998	11 773.23	38.24	10 113.81	67.55

Note: Data are on an approved basis.
Source: Almanac of China Foreign Economic Relations and Trade, 1991–2000.

Organisation and scale of operations

By comparison with overseas investment enterprises in other countries, the scale of operation of China's overseas investment enterprises tends to be relatively small. Data on the number of enterprises and the total amount of investment, as indicated in Table 1, show that the average scale of investment is roughly between US$320 000 and US$2 850 000, and that in 1997 Chinese overseas investment projects involving an investment of over US$5 million accounted for less than 1% of the total. Amongst non-trade overseas investment enterprises, only 30 involved an investment by the Chinese partner of over US$5 million.

Examining the scale of operations in terms of different categories of investment, Table 3 shows that, on the basis of the 1995 data, enterprises in the resource development sector had a relatively large scale of operations, with the average being US$2.97 million, followed by the industrial manufacturing and agricultural sector enterprises at US$880 000 and other enterprises at US$855 300. The average scale of operations for overseas trade and contracting enterprises was just over US$300 000.

The forms of organisation used by Chinese overseas investment enterprises fall into the following five categories: equity-type joint-venture companies; contract-type joint-venture companies; wholly-owned enterprises; branch offices; and acquisition of local enterprises (in part or in whole). Owing to risk sharing and market dominance, the most common form of overseas investment is the joint-venture enterprise, accounting for two-thirds of all Chinese overseas investment (Zhao, 1998). Chinese investment may take the form of cash, physical objects or technology inputs, but, as

a result of China's foreign exchange controls, companies are encouraged to invest using physical objects or technology inputs, including equipment, machinery, tools, raw materials, vehicles and so on. In the case of cash inputs, either the investing company makes use of funding obtained from the international capital markets or international organisations, or else financing is obtained from local banks in the host country.

Chinese investment may take different forms in developed and developing countries. In the developed nations, since the host country's economic and technical levels tend to be relatively high, in the case of large and medium-sized resource development or production projects, the Chinese enterprise's investment usually takes the form of cash or international financing. In the developing nations, Chinese overseas investment in production-related projects tends to be in the form of machinery, raw materials, technology or labour. For trade enterprises, Chinese investment is usually in the form of cash.

Overall, the cash input form of investment accounts for around one-third of China's outward FDI, with physical objects and rights accounting for the remaining two-thirds. Foreign exchange remitted from China itself accounts for less than 10% of cash inputs; in other words, 90% of cash investment is secured from the international capital markets (Ma & Ju, 1998). The methods of financing used by China for overseas investment include overseas enterprise loans, international financing rental, secured loans etc. As Chinese enterprises lacked experience in making use of the international capital markets, relatively little foreign capital was used when they first ventured into transnational investment; however, as they accumulated experience in using international financing, these enterprises began to use foreign capital on a larger scale.

As regards the share in joint-venture companies held by the Chinese partner, it can be seen from Table 1 that, with the exceptions of 1984, 1985, 1988, 1989 and 1992, when it exceeded 50%, in every other year the average amount of Chinese overseas investment in joint ventures, as a proportion of the total investment, has been under 50%. We can also see that the Chinese holdings in overseas investment enterprises have tended to rise.

Geographical distribution of China's outward foreign direct investment

Geographical distribution by continent

By 1998 China had undertaken FDI in over 150 countries worldwide. If we explore the geographical distribution of this overseas investment, we can see that the regions with the largest number of Chinese overseas investment enterprises are, in order, Asia, Europe and North America. The regions that have received the largest amount of overseas investment are North America, Asia and Oceania. Table 5 shows the cumulative geographical distribution of China's overseas investment at the end of 1998.

Owing to its superior investment environment, North America has become the largest market for Chinese overseas investment, with investment standing at US$777.49 million, accounting for 30.09% of total Chinese overseas investment. The

TABLE 5

CHINESE OUTWARD FDI STOCK, BY REGION, END OF 1998 ($ MILLION AND %)

	Number of projects (share)	*Chinese investment (share)*	*Average Chinese investment value*
Asia	907 (37.65%)	586.765 (22.71%)	0.64693
Africa	300 (12.45%)	346.0708 (13.39%)	1.15357
Europe	499 (20.71%)	204.4561 (7.91%)	0.40973
Oceania	165 (6.85%)	434.6880 (16.82%)	2.63447
North America	356 (14.78%)	777.4909 (30.09%)	2.18396
Latin America	171 (7.10%)	262.2521 (10.15%)	1.53364
Total	2409 (100%)	2583.831 (100%)	1.07257

Note: Data are on an approved basis.
Source: Almanac of China Foreign Economic Relations and Trade, 1991–2000.

next largest investments were in Asia and Oceania, amounting to US$586.76 million and US$434.68 million respectively, and accounting for 22.71% and 16.82% of the total. The main reason for the heavy investment in Asia was the big push by Chinese capital into Hong Kong and Macao; Oceania has attracted a significant proportion of Chinese capital because of its extensive resource endowment. In terms of numbers of enterprises, Asia has the largest number of investment enterprises, with 907, accounting for 37.65% of the total. This is followed by Europe and North America, with 499 and 356 respectively, accounting for 20.71% and 14.78% of the total. Therefore, the average scale of investment per enterprise is highest in Oceania, where it stands at approximately US$2.634 million, 6.6 times the average figure for Europe and 4.07 times the average figure for Asia.

Geographical distribution by country

Table 6 provides details of the 10 host nations with the largest amount of Chinese overseas investment in 1998, through an analysis of the geographical distribution of Chinese overseas investment enterprises by country. At the end of 1998 the most important countries for Chinese overseas investment were the US, Canada and Australia, accounting for 42.32% of the total.

The main reason why the lion's share of investment is situated in the developed countries is that these nations have extensive resources, and resource seeking is one of the main objectives of China's overseas investment. In addition, most of these countries and regions offer a favourable investment environment, including sound financial markets and consumer markets, highly developed technology, advanced management methods, superior infrastructure and so on. China can use overseas investment to acquire the advanced technology it needs, and learn advanced management methods, aims which are consistent with the policy objectives that led the Chinese government to encourage overseas investment in the first place (Ma & Li, 1995).

The data in Table 6 also show us that Hong Kong, Macao and Thailand have consistently been major recipients of Chinese investment, and that, by comparison with the situation in 1990, investment in these three economies has grown

TABLE 6

CHINESE OUTWARD FDI STOCK BY COUNTRY, 1990 AND 1998 ($ MILLION AND %)

	1990					*Approved by Chinese government (as at 1998)*					*Growth rate 1990–1998 (%)*	
	Number of projects (share)	*(%)*	*Chinese investment value (share)*	*(%)*	*Average Chinese investment*	*Number of projects (share)*	*(%)*	*Chinese investment value (share)*	*(%)*	*Average Chinese investment*	*Number of projects*	*Chinese investment value*
Total	801	(100)	1028.7038	(100)	1.2843	2409	(100)	2613.2419	(100)	1.0848		
USA	112	(13.98)	288.6887	(28.06)	2.5776	274	(11.37)	401.0400	(15.35)	1.4636	145	39
Canada	36	(4.49)	52.9984	(5.15)	1.4722	82	(3.40)	376.4509	(14.41)	4.5909	128	610
Australia	48	(5.99)	309.2268	(30.06)	6.4422	96	(3.99)	329.2100	(12.60)	3.4293	100	6
Hong Kong	116	(14.48)	98.8973	(9.61)	0.8526	189	(7.85)	230.5003	(8.82)	1.2196	63	133
Peru	1	(0.12)	0.7178	(0.07)	0.7178	9	(0.37)	120.7198	(4.62)	13.4133	800	16718
Russia	33	(4.12)	26.8249	(2.61)	0.8129	259	(10.75)	99.5777	(3.81)	0.3845	685	271
Thailand	61	(7.62)	34.4485	(3.35)	0.5647	136	(5.65)	67.2345	(2.57)	0.4944	123	95
Macao	24	(3.00)	15.8822	(1.54)	0.6618	49	(2.03)	57.4102	(2.20)	1.1716	104	261
South Africa	–		–		–	50	(2.08)	54.2100	(2.07)	1.0842	–	–
New Zealand	3	(0.37)	2.1500	(0.21)	0.7167	15	(0.62)	45.8800	(1.76)	3.0587	400	2034
Brazil	7	(0.87)	9.9580	(0.97)	1.4226	23	(0.95)	42.0497	(1.61)	1.8282	229	322
Singapore	18	(2.25)	6.9036	(0.67)	0.3835	79	(3.28)	33.4310	(1.28)	0.4232	339	384
Malaysia	13	(1.62)	9.4121	(0.91)	0.7240	78	(3.24)	31.5991	(1.21)	0.4051	500	236
Chile	4	(0.50)	21.2950	(2.07)	5.3238	6	(0.25)	20.8700	(0.80)	3.4783	50	−2
Japan	44	(5.49)	7.5713	(0.74)	0.1721	86	(3.57)	16.0408	(0.61)	0.1865	95	112
Germany	18	(2.25)	6.5532	(0.64)	0.3641	32	(1.33)	11.1102	(0.43)	0.3472	78	70

Note: Data are on an approved basis

Source: Almanac of China Foreign Economic Relations and Trade, 1991–2000.

significantly (Hou, 1997). A significant proportion of Chinese investment has also been attracted by Russia, along with other countries including, Peru, South Africa and New Zealand. Comparison of the levels of Chinese overseas investment in 1990 and 1998 shows that the proportion of investment going to the US, Canada and Australia has fallen, indicating that investment is gradually becoming more widely distributed. Important new targets for Chinese investment include Peru, South Africa and New Zealand, and if one looks at the figures for Chinese investment growth over 1990–98, these three countries had the fastest growth.

At the end of 1990 total Chinese investment in Peru came to only US$710 000, but by the end of 1998 this figure had risen to US$120 719 800, a 167-fold increase. In reality, most of this US$120 000 000 increase in investment relates to the November 1992 purchase of the Peruvian iron mining company by Capital Iron and Steel, the largest overseas investment project in which Capital Iron and Steel had ever been involved.

Prior to 1990 there was no diplomatic relationship existing between China and South Africa—even of an unofficial nature—and as a consequence Chinese enterprises had no investments in South Africa. However, in order to establish diplomatic relations with South Africa, the Chinese government encouraged the pursuit of economic and trade relationships; thus, from 1996, Chinese capital started to flow into the country, with the number of Chinese enterprises investing in South Africa increasing rapidly. By 1998 the total amount of Chinese investment in South Africa had reached US$54.21 million, with 50 Chinese enterprises having set up business there, but the average scale of investment was clearly still relatively small.

During the same years Chinese investment in New Zealand rose from US$2.15 million to US$45.88 million, a more than 20-fold increase. This is mainly because of Chinese investment, since 1995, in many resource development projects in New Zealand, including forestry, aquaculture and so on. As China's investment projects in New Zealand mainly involve resource development, they tend to be on a relatively large scale.

In addition to the three countries noted above, China's other major investments have also tended to increase. For most countries, with the exception of Chile, Chinese investment increased by 100% to 300%; this includes Hong Kong, Russia, Macao, Malaysia and Brazil, whilst the rate of growth in the developed nations has tended to be lower. Examples include Australia, where investment grew by only 6% over the 8 years 1990–98, and the US, where it grew by 39%. Of all the developed nations, only in Canada did Chinese investment increase six-fold.

If one analyses the number of overseas investment enterprises, one can see that prior to 1991 the three host countries with the largest number of Chinese enterprises were Hong Kong, the US and Thailand. By 1998 the top three host countries were the US, Russia and Hong Kong. Overall, those countries with a relatively large number of Chinese enterprises include, in the Asia region, Japan, Singapore, Thailand, Malaysia and Hong Kong, and elsewhere developed nations such as the US, Australia, Canada and Germany, as well as Russia and South Africa. As regards the rate of growth in the number of Chinese overseas enterprises set up, in addition to South Africa, where the number increased from zero in 1990 to 50 in 1998, countries where the number more than tripled include Russia, where the number rose from 33 to 259,

a 685% increase, Singapore, where the number rose from 18 to 79, an increase of approximately 340%, and Malaysia, where there was a five-fold increase from 13 to 78. The number of Chinese enterprises in the US, Thailand, Australia, Canada and Macao also more than doubled. As for Hong Kong, which one might consider as one of the main areas for Chinese overseas investment, the increase in the number of Chinese enterprises set up there in the same 8 years was 63%, the lowest figure for any of the major recipients of Chinese investment.

Chinese direct investment in Russia

There has been economic collaboration between China and Russia in various fields for many years. This is mainly due to their geographical proximity to one another and the complementary nature of their economies. Following the break-up of the Soviet Union on 25 December 1991, when the Russian Federation became an independent nation, China worked aggressively to encourage and support various forms of economic and trade collaboration with Russia, in order to develop bilateral economic ties. For example, in 1992 China signed a trade agreement and an agreement for the protection of investment with Russia to establish inter-governmental economic and trade links. China hoped not only to develop bilateral trade ties but also to establish economic and technical collaboration in a variety of forms. On 12 December 1996 the Sino–Russian Conference on Economic and Technical Collaboration was held in Beijing; both countries announced that their respective governments would continue to encourage major companies to engage in direct trade and investment, and that they would strengthen collaboration in the banking sector in order to promote further development of bilateral trade links. Now Russia is China's eighth largest trading partner. In 1999 the total value of Sino–Russian trade was around US$5.72 billion; Chinese exports to Russia came to US$1.497 billion, with imports from Russia totaling US$4.222 billion, giving China a trade deficit with Russia of US$2.725 billion. Textiles and food products account for the bulk of Chinese exports to Russia; the main products imported from Russia are steel, chemical fertilisers and timber. The two nations' import/export structure is thus still dominated by traditional products.

Table 7 shows the development of Chinese direct investment in Russia since 1990, and we can see that during the period 1991–93 there was considerable investment in Russia by Chinese enterprises. This enthusiasm waned somewhat during the period 1994–97, and Chinese direct investment did not start to pick up again until 1998. This fluctuation is related to the political and economic situation in Russia, as well as the overall international situation. The wave of direct investment during 1992–93 was partly due to encouragement by the Chinese government and partly due to optimistic expectations regarding the prospects for economic growth in Russia. Russia's 'shock therapy' approach to economic reforms in 1992, which attracted worldwide attention, coupled with Russia's endowment of natural resources, extensive energy supplies and well-developed industrial infrastructure led many countries to invest in Russia. Unfortunately, excessively rapid reform led to a dramatic reduction in output and a sharp fall in capital investment; the problems of inflation and unemployment became increasingly serious. The rate of increase in Chinese direct investment in Russia over the period 1994–97 was therefore significantly lower than in the previous few years;

TABLE 7
CHINESE OUTWARD FDI IN RUSSIA

	Number of projects	*Chinese investment value ($ million)*
Until 1990, cumulative	33	26.8249
1991	66	21.8018
1992	86	40.106
1993	35	6.453
1994	5	0.57
1995	1	0.05
1996	1	0.08
1997	7	1.192
1998	25	2.5
1999	12	3.8

Note: Data are on an approved basis
Source: Almanac of China Foreign Economic Relations and Trade, 1991–2000.

it was not until 1998 that Chinese enterprises began once again to invest in Russia. By 1999 Chinese investment in Russia exceeded US$100 million, with a total of 271 Chinese enterprises having invested there. The main business areas in which they were involved included import/export trade, microelectronics, communications, garment processing, home appliance assembly, restaurant operation, timber processing and agriculture.

Although from 1998 on Chinese enterprises became willing to invest in Russia once again, the investment environment in Russia still had many unattractive features which led Chinese enterprises and those of other countries to slow the pace of investment.

Assessment of Chinese FDI—overall benefits and major problems

Benefits of overseas investment by China

A considerable list of benefits stemming from China's overseas investment over the past few years are briefly described below:

1. Using foreign resources to make up for the shortage of domestic resources.
   To make up for shortage of fishery resources, Chinese enterprises have established several dozen joint ventures and wholly-owned fisheries companies in over 20 different nations and regions; these companies are engaged in fisheries operations in the Indian, Pacific and Atlantic Oceans, significantly increasing the supply of fish products in China. To compensate for China's inadequate forestry resources, Hsi-lin Ltd, a wholly-owned subsidiary established by China Investment and Trust in the US, has shipped over 700 000 m^3 of timber back to China within a 5-year period. In addition, in collaboration with Australia, the China Iron Mine run by China Metallurgy Import–Export ships a considerable quantity of high-quality iron ore back to China every year, to provide a stable supply of raw materials for the development of China's iron and steel industry (Li & Cao, 1996).
2. Access to advanced foreign technology and management experience.

As observed earlier, some large Chinese enterprises have managed to obtain technology through mergers with or acquisitions of foreign corporations, whilst smaller enterprises have purchased machinery overseas and brought the new technology back to China. For example, the Shanghai Meilin Food Company brought the advanced equipment purchased for its Canadian plant back to China; this included precision measuring instruments and tools which they were able to use to significantly improve the production efficiency of their plants in China. Another example is China Deep-Sea Fisheries, which purchased large fishing vessels overseas as a starting point in learning how to design and manufacture their own fishing equipment. These are the best examples of using overseas investment as a means of obtaining technology (Yin, 1998).

3. Making increased use of overseas funding.
   Estimates indicate that one-third of China's overseas investment is in the form of cash investment, but only 10% of this amount is actually remitted out of China. This means that the remaining 90% is obtained from the international capital markets. This method of using international markets to obtain funding helps compensate for the enterprises' shortage of capital, and has led to increased use of foreign capital by China. The benefits of using foreign capital overseas in this way are no less than those that would have been obtained by using this funding within China itself; for example, when China Investment Trust acquired a share in Australia's Porterland Aluminum Refinery, the funding which it obtained from international sources produced a profit of several tens of million of US dollars in a 2-year period, showing a very high rate of return (Pan, 1998).
4. Developing and expanding export markets.
   Overseas investment by hi-tech business groups such as Lian Xiang and Si Tong has helped to promote export sales of their products. In addition, the transnational operations of companies such as China Chemical Engineering and China Construction have helped boost exports of their construction equipment, facilities, materials, technology and labour (Li & Cao, 1996).
5. Promoting industry adjustment.
   Dongbei Pharmaceuticals stands as a good example of industry adjustment; with its production capacity far greater than domestic demand, and with pharmaceutical exports affected by high tariff barriers, the company adopted an overseas investment strategy. Through such a strategy, it was able to transfer some production capacity overseas, thereby helping to absorb the surplus capacity in the domestic market. In the hi-tech sector, the Saige Group has been aggressively developing new technologies and new products, while also combining trade and investment to export mature products and technologies to backward nations and regions, thereby helping the enterprise to transform itself rapidly (Li & Cao, 1996).
6. Securing foreign exchange.
   Estimates indicate that 55% of China's overseas investment enterprises are making a profit, 17% are making a loss, whilst the remaining 28% are breaking even (Shi, 1998). Those companies making profits can help with the inflow of foreign exchange. For example, the bicycle and tyre factories established by Shanghai bicycle manufacturers Yongjiu and Fenghuang in Ghana and Brazil have earned profits in excess of US$100 million through exports to neighbouring countries. The

joint venture which Huan Yu Electronics established in London in partnership with a Hong Kong company to manufacture 14-inch colour television sets recouped the value of the original investment within 2 months. The profits made by these overseas investment enterprises are clearly of great benefit in helping to improve China's international balance of payments (Li & Cao, 1996).

Problems of China's overseas investment enterprises

There are some major problems affecting the operations of China's overseas investment enterprises. Firstly, overseas enterprises generally have a small scale of operation, and are weak in terms of their capabilities, competitiveness and ability to develop overseas markets (Wang & Xu, 2000). Secondly, there are several blind spots affecting the development of overseas enterprises; many Chinese companies reach their decisions on overseas investment when they are still unclear about why they are investing overseas, where they should locate their factory, how they can develop overseas markets and so on. In particular, China's policy of developing various medium-size and large state enterprises into business groups, and insisting that the group establish itself as one of the world's largest enterprises within a specified period of time, has led some companies to rush blindly into overseas investment in order to achieve the goal of internationalisation as quickly as possible, a move which often ends in failure (Lin, 1998; Cai, 1999).

Thirdly, overseas enterprises have a low level of managerial competence, such that, when establishing their overseas operations, many simply use the same management system they use in their domestic enterprises; they make no real effort to investigate other countries' experience or learn from their strengths. This often results in poor management of the overseas subsidiary, causing it to make a loss. In more serious cases, the insolvency of an overseas subsidiary can have a negative impact on the asset and liability structure of the parent company (Li & Li, 2000).

Finally, since equity markets remain relatively small in size, and are subject to discretionary administrative intervention in China, offshore investments can offer protection against domestic inflation and exchange rate depreciation. China's enterprises have the incentive to set up subsidiaries overseas to achieve a more balanced portfolio, and to evade foreign exchange and other restrictions with which they are saddled at home. This is the phenomenon generally referred to as capital flight.[4] In other words, for Chinese enterprises, overseas development is a further possible destination for capital flight (Gunter, 1996; Song, 1999), and the large current scale of capital flight has caused a considerable quantity of China's state-owned assets to flow overseas.[5]

Conclusions

China's overseas investment has not taken the same form as that of the European nations, the US, Japan and the other advanced nations (i.e. entirely in accordance with the competitive advantage of their own domestic industry, using overseas investment to create a comprehensive industrial system). However, considering that China's overseas investment began only 20 years ago, the speed at which it has developed is

quite impressive when compared with that of other developing nations. Within the space of 20 years 2400 overseas investment enterprises have been established, spanning the globe. A characteristic of China's overseas investment is that, in terms of the scale of investment, it tends to be dominated by small and medium-size enterprises, with an average scale of operations of US$1 million, and with the majority of companies having a scale of operations between several hundred thousand and several million US dollars; furthermore, the majority of enterprises tend to be joint ventures with host nation companies.

The scale of operation of China's overseas investment enterprises has, however, gradually expanded from small-scale trading companies and agricultural enterprises to include medium-size and large resource development companies and industrial enterprises, and, as a result of economic liberalisation, the form of China's outward FDI has gradually shifted from government-directed investment to profit-oriented investment directed by the enterprises themselves. Nevertheless, the majority of companies undertaking overseas investment are still nationally or regionally state-owned enterprise business groups. The emergence of China's overseas investment is prompted by political motivation, by market seeking, by the desire to take advantage of lower labour costs, and by the availability and price of natural resources. Moreover, the physical and human infrastructure, together with the macroeconomic situation and institutional structure of the host country, also play decisive roles in China's outward FDI.

Although China's overseas investment extends to 150 different countries, it is still concentrated in a handful of more economically developed countries and regions. Chinese overseas investment is concentrated in Australia, Canada and the US, because of their superior investment environment, developed financial markets and consumer markets, high technology, advanced management methods and first-rate infrastructure. Geographical and cultural proximity also help to attract Chinese investment to other countries in the Asia Pacific region; thus, over the past few years, China has gradually stepped up the pace of its investment in the region—in particular, investment in Thailand, Malaysia and Singapore has increased rapidly. Following the break-up of the Soviet Union, Chinese investment also began to penetrate the Commonwealth of Independent States and Eastern Europe. Owing to their extensive resource endowment, China has gradually begun to expand its economic and technical collaboration with these countries.

On the whole, China has become an increasingly important outward FDI country, and some Chinese enterprises have already displayed an impressive performance in their overseas operations. The unique characteristics of Chinese overseas enterprises' network linkages involve non-contractual transactions based on interpersonal links and trust that go beyond pure business relationships, and these networks will shape the internationalisation process of Chinese enterprises. Since FDI is probably the major driving force contributing to the globalisation of the international economy, with the continuing rapid growth of Chinese outward FDI, the increasing global integration of financial markets and internationalisation of investment portfolios, the Chinese transitional economy is set to become integrated irreversibly into the global economy.

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[1] The literature on FDI behaviour continues to grow rapidly; for example, Vernon (1966) proposed a product life cycle (PLC) for trade and investment, whilst firm-specific assets such as product innovations or product technologies played a vital role for FDI (Hymer, 1976; Dunning, 1981). Kojima (1978) pointed out the relationship of FDI with trade and location factors, particularly relative costs and demand-induced innovation.

[2] Tuan (1995) notes that the general belief is that China's overseas investment during this period was motivated mainly by government policy objectives, particularly those relating to the establishment of international trading relations.

[3] Chinese enterprises in South America lack qualified personnel and sufficient information on the host country markets; they thus perform poorly (Zhang, 2000).

[4] Sicular (1998) pointed out that capital flight will persist in China if, as a result of discriminatory policies or limited portfolio options, Chinese residents can achieve higher returns at lower levels of risk on their investment portfolio by investing abroad.

[5] China has recently experienced large-scale capital flight, which has been accompanied by dynamic growth and the attraction of foreign investors. According to Han's estimate, the total amount of capital flight from China over the period 1989–97 was US$126 billion, with the average outflow being US$14 billion a year (Han, 1999).

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