10 Foreign Investment Strategy

Prior to 1979 China’s economic policy was based on the principle of self-reliance. Foreign trade and investment played a very small role. The reforms from 1978 onward led to greater openness, more decentralized authority over economic policy, and a growing foreign trade system. The 1979 Law on Joint Ventures and subsequent legislation reinforced the trend toward an improving foreign investment climate in China.

The People’s Republic of China has played the foreign investment strategy with high success. One by one it has broken the barriers to capital inflows by bank lenders, governments, international organizations, direct business investors, bond investors, and even stock market investors. In 1992–4 annual investment inflows ranged between 4 and 6 per cent of GNP, and may be expected to remain at that level in future.

Several strategies are becoming evident in China’s treatment of foreign investment. First, the PRC has attracted sufficient amounts of foreign capital to help sustain a remarkably high economic growth rate. It is doubtful that this growth rate would be possible without these large amounts of foreign capital, and the management expertise and technology that accompanies these inflows. Second, increased two-way foreign investment flows between China and Hong Kong, and China and Taiwan, are creating a new business environment in this region. As a result economic and financial interdependence is increasing rapidly. In fact, the increased interdependence between Taiwan and China has brought forth a debate within Taiwan regarding appropriate policy toward outward investment, and increased economic links with the mainland.

Third, China is moving toward ‘center of the stage’ with regard to investment flows in the Asia-Pacific region. Over the period 1980–90 China ranked second, only behind Singapore as a recipient of foreign direct investment flows into developing countries. China has become the leading recipient of direct investment and loan capital provided by Japan. And the financial ties with Hong Kong and Taiwan indicate a growing triangular relationship, likely to become a dominant aspect of Asia-Pacific regional financial flows.

Based on the trends described above, we can expect that by the 21st century China will have become a dominant player in both regional and
world investment flows. With continued success in implementing strategies appropriate to its resource base and needs, China will be able to demonstrate unequivocably its superpower status in regional and global foreign investment.

OVERVIEW OF FOREIGN INVESTMENT FLOWS TO THE PEOPLE’S REPUBLIC

Foreign investment inflows play a vital role in furthering the growth process in developing countries. This fact has been emphasized repeatedly in the economics literature. The economic development process is slow, and often several decades are required before any dramatic economic development gains can be seen. For this reason, foreign investment inflows must expand continuously to have any lasting effect on growth and be relatively free from disruption.

Different Flows for Different Purposes

China has been able to attract foreign investment taking many different forms. Bilateral flows refer to investment from other countries, and multilateral flows refer to loans and investments from international organizations such as the World Bank and Asian Development Bank. These institutions finance large investment projects in China (electric power, railroad extension, and agricultural development).

Official flows are made by governments of OECD countries (US, Japan, Germany, United Kingdom, France). Often these official flows finance purchase of capital goods exported by the lending country (telecommunications equipment, jet aircraft, trucks and construction equipment). Direct investment is carried out by foreign business firms that intend to produce and distribute their products in China, or use China as a low-cost production base from which to export. Portfolio investment includes foreign purchase of bonds and stocks issued by Chinese governments and enterprises.

Foreign Investment Flows to the PRC

We examine data originally provided by the Organization for Economic Cooperation and Development (OECD) showing financial flows to the People’s Republic of China. In this case financial flows are net flows (Table 10.1). The data in Table 10.1 reflect broad trends in the global