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GLOBAL INVESTMENT TRENDS AND POLICIES: AN OECD PERSPECTIVE

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1. Introduction

It is a great pleasure for me to be here again for the second time in this beautiful city of Xiamen to attend this Conference organised jointly by the OECD and the Chinese Ministry of Foreign Trade and Economic Co-operation on the occasion of the Fourth China Fair for International Investment and Trade. The subject of this event -- the Challenges and Prospects of Foreign Direct Investment in China -- is particularly relevant and important for us all. I would like to extend my sincere thanks and congratulations to all who have participated in its preparation.

After becoming the second largest recipient of FDI in the world in just a few years, China is now about to experience again major changes as a result of its entry into World Trade Organisation and the other key policy decisions it has recently taken to increase the efficiency of its economy and open it further to the outside world.

As it has been the case until now , foreign direct investment is likely to remain a key factor of the success of China's policies. In fact, the co-operation programme on foreign direct investment which the OECD and MOFTEC launched only one year ago has already provided amazing evidence of the far reaching ramifications that foreign investment has had on China's economy, notably on the structure of its trade and industry. We will have the opportunity in the course of this seminar to discuss some of the driving forces and economic effects of FDI on China's development as well as China's future plans and

policies for enhancing further the role its FDI inflows. As Chairman of the OECD Committee on International Investment and Multinational Enterprises; I can assure you that OECD is fully prepared in this respect to share its experience and accompany China in its vital reform process.

The OECD has over the years made a unique contribution to the study and understanding of the economic effects of foreign direct investment in the world economy, the so-called "globalisation process" which is strengthening and deepening the ties that bind the world's regions together and in which China already plays a major role. As we all know, the advent of new technology and of the new economy is likely to feed and shape this phenomenon for years to come.

The OECD has also worked extensively to manage the effects of globalisation through the development of rules and encouragement of best practices. These principles are embodied in longstanding liberalisation codes and codes of conduct. In fact with the adoption of corporate governance principles and the convention to combat bribery important breakthroughs have been made in the last couple of years to improve the policy framework in OECD countries. My Committee has also just last June completed a far reaching review of the Guidelines for Multinational Enterprises. These Guidelines provide a robust set of recommendations for responsible corporate behaviour world wide consistent with existing legislation. They are part of the OECD Declaration on International Investment and Multinational Enterprises, which provides a balanced framework to improve the international investment climate and encourage the positive contributions multinational enterprises can make to economic, social and environmental goals -- which is what the OECD is all about.

But let me now turn to the subject of my presentation which is to provide you with a brief overview of recent FDI trends and of the main underlying factors. This should serve as an introduction to our discussion over the next two days.

2. Major trends

2.1. The World and the OECD

Foreign direct investment (FDI) has continued to grow sharply world-wide both in absolute value and as a percentage of GDP. In 1998, world FDI outflows reached a record level of US$649 billion. From 1993 to 1998, world FDI has grown at the annual rate of 24.0%, which makes FDI the single most important vehicle for private capital flows among countries.

This growth can mainly be traced to direct investment to and from OECD countries which maintained their dominant position as recipient and source of the FDI. Mergers and acquisitions, notably in the telecom and chemical industries and across the United States and Europe, were the main driving force. The United States and the United Kingdom were the most prominent home and host countries, accounting for more than half of total OECD inflows and more than 45% of outflows.

Inflows into the United States came mainly from Europe. The most important investors were the United Kingdom, Germany and the Netherlands. The United Kingdom represented more than one third of total investments in the United States.

On the outflow side, Europe is still the most important recipient of US FDI. However, between 1998 and 1999, its share decreased from 61% to 53% and from 28% to 22%, respectively. Latin America's and especially Asia's shares of outflows increased, each representing around 15% of total FDI outflows.

The growing share of emerging economies in global outward investment represents a longer trend: While in the 1990's global flows more than trebled, investments in developing countries grew almost six-fold.

2.2. Transition economies

The history of FDI is relatively short for transition economies. FDI inflows have been growing, although at lower pace than imports of goods. The ten countries aiming at EU accession, performed, on average, much better in the nineties than other countries in the region. Countries belonging to the former Soviet Union (other than the Baltic republics) and SEE countries performed less promisingly.

Countries in the first category began to receive significant inflows of FDI after their economies had been more or less stabilised in the second half of the decade. The second category has been plagued with distortions in factor markets and macroeconomic instabilities. Moreover, they still lack adequate market institutions and legal systems. These factors continue to act as a draw on FDI inflows. The situation is less dramatic in countries with natural resources because resource-seeking investments are traditionally less sensitive to economic policies and economic prospects of the host country.

Prospects of attracting FDI in the future seem to be relatively bright for EU applicants. The perspective of membership induces them to adopt appropriate policies and laws with a view to make their economic environment more similar to that in the EU. Because of the self-perpetuating nature of FDI their relatively higher levels of FDI stock in themselves attract more foreign investment. These investments, in turn, assist the transition process.

2.3. Latin America

Most of the countries in Latin America have undergone drastic policy reformulation in the 1990s. Macroeconomic stabilisation, trade liberalisation, privatisation programmes, deregulation of policies regarding private investment, and regional integration all have contributed to creating a favourable climate for foreign investment in these countries. As a result, the level of FDI inflows into the region has increased eightfold compared with the end of the 1980s. The healthy growth of FDI in the region throughout the 1990s demonstrates that the confidence of foreign investors has recovered after going through the difficult decade of the post debt-crisis. In fact, the share of the region in global inward investment has at last recovered to the level prior to the debt crisis. The growth of FDI is largely influenced by privatisation programmes throughout the region. This implies that there still is a year-to-year fluctuation of investment flows by country on one hand, and a shift towards market oriented investment on the other.

The four largest economies of Latin America – Mexico, Argentina, Brazil and Chile – have been constantly receiving over 70% of the total inward FDI in Latin America since the 1970s. This trend remained unchanged in the 1990s. It should, however, be kept in mind that the amount of FDI attracted by some of the smaller countries in the region are quite significant when measured against the size of their economies.

2.4. Asia

Asia has been attracting the lion's share of international investment in developing countries for some time. Inward investment into Asia in the 1990s experienced healthy, uninterrupted growth prior to the financial crisis. It recorded a decline in 1998 as the impact of the crisis took effect. Consequently, its share in the global investment flow declined and became almost on a par with that of Latin America. The Asian financial crisis in the late 1990s had varying impacts in countries of the region, depending on the nature of investment and local economic conditions.

Investment in Asia in the 1990s has been characterised by the rising prominence of China both as an FDI recipient and investor, and by the growth of intra-regional FDI. China emerged as a popular destination of FDI in the early 1990s, and became the second largest FDI recipient in the world after the United States by 1993. Other main destinations of international investment within Asia in the 1990s are Singapore, Malaysia, Thailand, Indonesia, Hong Kong (China), Chinese Taipei and the Philippines. These eight countries together account for over 80% of investment into non-OECD Asian countries.

By 1997, the level of inward investment in newly industrialising economies [NIEs – Chinese Taipei, Singapore and Hong Kong (China)] had almost doubled compared with the beginning of the decade. Flows into Hong Kong (China) and Singapore have not been stable, while Chinese Taipei attracted a steady flow until the crisis. The volume of FDI in Chinese Taipei and Hong Kong (China) declined considerably in 1998, due to the slowdown of the regional economies. OECD investment into Hong Kong (China) turned negative, minus US$ 1.1 billion in 1998, from US$ 4.3 billion in 1997. Although it is suggested that China surpassed the United States and Japan to become the largest investor in Hong Kong (China) since the early 1990s, the decline of OECD investment seems to be the main explanatory factor.

Hong Kong (China) has been the biggest investor into China since the inauguration of China's open policy in 1979, consistently accounting for roughly 60% of foreign investment. Contrary to its dynamism in China, Hong Kong (China) is much less active in other Asian countries. China's outward investment expansion is another noteworthy phenomenon of the 1990s. Chinese investors – mostly state-owned enterprises – have demonstrated diversified interests, with a high concentration of investment in the trade and services sector in Hong Kong (China) and the availability of raw materials as the main motives for their investments in Australia and Canada. Chinese investment also went to the United States, in search of proprietary technology. Market-seeking investment from China can be found in a great variety of locations around the world.

Since the latter part of 1980s, inward investment in ASEAN countries has grown at an impressive rate. The growth was largely led by Japanese investment, triggered by the appreciation of the yen, which pushed Japanese manufacturers out of the home country. The share of Japanese manufacturing investment in ASEAN countries (Malaysia, Indonesia, Philippines, and Thailand) grew from 8% in 1987 to 18% in 1992.

Although it has not regained its peak values before the financial crisis, Malaysia has remained the major recipient of FDI among the ASEAN countries with a 16-17% share. Malaysia owes this success to export-oriented investments at an early stage. Indonesia owes its success in attracting investment principally to the oil and gas sector but was hit hardest by the crisis. Thailand has been successful in attracting both market-seeking and export-oriented investors during the 1990s. It increased its FDI inflow by 47% in 1998.

3. The main lessons

While the continuous expansion in the United States and Europe undoubtedly helped, the spectacular expansion of international direct investment in the 1990's could not have happened without considerable improvements in the investment climate. A more widely spread recognition of the benefits of FDI has led to a removal of direct obstacles to FDI. Countries have also reinforced their institutional capacity to ensure due process of law and transparency in their internal and external economic relations and have introduced

more active promotion policies. The search for efficiency gains through deregulation, demonopolisation and privatisation has opened new investment opportunities for domestic and foreign investors.

Experience shows that the rule of law, stable and sound economic polices, supporting legislation and institutions and a facilitating attitude on the part of the government are all prerequisites in any attempt to attract FDI.

Twenty years ago China took steps to end its relative isolation and set this great nation back on the path to economic development through integration with the world economy. China is now about to again engage in a set of reforms which could enable it to make giant strides in its development. The reforms needed are indeed challenging, both technically and politically. China's success will have a decisive impact not only on its own performance, but also on the shape of the global economy in this new century.

As I have noted already, the OECD has considerable experience with the implementation of economic reforms and is currently deploying a lot of energy in accompanying its members in making the best use of globalisation and coping with its domestic implications. International direct investment has been an important part of this effort. The OECD and more particularly the Committee I chair is more than willing to put its knowledge and experience at the service of Chinese policy makers.

I look forward to the continuation of the investment policy dialogue between OECD and China.