SMEs' FDI Will Help Developing Countries

By ***Hatakeyama Noboru***

FOR economic development, the contributions of small and medium-sized enterprises (SMEs) are vital. This is especially true for developing countries. Their economies often grow by inviting foreign direct investment (FDI). It would not be too difficult to invite big companies because not only are they able to carry out the necessary research on the market outlook and rules of recipient countries in advance, but they are also financially sound in most cases. However, when it comes to SMEs, most of them are not familiar with the market outlook or the rules of recipient countries. In addition, they have a concern that they will not be able to enjoy the same financial facilities they have in their home countries. It would therefore be quite difficult for developing countries to invite SMEs as investors. If developing countries only succeed in inviting big companies and fail to invite SMEs, the trade balances of those countries will not improve sufficiently and may even decline. Why? This is because in the early stage of those investments, the big companies will have to import parts and components manufactured mainly by SMEs in their respective home countries. Machine tools necessary for assembling final products may also have to be imported. Those imports will offset the precious trade surplus made by the exports of goods produced by big companies. Therefore, the trade balance of those countries will not get better and may even worsen.

To cope with this situation, what measures are worth trying? At least two measures should be considered seriously.

Firstly, the international rules for FDI should be agreed in World Trade Organization (WTO) negotiations. As you may know, this matter was referred to as the so-called "Singapore Issues" at the beginning of the WTO negotiations for the Doha Development Agenda. However, it was quite ironical that, mainly due to the strong requests from developing countries, it was decided not to discuss the Singapore Issues, including investment rules, at the current round of the WTO negotiations. International investment rules do require most-favored-nation treatment, national treatment and deregulation of investment-related rules. Unless these measures are taken in recipient countries, many SMEs would not take the risk of direct investment. However, some influential politicians and bureaucrats in developing countries who may have vested interests in the current system and want to wield arbitrary power on FDI even oppose discussing this issue. This situation has to be rectified as soon as possible.

Secondly, a system should be established to enable the SMEs that invest in developing countries to enjoy the same financial facilities they have in their home countries. For example, a "draft discounting system" is available in Japan. An assembler who purchases parts and components from SMEs issues drafts promising payment in 3 months. The SMEs which receive the drafts ask banks to purchase them at discounted rates. Thanks to this system, SMEs can obtain cash without waiting for 3 months. This system might be specific to Japan, and there is no equivalent in developing countries. The Ministry of Economy, Trade and Industry (METI) reportedly has a plan to assist SMEs which invest in developing countries by introducing an alternative to the draft discounting system. According to the report, a special purpose-company (SPC) will be established in the developing country in which SMEs invest. The SME will sell its parts and components to an assembler, for example. The assembler will not make payment immediately, and the credits of the SMEs will be borne against the assembler. The SPC will purchase those credits with money raised by issuing commercial paper. This commercial paper will be sold to local banks, and even local individuals or Japanese institutional investors. Thanks to this system, SMEs will be able to get cash in developing countries almost immediately after they sell their goods to assemblers and their credits to local banks. In addition, since the commercial paper is settled in local currency, this system will also help to absorb the overflow of foreign currency that some developing countries earn, and they can use it for regional economic activities instead of purchasing US Treasury bills.

There may be other ways to increase the FDI of SMEs in developing countries. SMEs are not aggressively trying to invest overseas. However, unless SMEs carry out FDI in developing countries, the industrial structure will have a leaking hole in terms of the trade balance. SMEs are not seeking to fill this hole; they are just waiting until the necessary conditions are arranged. Therefore, governments of developing countries which wish to have balanced trade accounts as well as those of developed countries which wish to assist developing countries have to listen to the silent voices of SMEs. JS

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Japan Economic Foundation,
11th Floor, Jiji Press Building,
5-15-8 Ginza, Chuo-ku,
Tokyo 104-0061 Japan
Fax: +81-3-5565-4828
E-mail: japanspotlight@jef.or.jp

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