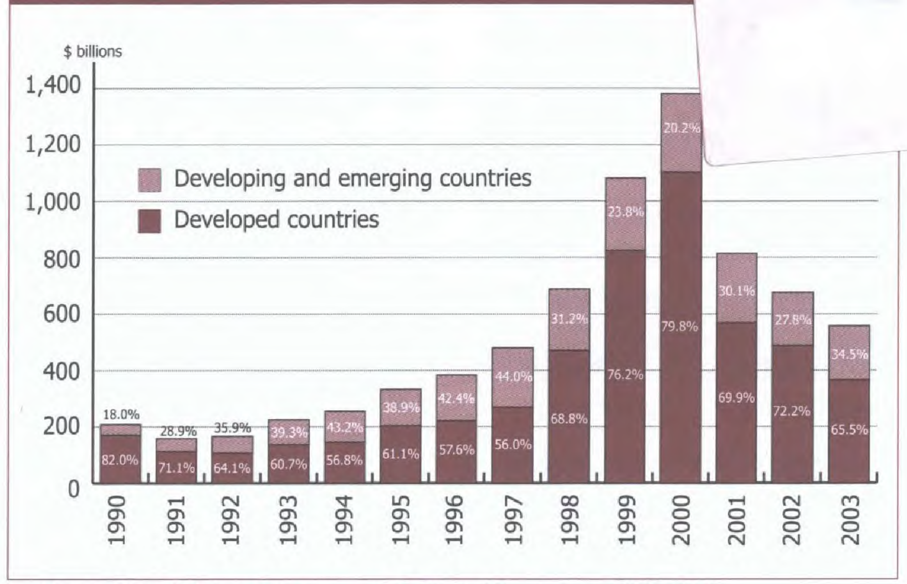
Foreign Direct Investment (FDI) in China

Overview

Throughout the 1990's investment inflows into the developing economies increased steadily. As a result, their share in total world investment increased until the late 1990's, when a spree of merger and acquisition activity – largely confined to the developed countries- reversed this trend. However, with the global slowdown beginning in the year 2000, world FDI flows fell markedly, particularly in the developed economies, and the share of the developing countries began to rise again (Figure 4).

Figure 4: World FDI Inflows



Source: United Nations Conference on Trade and Development (UNCTAD); World investment Report 2004 (www.unctad.org/wir)

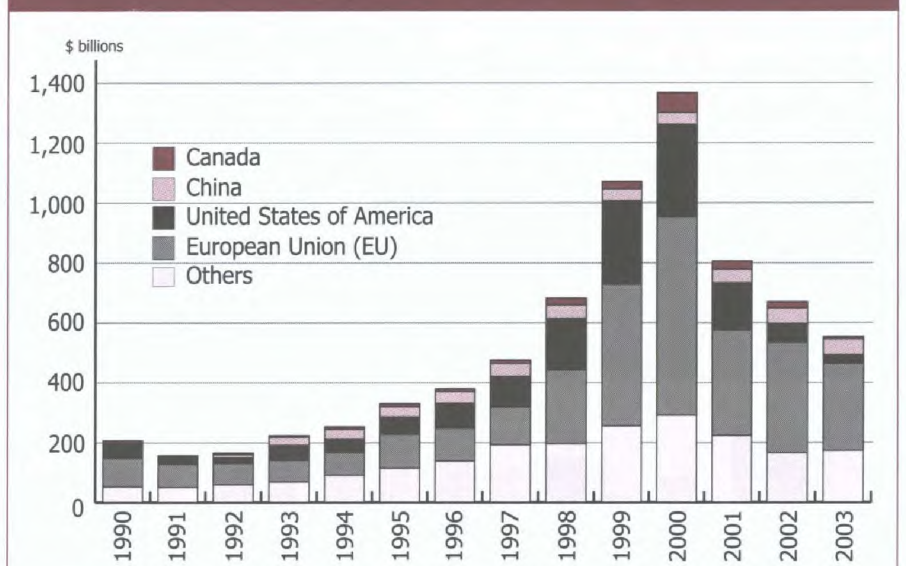
China attracts an increasing share of world FDI flows

Historically, the United States (US) has attracted the largest amount of annual FDI flows (Figure 5). However, over the 1990s, China[2] began attracting increasingly larger amounts of FDI flows. Accordingly, China's share of global FDI inflows jumped from 1.7% in 1990 to peak at 10.7% in 1995.

As investment inflows into the US slumped markedly between 2001 and 2003, China supplanted the US as the top country for FDI inflows last year.

From a different perspective, China increased its share of global FDI inflows into developing countries from 9.3% in 1990 to 27.7% in 2003 and its share of FDI into Asian developing countries from 14.4% to 49.9% over the same period.

Figure 5: World FDI Inflows Into Select Countries and Regions



Source: United Nations Conference on Trade and Development (UNCTAD); World investment Report 2004 (www.unctad.org/wir)

With the increase in these inflows, China's share of the global FDI stock thus advanced from 1.3% in 1990 to 6.1% in 2003. China's share now lags only those of the US (18.8%), the UK (8.2%) and Germany (6.6%).

1 Although, when aggregated, FDI flowing into the European Union (EU) countries accounted for about half of the world total in 2000-2003.

2 For the purpose of this analysis, China refers to the People's Republic of China, but excludes Hong Kong and Macau.

FDI inflows are important to China's economic development

Investment inflows into China have become increasingly important to China's economic development, as outlined in Table 1.

The share of FDI inflows in China's Gross Fixed Capital Formation (GFCF) jumped from 1.9% in 1985 to 14.8 % in 1995 before settling back to 12.4% in 2003. Thus, with the increase in FDI inflows, the share of FDI flows in GFCF in China in 2003 has surpassed the ratio for developing countries in Asia (9.3%) as well as the share for all developing countries (10.0%).

Inward FDI flows amounted to 6.1% of exports and 3.9% of imports in 1985 and rose to 24.1% and 27.8%, respectively, in 1995. However, as China's exports and imports expanded at a faster pace than FDI inflows in the following years, these shares have slipped back to 17.6% and 19.2%, respectively, in 2001. These shares nevertheless exceeded the averages registered for all developing countries in 2001 – 10.2% and 10.7% for the share of FDI flows in exports and imports, respectively.

In per capita terms, FDI inflows increased from US$ 1.6 per person in 1985 to US$ 37.10 in 2001. Due to its sizeable population, China lagged somewhat the average per capita FDI inflow into developing countries in 2001 (US$ 40.80), but is still more than 11 times greater than that for India (US$ 3.30 per person).

Table 1: FDI in China's Economy

	1985	1990	1995	2000	2001	2002	2003
FDI inflows, share of Gross Fixed Capital Formation (GFCF)	1.9%	3.5%	14.8%	10.3%	10.5%	11.50%	12.4%
FDI inflows, share of Exports	6.1%	5.6%	24.1%	16.4%	17.6%	n.a.	n.a.
FDI inflows, share of Imports	3.9%	6.5%	27.8%	19.8%	19.2%	n.a.	n.a.
FDI inflows per capita (US$)	1.6	3.1	29.9	32.5	37.1	n.a.	n.a.
FDI inward stock, share of GDP	3.4%	7.0%	19.6%	32.2%	33.2%	35.4%	35.6%
Foreign Investment Enterprises (FIE):							
Share of industrial output	n.a.	2.3%	14.3%	31.3%	28.0%	33.4%	n.a.
Share of total trade	n.a.	n.a.	n.a.	n.a.	n.a.	53.1%	57.1%
Share of exports	n.a.	n.a.	n.a.	n.a.	n.a.	52.1%	55.8%
Share of imports	n.a.	n.a.	n.a.	n.a.	n.a.	54.2%	58.6%

n.a. indicates data not available

Source: United Nations Conference on Trade and Development (UNCTAD); World investment; Ministry of Commerce of the People's Republic of China -MOFCOM (www.fdi.gov.cn)

Cumulative inward FDI, or the inward FDI stock in China, has expanded faster than Gross Domestic Product (GDP) over the last 20 years. Therefore, the size of the inward FDI stock in relation to GDP has increased from 3.4% in 1985 to 35.6% in 2003, and now exceeds the average relative size in Asian developing countries (30.3%), as well as the average for all developing countries (31.4%). However, it should be pointed out that among other East Asian countries in 2003, the relative size of inward FDI stock reached 50.6% in Vietnam and 57.2% in Malaysia, while inward FDI stock only represented 5.4% of GDP in India.

In parallel with increasing inward FDI, the role of foreign investment enterprises (FIE) in China's economy has also seen considerable expansion. The FIE's share of Chinese industrial output increased from 2.3% in 1990 to 33.4% in 2002. In 2003, FIE's accounted for 55.8 % of exports, 58.6% of imports, and a combined 57.1% of total trade.

Geographical distribution of FDI in China

Economic reforms in the late 1970s and the establishment of Special Economic Zones (SEZs) in the southern provinces of Guangdong and Fujian laid the foundation for opening China to FDI inflows. In the 1980s, additional SEZs were established in Hainan and in 14 coastal cities. Although additional economic reforms in the 1990s opened the rest of China to FDI, China's eastern region attracted 88% of inward