China's Foreign Trade and Investment Links

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1 Capital and Trade Flows

The U.S., Japan, and belatedly Europe have recognized that the centre of economic dynamics is moving towards East Asia, particularly China. This was expressed by the President of the European Commission, Romano Prodi, in his speech at the China-Europe International Business School in 2004 pointing out that China will probably become the world's largest economy by the middle of the 21st century, surpassing the EU and the U.S. Obviously, it is believed that historical relations of the early decades of the 19th century, when China accounted for about one-third of the world's GDP, will be finally reconstituted.

China has become the most attractive FDI destination of the world. Among various partners, the EU, the largest home base for FDI in the world, has been a significant source of direct investment. By 2000, European firms had invested in 11,000 enterprises within China. At the end of 2003, EU aggregated foreign direct investment amounted to 37.9 billion US$, compared to 44.1 billion provided by the U.S. and 41.4 billion US$ coming from Japan. The EU's share of total foreign investment was 7.6%, below the corresponding shares of the U.S. (8.8%) and Japan (8.3%).

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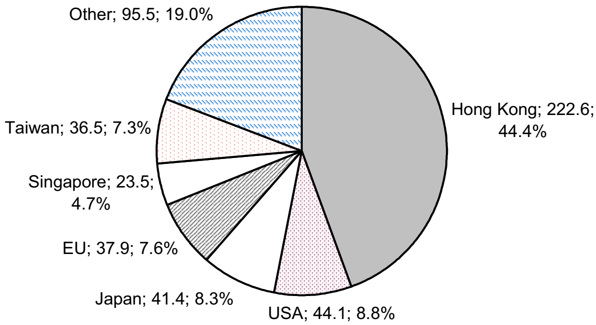

Fig. 1. Aggregate FDI of China, end of 2003 (US$ billion)

Source: Ministry of Commerce of China, http://www.mofcom.gov.cn.

These shares, however, do not reveal the real picture of FDI. As shown in Fig. 1 aggregate FDI of Hong Kong amounted to some 220 billion US$ and aggregate FDI of "Other" to almost 100 billion US$. It is estimated that roughly half of Hong Kong's FDI is recycled capital from the Mainland which, in spite of China's controls of its capital account, finds ways to move in and out. It was recycled in order to benefit from tax advantages and other preferences granted to foreign capital. The most important regional capital sources belonging to the category "Other" are places such as the Salomon Islands and Cayman Islands. They certainly produce more than coconuts, but are definitely not in the position of providing huge amounts of capital. Obviously, capital from China is round-tripping, moving even to exotic places, in order to obtain a privileged status when reinvested on the Mainland. Even investment figures of Taiwan are not reliable. Fig. 1 shows that Taiwanese aggregate FDI amounted to 36.5 billion US$. However, due to political restrictions, a substantial portion of Taiwanese investment is channelled via Hong Kong into China, being counted as Hong Kong investments. An overview of the main sources of China's FDI between 1986 and 2003 is provided in Fig. 2.

As a result of the steadily declining barriers to foreign trade, trade between China and its main partners increased dramatically. By 2003, total trade between China and the EU, according to Chinese statistics, amounted to 125.2 billion US$. This was almost the same as the 126.3 billion US$ of U.S.-China trade and somewhat less than the 133.6 billion US$ of Japan's trade with China (Figure 3 and 4 and Table 1 and 2).