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RISING FDI INTO CHINA: THE FACTS BEHIND THE NUMBERS

Over the past decade, China has established itself as the top recipient of foreign direct investment (FDI) among developing countries. In 2005, inflows reached the new record high of $72 billion - corresponding to a 20% rise from 2004. In this Investment Brief, we take a closer look at the Chinese data. There are several factors explaining the FDI increase but there are also reasons to interpret the overall numbers with care.

Since the mid-1990s, China has become the largest recipient of FDI in the developing world. With inflows of $72 billion, the country ranked among the world's top three recipients in 2005. Meanwhile, recent developments have highlighted some problems in China's FDI statistics, particularly those related to the sectoral composition of FDI inflows. Data users, therefore, need to interpret carefully the overall FDI numbers.

As stressed in a previous UNCTAD Investment Brief (issue 2, 2006), accurate, reliable, timely and comparable statistical information on FDI is the basis for policymaking. To this end, much work is currently under way in China.

Financial services enter FDI data

One challenge relates to the sectoral coverage of Chinese FDI data. In the *World Investment Report 2006*, a hefty increase of 20% was noted in the 2005 flows to China compared with 2004 (figure 1). This rise was partly related to changes in the methodology underlying Chinese FDI statistics. Data on inward FDI released by the Government of China previously did not include FDI in financial services. As a consequence, the data reported by UNCTAD for 2004 and 2005 are not directly comparable. If the financial sector is included in the data for 2004, total inflows go up from $60.6 billion to $63.8 billion. This would still imply a 13% increase in 2005.

Non-financial FDI in China was $60 billion in 2005, thus registering a slight decline (from $60.6 billion). By contrast, flows into financial services surged to $12 billion, driven by major investments in Chinese banks. While the opening-up of the banking industry to FDI has happened gradually, it is only in the past two years that foreign banks have rapidly entered the Chinese market by acquiring ownership stakes in Chinese banks. By the end of 2005, 18 foreign financial institutions had invested in 16 banks. The largest deals involved four of the five top Chinese banks.

The amount of FDI in financial industries reported by the Government is based on data collected separately by China's three financial watchdogs: the banking, insurance and securities regulatory commissions. According to the China Banking Regulatory Commission, however, its data on foreign investment are not based on the standard balance-of-payments (BOP) definition of FDI and do not include greenfield investments. Accordingly, some uncertainty remains as to whether the released data reflect the actual size of FDI in the financial sector.

Implications of FDI in real estate

The real estate industry has become another hot spot for FDI. According to the Ministry of Commerce (MOFCOM), inflows to China in this industry surged to $5.4 billion in 2005. This may still be an underestimation as the data do not include real estate purchases. According to the State Administration of Foreign Exchange (SAFE), purchases of real estate by foreign institutions amounted to $3.4 billion in 2005. If these were included, FDI in real estate would in fact be some $8.8 billion.

But even this higher figure may underestimate actual foreign involvement. According to SAFE estimates, FDI now accounts for 15% of China's real estate market. Investment in this industry has become an important channel through which so-called “hot money” flows into the country. This has prompted action by the Chinese Government, which in July 2006 promulgated a new regulation to restrict foreign investment in real estate.

Round-tripping and other data issues

Another issue that has long received attention in the case of China is the "round-tripping" of investment. Round-tripping is driven by differences in the treatment of foreign and domestic investors, which may motivate investors to channel funds out of, and subsequently into, an economy in the form of FDI. Because the funds originate in the host economy itself, "round-tripping" inflates actual FDI inflows. In China, a significant share of FDI inflows is round-tripped, mainly via Hong Kong (China). Official estimates of this type of FDI by the Chinese Government are not available, but others have suggested that such flows may account for up to 25% of the total inflows. The Government has started to address this issue. In November 2005, for example, SAFE promulgated a regulation concerning foreign exchange management related to "round-tripping" investments.

A statistical issue that has been analysed in the *World Investment Report* relates to the size of China's stock of inward FDI. In 2005, MOFCOM released revised inward FDI stock data, effectively reducing its estimated size by a half. The previous data had not been based on international investment position statistics, but rather on the accumulation of FDI inflows.

Future directions

As shown above, several different Government agencies are involved in collecting and reporting data on FDI. The statistical systems of financial and non-financial FDI are separate, and data on foreign investment in financial industries are collected by China's financial regulatory agencies. Both MOFCOM and SAFE report FDI data, but due to methodological differences, significant discrepancies exist between the two sources. One example is that MOFCOM reports FDI data on a gross basis (only credit transactions), while SAFE reports FDI data on a net (credit less debit) or BOP basis.

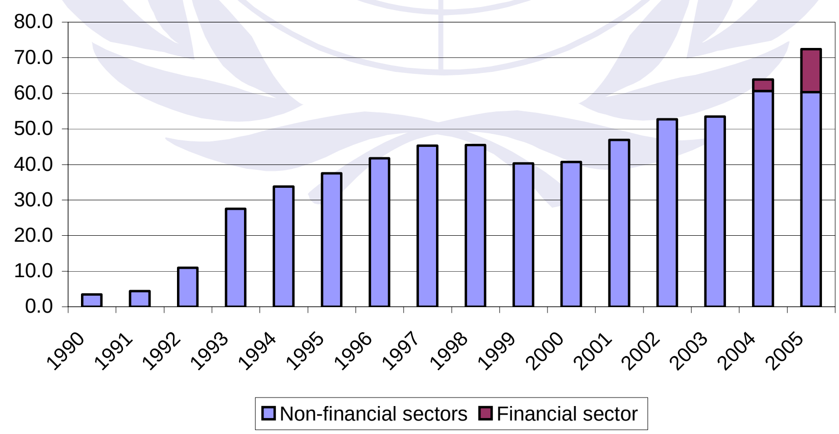
China's FDI statistics deviate significantly from international standards. For example, the threshold level applied in the definition of FDI is 25%, rather than 10%, as recommended by the International Monetary Fund (IMF).

With regard to problems related to China's FDI statistics, a more centralized statistical system that is consistent with international standards would help policymakers, as well as other data users, to understand better the facts behind the FDI numbers. Until then, comparisons of China's FDI inflows with those of other recipients should be interpreted with care.

At the international level, UNCTAD is working together with other international organizations to improve and harmonize FDI statistics.

Source: UNCTAD.

Figure 1. FDI inflows to China, 1990-2005
(Billions of dollars)



For more on this topic see: *World Investment Report 2006* (www.unctad.org/wir) and the *UNCTAD Investment Brief* 2-2006 (available at http://www.unctad.org/Templates/Page.asp?intItemID=3336&lang=1).

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