Policy Suggestions to China's Outflows of Foreign Capital

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To China, the slow inflow of new capital and rapid outflow of introduced capital may be the manifestation of the international capital flow to South-east Asian countries. The Chinese government should use macroeconomic policies properly to stabilize investors' mental expectation, to expand the scope of investment, to push forward actively the negotiation of Sino-US and Sino-European bilateral investment treaty and to improve Chinese "soft" environment.

1.Background

The issues about rapid outflows of foreign investment from China have continuously fermented recently. The newly released official statistic data also cause growing panic about the outflows of foreign investment. Several sets of data have aroused attention:

1.1The quick shrinkage in foreign exchange reserve

According to the data offered by State Administration of Foreign Exchange (SAFE), Chinese foreign exchange reserve hit a record in June, 2014, up to $3.993213 trillion. After the peak, Chinese foreign exchange reserve decreased each month to $3.51412 trillion in September, 2015, with the amount of shrinkage $479.093 billion, 12% of the peak. The flight of capital might cause such a dramatic change in foreign exchange reserve in such short time.

1.2The consecutive deficits in capital and financial account

According to the data offered by SAFE, from the first quarter in 1998 to the second quarter in 2015, all together 70 quarters, the capital and financial account (not including reserve assets) reached negative in 21 quarters, while from the second quarter in 2014 to the second quarter in 2015, the capital and financial account reached negative for 5 straight quarters, which never happened before.

1.3China first became a net capital exporter

China has gone through a rapid expansion of scale of capital export. According to the data released by UNCTAD, China surpassed America in 2014 to become the largest recipient of FDI in the world. According to Commerce Department, China first became a net capital exporter in 2014. Chinese outward foreign investment has exceeded the utilization of foreign capital, for about $20 billion.

2.Facts and truths

The data above only reflect the broad environment where capital flows, rather than the measurement of the capital flow itself. In this part, we are going to measure the capital from different angles and make comments on the claim that "withdrawal of foreign investment in China".

2.1Which capital withdrew from China?

According to the data offered by SAFE, the deficit of Chinese capital and financial account (not including reserve asset) reached $125.9 billion in the first half of 2015. In the first half of 2015, the deficit of the first quarter reached $98.3 billion; the second quarter $27.6 billion. There are three main subjects in the financial account, which are direct investment, portfolio investment and other investment. The favorable balance of direct investment was $92 billion, with year-on-year growth of 1%. The unfavorable balance of portfolio investment was $24.1 billion, while $36.9 billion in the same period of last year. The unfavorable balance of the other investment was $193.1 billion, with year-on-year expansion by 2.7 times and 3.3 times of the unfavorable balance of the whole capital and financial capital (including reserve asset).

Apparently, the flight of capital is mainly on portfolio investment. especially including investments called “hot money”quit from China The direct investment which could show economic fundamentals is still rising overall.

2.2The foreign capital, rapid outflow or slow inflow?

We will restrict capital flow to direct investment corresponding to the economic fundamentals. From the perspective of foreign direct investment in China, during the past decade from 2005 to 2014, the annual increasing rate of new FDI inflow reaches 21%, compared with the rate of outflow 39%. Things are different specific to the ten years. During the four years from 2005 to 2008, the annual increasing rate of new FDI inflow reaches 30%, while the rate of the original FDI outflow reaches 23%. From 2011 to 2014, the annual increasing rate of new FDI inflow reaches 10%, while original FDI outflow 47%.

Apparently, in recent years, the original FDI outflow is faster than new FDI inflow. It’s especially worth noting that during the five years from 2010 to 2014, the proportion of original FDI outflow in new FDI inflow has increased all the way, 8.18%, 10.85%, 11.42%, 15.46% and finally 23.86%.

2.3Which investors left China?

China is one of the most important investment destinies in the world, but the investment is always mainly from Hongkong, Taiwan, Japan, Korea, Singapore, America, Germany, France, Britain and Netherlands, the most important ten investment sources. In 2013, their investment in China is 91.11% of the whole foreign investment. To investigate which investors left China, we make a comparison between January to July in 2015 and the same period in 2014 based on the data provided by Commerce

Department. From January to July in 2014, the top ten investors are Hongkong, Singapore, Taiwan, Korea, Japan, America, Germany, Britain, France and Netherlands. From January to July in 2015, the ranking of investors remains unchanged except that Macao replaced Netherlands. However, in terms of investment scale, the investment from Hongkong increased $7.15 billion year-on-year. The investment from Singapore decreased $150 million, $220 million from Korea, $750 million from Taiwan, $720 million from Japan, $530 million from America, $80 million from Germany, $20 million from Britain and increased $360 million from France. Netherlands dropped out of the top ten lists.

From January to July in 2015, Chinese actual utilization of foreign direct investment was $76.63 billion, with year-on-year growth of $5.49 billion and $7.15 billion increase from Hongkong alone, which means that FDI from countries and regions decreases. Especially, the main investors all decrease their investment, and Taiwan, Japan and America decrease most.

2.4Where do the investors quit?

According to China Statistical Yearbook, we can see the allocation of foreign investment areas. In East China, the number of foreign-invested enterprises in almost all the provinces increased constantly before 2008, but after 2008, the number in many provinces decreased. The number of foreign-invested enterprises in East China still increases overall but slows growth compared with the 40% increase in 2008. In central China, the number of foreign-invested enterprises in almost all the provinces increased constantly before 2008, but after 2008, the number in all the provinces showed a downward trend except that the number in Jilin, Shanxi, Hubei and Jiangxi Provinces remained still. The number of foreign-invested enterprises in central China overall decreased all the way down to 46589 enterprises in 2013 from the peak of 50145 in 2010, with the decrease of 3556. In West China, the number of foreign-invested enterprises in almost all the provinces increased constantly before 2008, but after 2008, the number in many provinces remained unchanged or decreased. The number of foreign-invested enterprises in West China overall declined all the way down to 37945 after it reached the peak of 42203 in 2010, with total decrease of 4285.

As a whole, the investment and settlement of foreign investors in Chinese enterprises reached peak from 2008 to 2010. After that, the increasing rate slowed down and even declined. There is surprisingly outflow of foreign capital in terms of the number of enterprises in central and West China.

2.5What kinds of industries do the investors quit?

China Statistical Yearbook also tells us about the industrial distribution of with foreign investment. In 2005, the industrial distribution is agriculture accounting for 1.2%, mining 0.6%, manufacturing 70% and service industry 27.8%. The proportion of FDI in manufacturing industry in 2013 fell by half, while in service industry doubled compared with that in 2005.

More importantly, FDI in manufacturing industry reached peak of $52.1 billion in 2011 and then declined all the way down to $45.6 billion in 2013 and $39.9 billion in 2014. While at the same time, FDI in service industry kept increasing. Therefore, that FDI decreased in manufacturing industry and increased in service industry reflect the absolute reduction of FDI in manufacturing industry.

2.6Where do the investors go after they quit China?

Based on World Investment Report by UNCTAD, we can grasp a preliminary idea of where the investment flows after they quit China. We calculated the correlation coefficients of increasing rate of FDI in China and representative countries based on the report. It turns out that China is positively related with America, Europe and Japan. There is the weak negative correlation between China and Korea. China is positively correlated with Hongkong and Taiwan. There is the positive correlation with 11 eastern European countries, Latin America, Caribbean and South America. China is also positively related with India and Bangladesh. However, China is negatively correlated with overall South-east Asian countries (correlation=-0.88), among which Singapore, Thailand and Vietnam have the most significant negative correlation.

The calculation shows that to China, the slow inflow of new capital and rapid outflow of introduced capital may the manifestation of the international capital flow to South-east Asian countries.

3.Countermeasures and suggestions

For the above part, we have investigated the origin and facts of the withdrawal of foreign investment from China. Followed are six pertinent policies and suggestions.

3.1Use macroeconomic policies properly to stabilize investors' mental expectation

The issue about the withdrawal of foreign investment is, to a great extend, related with the rapid outflow of portfolio and other investment from China recently. Portfolio and other investment, which are quite different from direct investment, more focus on short-term yields and somewhat speculative. With the deepening of opening up of financial industry, portfolio and other investment will become "new normal" in China. Chinese government and departments should use macroeconomic policies properly to stabilize investors' mental expectation. The "high diving" in stock market in first half year and followed flight of foreign capital are much linked to biases and errors in policy orientation, effect evaluation and other aspects by decision-making departments.

3.2Push forward actively the bilateral investment treaty negotiation to increase the investment from America and Europe

China is one of the most important investment destines in the world, but the foreign investment from the developed countries in Europe and America is always limited. The advantage of export processing platform is very important to Asian neighbors, while Europe and America focus more on Chinese market potential and size. However, the problem is that developed countries in Europe and America don't invest more in China with the growth from China as a low income country to a high- and middle-income country. The investors from Europe and America maybe not only focus on market, but rather intellectual property rights, market circumstances or other factors. Therefore, we need push forward actively the negotiation of Sino-US and Sino-European bilateral investment treaty and to improve Chinese "soft" environment.

3.3Optimize regional economic policy to lead foreign investment to shift to mid-west China

There is no obvious trend that foreign investment shifts from East China to central and West China. On the contrary, enterprises quit central and West China. Although the inland areas has low labor cost, there are also high cost of transportation and straggling developing level, which inhibit the inflow of foreign investment. China is a vast country with various levels of development. Chinese government and departments should make policies with respect to regional differences and allowing local areas certain flexibility and autonomy in policy-making to avoid the policy of "cutting at one stroke" in dealing with different situations. Any economic policies of a great country with unbalanced development should in essence appeal to regional economy at the same time.

3.4Adjust laws, regulations and rules at proper time to regain the prosperity of foreign investment in manufacturing industry

The problem of distribution of foreign investment in Chinese industries is not only about decreasing proportion in manufacturing industry, but more important the absolute declines in foreign investment in manufacturing industry. Therefore, China need adjust laws, regulations and rules to bring manufacturing industry to become popular investment spot. Currently, the rapid increase of wages has become a significant factor inhibiting foreign investment flowing into manufacturing industry. In fact, by systematic level reforms (like family planning, family register and retirement); China can still maintain the competitive edge of labor force. In addition, three laws, new Labor Contract Law, Enterprise Income Tax Law and Antitrust Law passed during the period of overheated economy in 2008 need be timely adjusted to create conditions for the return of prosperity of foreign investment in manufacturing industry.

3.5Further expand opening up to attract more foreign investment into extended service industries

The utilization of foreign investment in Chinese service industry lags behind with unsound structure. The data offered by UNCTAD shows that in 2013, 63% of the global foreign investment is in service industry, while 26% in manufacturing industry. However, in China, the proportion of FDI in service industry was just close to 60% until 2013 from the actual utilization of FDI that year. The proportion of FDI in manufacturing industry still remained around 40%. In 2013, at the top of the service industry was real estate for the highest percentage of 41%, followed whole and retail, lease, business services, transportation, warehousing, postal service, information transmission and computer services and software industry, which occupied more than 80% of FDI in service industry. Real estate has always been the sector with largest amount of FDI in service industry, while financial sector only for 3.3% of FDI. This contracts with that in 2013; the proportions of Chinese outward foreign direct investment in manufacturing and service industry are 6% and 76%. In service industry, the proportion of Chinese OFDI in financial sector amounted to 18%. In general, the opening up of Chinese service industry, especially the financial sector need go a step further.

3.6Deepen the process of China and ASEAN integration to promote benign circulation of trade and investment

ASEAN is the third largest China's trade partner and China is the largest trade partner of ASEAN. Moreover, ASEAN is one of the most important China's overseas investment destinies. Nowadays, from the perspective of trade, China has a trade surplus with ASEAN. From the perspective of investment, Singapore has always been China's main investor and the investment from Singapore is far beyond it in size from China to Singapore. Followed Singapore is Indonesia, Thailand and Vietnam. Though the three countries are the main investment destinies in ASEAN, the investment from China is much more than it from the three countries to China. To promote benign circulation of trade and investment between China and ASEAN, the integration of China and ASEAN must be deepened to form a more complementary division pattern. Therefore, China and ASEAN should work together to make progress on two goals.

The first goal is the upgrading of China-ASEAN FTA. In August, 2014, China and ASEAN officially negotiated the upgrading of China-ASEAN FTA. The two sides held two rounds of talks in September, 2014 and February, 2015, which ended with significant progress. The second goal is RCEP with China and ASEAN. Since TPP has been reached, China should actively push forward the final agreement of FTA joined by China, Japan, Korea, and ten ASEAN member nations, Indonesia, Australia, Singapore and other 16 countries. Through the upgrading of integration China-ASEAN FTA and early successful negotiation of RCEP, China and ASEAN are very likely to form a more reasonable value chain division system to avoid "zero-sum game" in bilateral trade and investment.

Translator/ Shi Ying