ACCOUNTING FOR THE RECENT SURGE OF FDI TO CHINA

Sarah Y. TONG

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Executive Summary

1. Foreign direct investment (FDI) to China has grown significantly since early 2000s, at 13% a year between 2001 and 2008. More strikingly, this strong momentum continues amid the prolonged economic and financial crisis. FDI to China averaged US$111 billion in 2009-2011, up from US$88 billion in the previous three years.

2. The strong figures as reported by China's Ministry of Commerce are still believed to have underestimated FDI to China. An average of US$208 billion FDI during 2009-2011 was reported by the State Administration of Foreign Exchange in its Balance of Payment tables.

3. China's robustness in drawing FDI despite rising production cost could be attributed to the great investment opportunities present.

4. First, China is a large and diverse country which still holds comparative advantage as a relatively low-cost producer. Second, China has opened up new sectors to foreign investors, especially in various services. Third, China has also attracted growing investment that targeted China's expanding domestic market.

5. The tertiary sector has replaced manufacturing to become the major FDI recipient. More specifically, most investment in the service sector was made in real estate, wholesale and retail trade, and leasing and commercial services. Investment in R&D has also risen significantly.

6. As the investment in services increases, foreign investors are moving westward to China's inland regions. Although coastal regions continue to dominate FDI, provinces in China's vast hinterland, especially in central region, are making real gains.

7. The current growing FDI trend to China is likely to continue. First, global FDI flow is expected to grow again as world economic recovery is reinforced. Second, rising investment in China's various services is also likely to prevail. Third, large business opportunities still await foreign investors in China's central and western regions.

8. The rapid increase of FDI to China and its changing features have important implications. Foreign investors' "going west" will narrow development gaps between Chinese regions, while investment in the tertiary sector will help transform China into a consumption-driven economy. Both shifts are helpful in reducing China's trade imbalances.

9. Changing dynamics in China FDI inflow may redirect export-oriented investment to other emerging economies in the region. More importantly, opportunities abound in China for Asia's more advanced economies for both trade and investment, as China opens up its tertiary sector and expands its consumption.