GLA ECONOMICS

Enter the Dragon

An analysis of Chinese FDI into London

December 2004

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enquiries **020 7983 4000**
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For more information about this publication, please contact:
GLA Economics
telephone 020 7983 4922
email glaeconomics@london.gov.uk

GLA Economics provides expert advice and analysis on London's economy and the economic issues facing the capital. Data and analysis from GLA Economics form a basis for the policy and investment decisions facing the Mayor of London and the GLA group. The unit is funded by the Greater London Authority, Transport for London and the London Development Agency.

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1. Reasons for looking at China and FDI

This report looks at Chinese Foreign Direct Investment (FDI) into London from four sources:

- The People's Republic of China (henceforth China)
- The Hong Kong Special Administrative Region of China (henceforth Hong Kong)
- Taiwan, province of China (henceforth Taiwan)
- Republic of Singapore (Singapore)

Although Malaysia has an influential Chinese community, Malaysian investment has not been included within this report as ethnic Chinese are a minority within Malaysia's population. Singapore is included on the grounds that three-quarters of its population are ethnic Chinese.

China has one of the fastest growing economies in the world. China's average annual growth rate over the last ten years was more than eight per cent, while growth in 2002 and 2003 was 8.3 per cent and 9.1 per cent respectively. The Chinese authorities want to quadruple Gross Domestic Product (GDP) between 2000 and 2020. To achieve this, China's economy needs to grow by an average of 7.6 per cent each year.

In 2001, China was the sixth largest economy in the world and the fourth largest trading nation. Its share of global exports is expected to reach seven per cent by 2005. The UK has recognised China as an important trading partner, and between 1993 and 2003 the amount of UK trade with China increased by 80 per cent[1] while imports from China have grown by more than 80 per cent.

China has become increasingly integrated into the global economy and in 2001 joined the World Trade Organisation (WTO). China attracted more than $44 billion of overseas investment in 2002, which increased to $53.8 billion in 2003. However, as China's economy expands it is growing not only as a destination for investment from richer nations, but as a major investor into other countries.

Hong Kong, Singapore and Taiwan are all established economies in Asia, enjoying relatively rapid growth rates. Trade has become increasingly important for these countries, notably with China.

Hong Kong's economy has expanded at an average of 3.1 per cent per year for the past ten years with their GDP reaching $158 billion in 2003. In 2002, Hong Kong exported more than $270 million and imported more than $250 million of goods and services. Hong Kong has a particularly competitive financial services sector.

Singapore's economy has been growing at an average of 5.0 per cent for the past ten years. Singapore's GDP was $90 billion in 2003. Between 1993 and 2002, exports from Singapore increased by almost 40 per cent. In 2002, Singapore exports totalled more than $158 million.

[1] Office of National Statistics, Pink Book, 2003

Taiwan's GDP was $286 billion in 2003. In the last ten years, Taiwan's economy has expanded at an annual average rate of 4.7 per cent. Government policy is aimed at improving manufacturing but also developing Taiwan's services sector.

There is a broad consensus that FDI brings many benefits to the UK economy. There are direct increases in employment and output. Foreign-owned establishments tend to have higher productivity than domestically-owned counterparts. FDI also stimulates wider economic effects through increasing competition, which encourages spill over effects boosting productivity and efficiency. Empirical evidence suggests that productivity spillovers are likely to be found at the competitors and customers of the foreign-owned companies as well as their suppliers [2].

2. Monitoring Chinese FDI

Chinese FDI has been growing since 1999 with Chinese companies looking to increase investment in European markets. Data from the Ernst & Young European Investment Monitor (EYEIM) [3] supports this observation. The EYEIM tracks information on inward investment projects that come into Europe from abroad. In this instance, Europe is defined as comprising both the European Union and non-European Union countries such as Russia and Switzerland. EYEIM data has been collected since 1997 and includes information about:

- Year of the investment project
- Country of origin
- Destination city and country
- Industry and activity of the project
- Employment generated from the project
- Capital expenditure

The strength of EYEIM is that it can be used to identify trends, patterns in the industry, and project, job and investment expenditure activity. The limitations of using EYEIM are that it does not account for joint ventures or mergers and acquisitions. Furthermore there is often missing data, as the capital expenditure and employment associated with projects are not always recorded.

3. The headline position 1997-2002

Projects

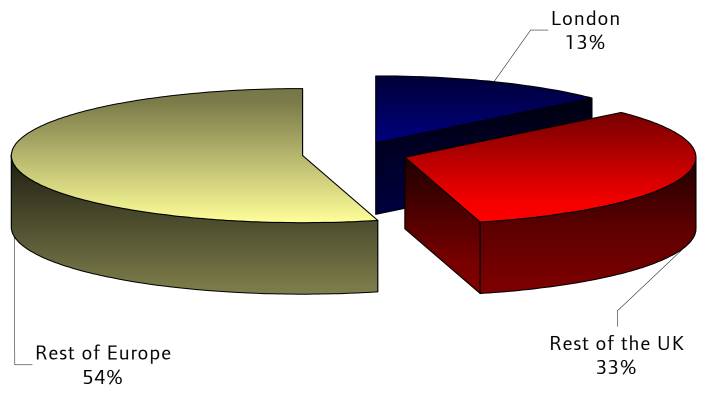
Since EYEIM began in 1997 there have been a total of 257 Chinese FDI projects into Europe. By aggregating all of these projects over seven years, the destinations and

[2] GLA Economics, 'London and Foreign Direct Inward Investment', Case for London, Technical report 2, 2004. Think London, 'One in seven: The impact of inward investment on the London economy', 2004.
[3] EYEIM data has kindly been supplied to GLA Economics by Think London. Like all FDI data, its coverage is not complete as it does not cover joint ventures or mergers and acquisitions.

nature of these projects can be analysed. In 2004 there are currently 38 projects with many more in the final stages of completion[4].

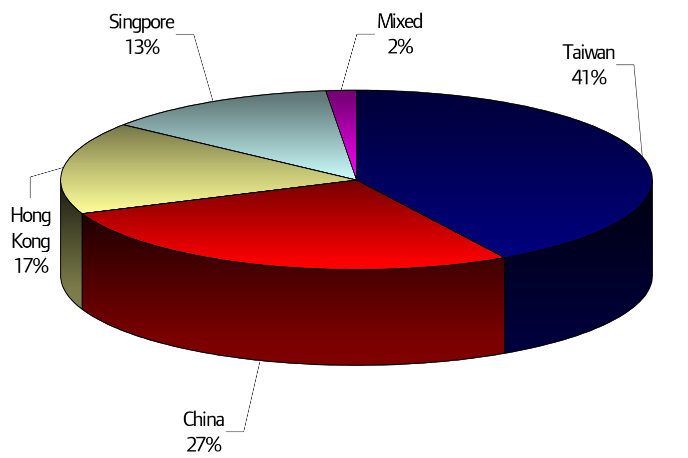
EYEIM measures all investment projects into Europe by country and city. It can be determined, therefore, whether the projects are going into London, the rest of the UK or other parts of Europe.

Figure 1. Breakdown of total number of Chinese FDI projects in Europe
1997-2004



London alone attracted 13% of Chinese FDI into Europe while the UK as a whole attracted 46%. Therefore, London attracts around 29% of the Chinese FDI projects that come to the UK.

Figure 2. Breakdown of the sources of Chinese FDI
1997-2004



Taiwan was the largest investor from 1997-2004 with 42% of projects. 27% of projects came from China, 17% from Hong Kong, and 13% from Singapore. 'Mixed' includes those projects that originate from two or more countries.

Table 1 presents the pattern of Chinese FDI in more detail. This gives the total number of projects from each economy with the percentage share in London, the rest of the UK and the rest of Europe.

[4] Data covers the period up to August 2004.

Table 1. Total Chinese FDI projects into Europe
1997-2004

Source	Total projects	Projects into London	Projects into rest of the UK	Projects into rest of Europe
Taiwan	107	9 (8%)	32 (30%)	66 (62%)
China	70	13 (19%)	20 (29%)	37 (52%)
Hong Kong	43	8 (19%)	18 (42%)	17 (39%)
Singapore	33	4 (12%)	13 (40%)	16 (48%)
Mixed[5]	4	0 (0%)	1 (25%)	3 (75%)
Total	257	34 (13%)	84 (33%)	139 (54%)

The key points to emerge from the EYEIM[6] data are as follows:

- London attracted 34 Chinese FDI projects over the period 1997 to 2004; 13 from China, nine from Taiwan, eight from Hong Kong and four from Singapore.
- London attracted a 13 per cent share of all Chinese projects but this rises to 19 per cent for China itself and 19 per cent for Hong Kong.
- London's share is lower for Taiwan with eight per cent of projects. Taiwan appears more orientated towards the rest of Europe.
- While London attracted 29 per cent of the Chinese FDI projects that came to the UK, this rises to 39 per cent for projects from China but falls to 22 per cent for projects from Taiwan.

As can be seen in Table 2, the UK is the largest European recipient country of Chinese FDI projects, receiving four times more projects than Germany[7] and six times more than France.

Table 2. Top five European countries receiving projects

	UK	Germany	France	Austria	Denmark	Hungary
China	33	13	8	0	1	1
Hong Kong	26	3	3	0	4	2
Taiwan	41	12	7	10	5	4
Singapore	17	1	2	1	1	4
All	**117**	**29**	**20**	**11**	**11**	**11**

[5] 'Mixed' includes those projects that originate from two or more countries.
[6] As noted EYEIM information is not entirely comprehensive and Think London report that 22 investment projects were made with their assistance from China for the period 1989 to September 2004. In addition, Think London is aware of other unaided inward investment projects into London.
[7] This finding with regard to the UK's positive relative position to Germany is surprising as the feedback received by Think London suggests that Germany is still the favourite destination for Chinese FDI.

Table 2 reveals the following:

- The UK received more than 60 per cent of FDI projects from Hong Kong and 50 per cent from Singapore, perhaps reflecting long-standing historical ties with these countries. Germany received a total of ten per cent from Hong Kong and four per cent from Singapore while France received 15 per cent from Hong Kong and ten per cent from Singapore.
- For China, the UK's advantage is less but still substantial with 46 per cent of FDI projects compared to 19 per cent for Germany and 11 per cent for France.
- Similarly, for Taiwan, the UK receives 38 per cent compared to 11 per cent for Germany and seven per cent for France.

Employment

EYEIM also measures employment generated from FDI projects. Over the 1997-2004 period, the EYEIM held employment data on jobs created for 200 of the 257 FDI projects (78 per cent). If it assumed that the remaining 22 per cent have on average the same number of jobs per project as for the projects where employment is known, then the total number of jobs created by all 257 FDI projects can be estimated.

The employment figures provided by EYEIM are the number of jobs directly created by the investment project. It does not measure those jobs that may be created indirectly through possible spill over effects. As Table 3 shows, it is estimated that Chinese FDI projects over 1997 to 2004 created 46,300 jobs in Europe, of which 20,500 (44 per cent) are in the UK and 1,000 (two per cent) are in London.

Table 3. Employment generated by Chinese FDI

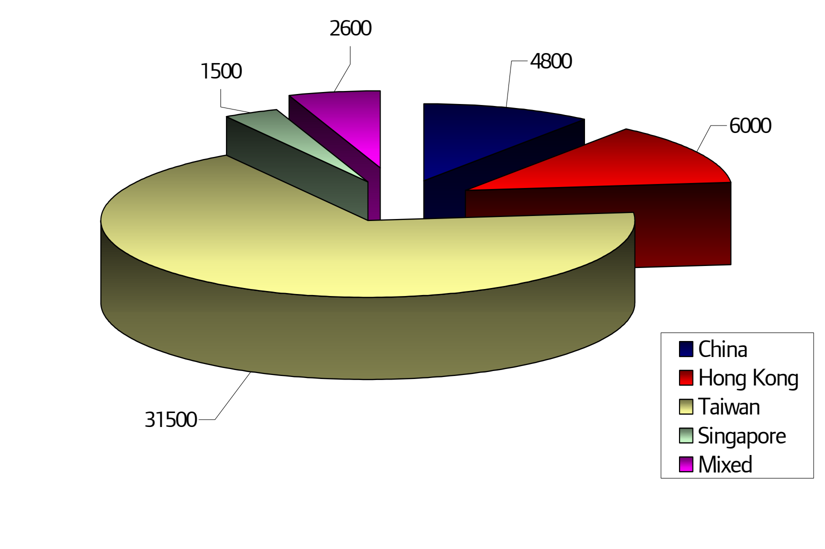
	Total Employment 1997-2004[8]	**Projects 1997-2004**	**Ratio Project: Employment**
London	1000	34	1:30
Rest of UK	20500	84	1:245
Rest of Europe	24900	139	1:180

It is estimated that Chinese FDI projects into the rest of the UK, rather than London, generate most jobs per project. For one project into the rest of the UK, around 240 jobs are created. Projects into London only generate around 30 jobs. This is most likely due to the nature of the activity or industry of the projects being different in London. The relatively high cost of labour, land and property in London means that it generally attracts less labour intensive and more specialised, high-value forms of economic activity.

[8] Figures are GLA Economics' calculations based on up rating the available data from EYEIM.

Figure 3 shows the total employment generated from Chinese FDI while Table 4 compares the number of jobs created to the number of projects.

Figure 3. Total employment generated from Chinese FDI
1997-2004



Almost 66% of European employment generated from Chinese FDI comes from Taiwan, even though Taiwan accounts for just 42% of projects.

Singapore, contributing 13% of Chinese FDI projects, generated less than 3% of jobs.

Table 4: Jobs created per project by Chinese economy

	Total employment generated	Total projects 1997-2004	Ratio Project: Employment
China	4800	70	68
Hong Kong	6000	43	140
Taiwan	31500	107	294
Singapore	1500	33	45
Mixed	2600	4	642

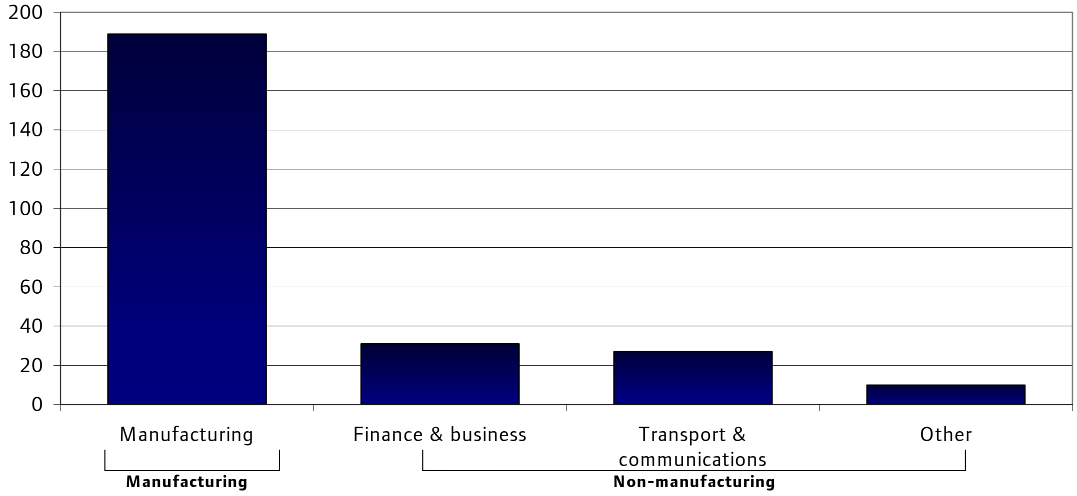
Capital expenditure

EYEIM provides some data on capital expenditure from Chinese FDI. However, out of the 257 projects, capital expenditure is recorded for only 84. As data is available for only 30 per cent of projects, this is not sufficient to analyse patterns of capital expenditure.

Industry

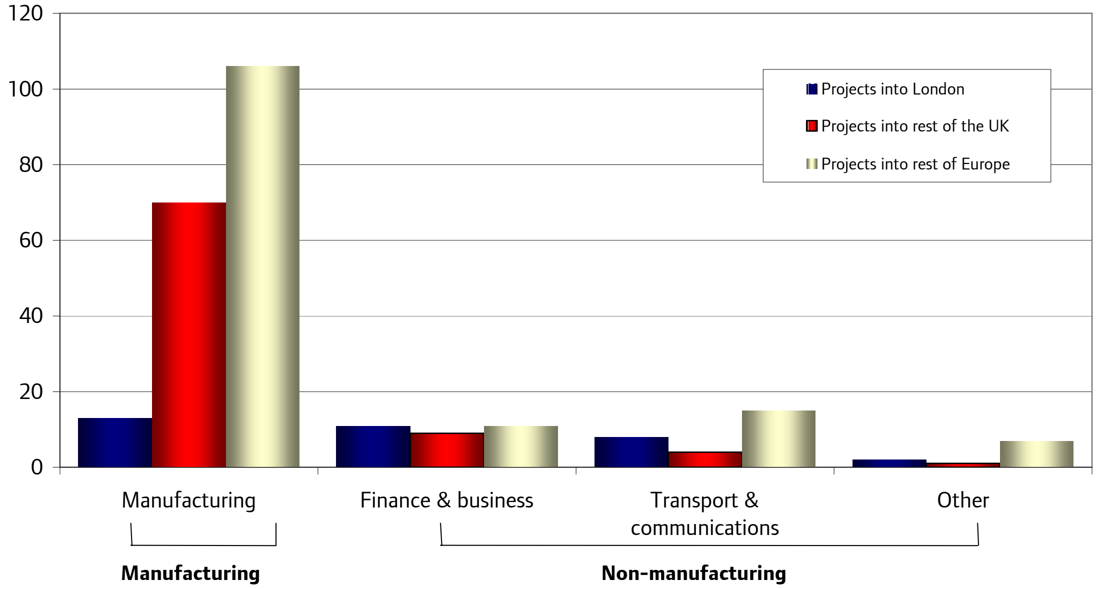
EYEIM breaks down projects by industry and activity. A project's industry reveals the nature of the investing company. A project's activity is the actual day-to-day tasks the FDI project will perform which may differ from the company's industry. For example a manufacturing company may establish a marketing operation.

Figure 4. Total number of projects by industry
1997-2004



As can be seen from Figure 4, manufacturing is the main industrial sector for Chinese FDI. More than 180 (70%) of Chinese FDI projects were in manufacturing. There were 31 projects (12%) in financial and business services and 27 projects (11%) in transport and communications. 'Other' includes a mixture of agriculture, education, energy, and retail and hospitality.

Figure 5. Total number of projects by industry
1997-2004



Figures 4 and 5 reveal the following:

- Manufacturing is the most significant industry for Chinese FDI, even in London. However, London receives only seven per cent of manufacturing projects in contrast to 37 per cent for the rest of the UK and 56 per cent for the rest of Europe.
- London's advantage is as the main destination for projects in finance and business services. London receives more than 36 per cent of these projects, more than the 29 per cent for the rest of UK and 35 per cent for the rest of Europe.
- London is also well represented in transport and communications projects. London receives 30 per cent of these projects, more than the 15 per cent for rest of the UK and compared to 55 per cent for the rest of Europe.
- London receives more non-manufacturing projects than the rest of the UK. London is not a centre for traditional factory based manufacturing therefore the number of projects that London can attract may be constrained by the prevailing industrial mix of recent Chinese FDI projects. London should be better placed to attract more 'creative' manufacturing such as specialised printing and publishing.

Activity

A project's industry does not always reflect its activity. For example, much of what in London is characterised as 'manufacturing' is in fact centres of administration and sales for manufacturing companies – the actual factory-level production of goods takes place elsewhere. This is an important point when assessing the pattern of FDI projects.

Table 5 looks at the percentage of projects within each industry that have an activity classification of 'manufacturing', 'headquarters', 'sales and marketing' or 'other'. For example, six per cent of projects with an industry classification of finance and business, have an activity which is classified as manufacturing.

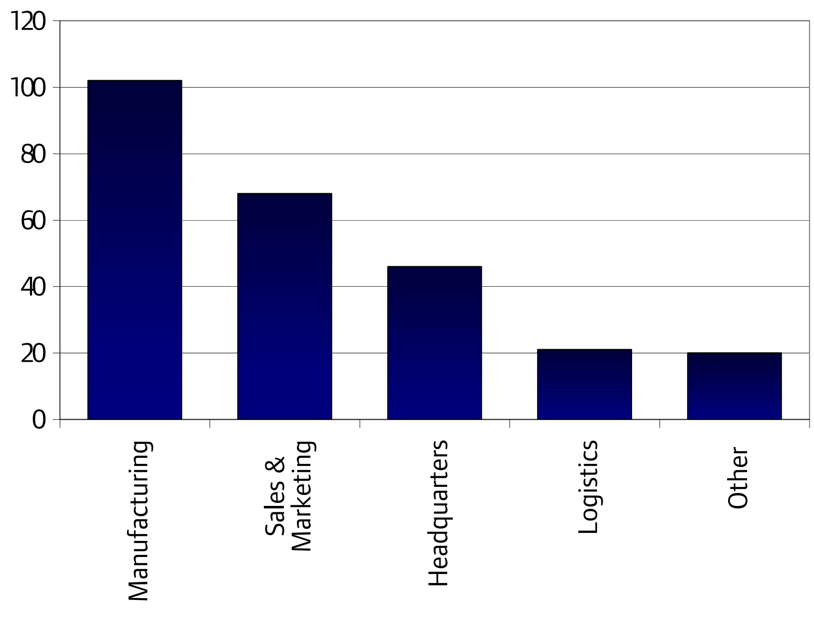
Table 5: Breakdown of activity within each industry

		Industry			
		Manufacturing	**Finance & business**	**Transport & communications**	**Other**
Activity within each industry	Manufacturing	52%	6%	4%	10%
	Headquarters	14%	23%	33%	30%
	Sales and marketing	20%	61%	22%	50%
	Other	14%	10%	41%	10%
	Total	**100%**	**100%**	**100%**	**100%**

As Table 5 shows, manufacturing activity accounts for only 52 per cent the number of projects in the manufacturing industry. Of the remaining manufacturing projects; 14 per cent are administrative headquarters and 20 per cent are in sales and marketing. Of the transport and communications projects, 41 per cent are in the 'other' activity category (this mainly includes logistics). Finance and business projects are mainly concentrated in sales and marketing with 61 per cent, and headquarters with 23 per cent. The 'other' industry classification has 50 per cent of its activity in sales and marketing. 'Other' activities include contact centre, education and training, research and development, shared service centre, and testing and services.

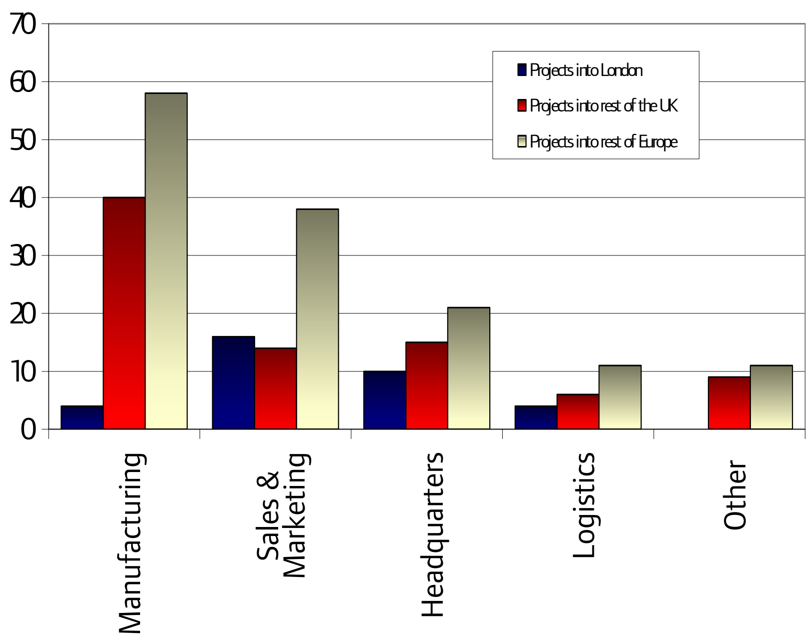
Figures 6 and 7 show the total number of projects by activity.

Figure 6. Total number of projects by activity
1997-2004



Manufacturing is the biggest activity of inward investment projects (40%), followed by sales and marketing (26%), and headquarters (18%).

Figure 7. Total number of projects by activity and destination
1997-2004



London attracts more sales and marketing Chinese FDI than the whole of the UK.

Figures 6 and 7 reveal the following:

- London attracts only four per cent of manufacturing activities compared to 39 per cent for the rest of the UK and 57 per cent for the rest of Europe.
- London's greatest strength is in sales and marketing. London attracts 24 per cent of projects, more than the 21 per cent for the rest of the UK, while 55 per cent of such projects are located in the rest of Europe.
- The UK is a favoured location for Chinese FDI headquarters projects. London attracts 22 per cent, with 33 per cent for the rest of UK and 46 per cent for the rest of Europe.

4. Underlying trends

It is possible to draw out some broad messages on the trends in Chinese FDI projects by looking at the data on an annual basis. Figure 8 shows total Chinese FDI by source. The number given for 2004 in Figure 8 is only for the period up until August, which means 2004 is on track to have the highest number of Chinese FDI projects recorded by EYEIM.

Figure 8. Total Chinese projects by source
Year-on-year

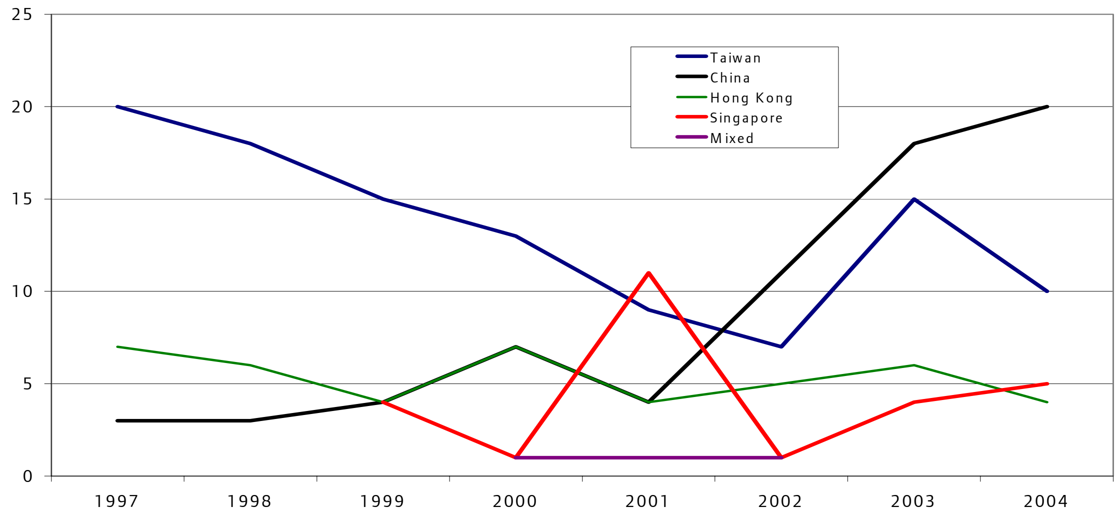


Figure 8 shows that the number of projects is rising. This growth is particularly in projects from China:

- In 1997 there were three projects from China. This had reached 18 by 2003 and has already reached 20 in 2004.
- The number of projects from Taiwan has declined from 20 in 1997 to 15 in 2003, although this marked some recovery from seven in 2002.
- The number of FDI projects from Hong Kong or Singapore fluctuates. For example there were no Singapore projects in 1997 but 11 in 2001.

Figure 9 illustrates the trends in the destinations of Chinese FDI projects to London, the rest of the UK and the rest of Europe.

Figure 9. Total number of projects in London, UK and Europe
Year-on-year

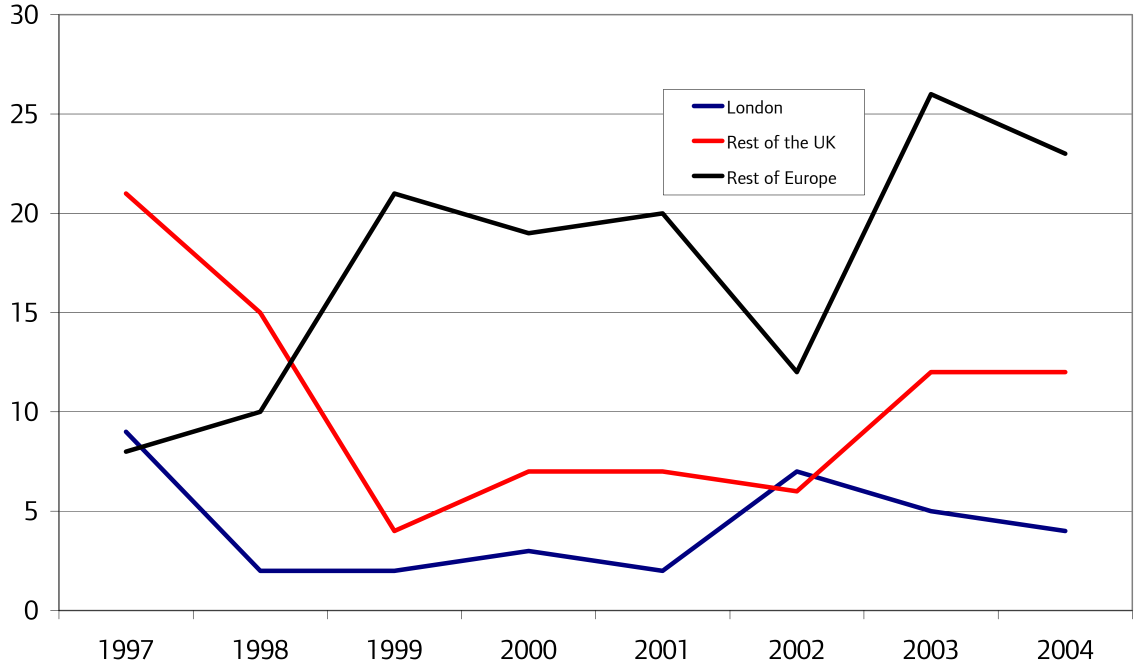
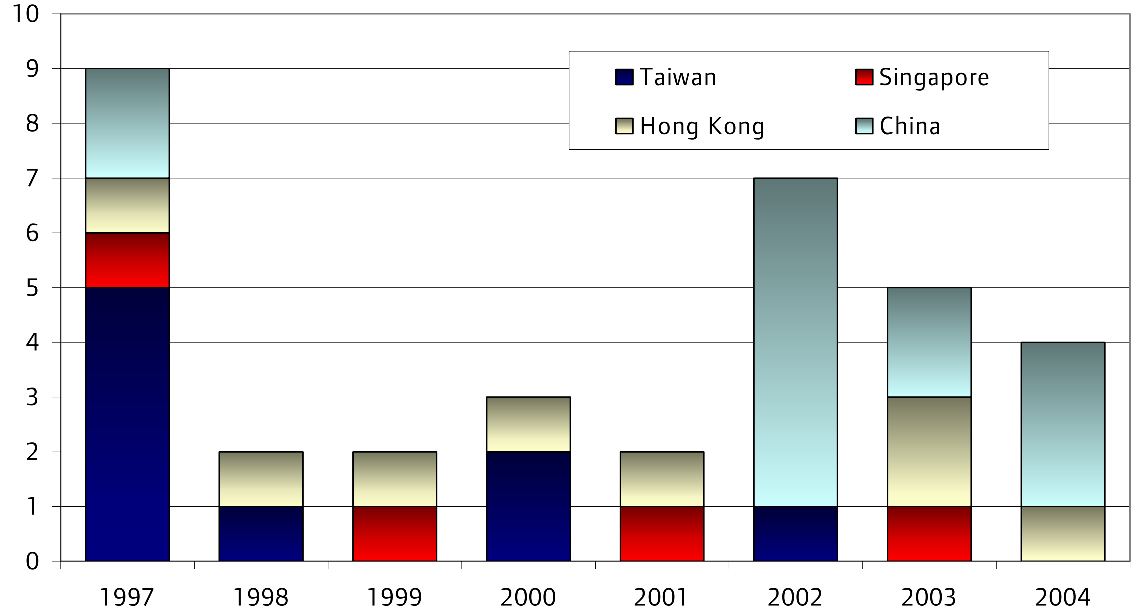


Figure 9 reveals the following:

- London is notable for having a relatively steady number of projects, averaging around 5.5 projects per year.
- The rest of the UK attracted the most number of projects (21) in 1997 before falling to only four projects in 1999. However since then there has been a recovery to 12 projects in 2003.
- The rest of Europe increased its number of projects from eight in 1997 to more than 25 in 2003.
- The UK and London have consistently attracted Chinese FDI projects between 1997 and 2003, although the rest of Europe has increased its share of projects.

Figure 10 shows the trend of Chinese FDI projects into London by each Chinese economy.

Figure 10. Total projects into London by source



The pattern of projects into London by country and industry or activity has changed:

- In 1997, Taiwan was the main source for Chinese FDI into London but since then Taiwan has fallen in importance with only one project since 2000.
- China has increased in importance. There were no recorded projects from China into London over 1999 to 2001, but six were recorded in 2002 and a further two in 2003.
- Projects from Hong Kong have remained consistent year-on-year with at least one project each year except in 2002.

Trends in Chinese FDI projects by industry

Projects by industry are grouped into manufacturing and non-manufacturing. There are not enough non-manufacturing projects to allow for a more detailed breakdown. Non-manufacturing includes projects in finance and business services, transport and communications, retail, and education.

Figure 11. Chinese FDI projects into Europe by industry

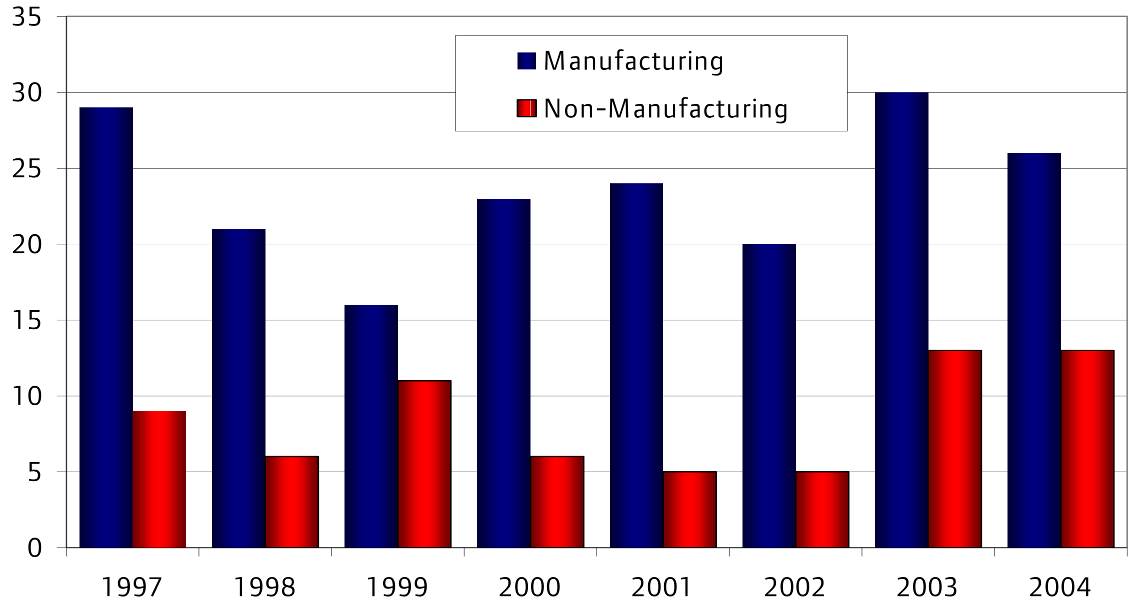


Figure 11 shows that the share of manufacturing projects has varied substantially between 1997 and 2004 from 89 per cent in 2003 to 60 per cent in 1999. The pattern for 2003 and now into 2004 suggests non-manufacturing projects are increasing their share. This is of significance to London, which has its advantage mainly in service activities.

Figure 12 shows that the rest of Europe has continued to increase its share of manufacturing projects while the rest of the UK's share has declined. London has generally not attained many Chinese manufacturing projects.

Figure 12. Percentage of manufacturing projects from Chinese countries

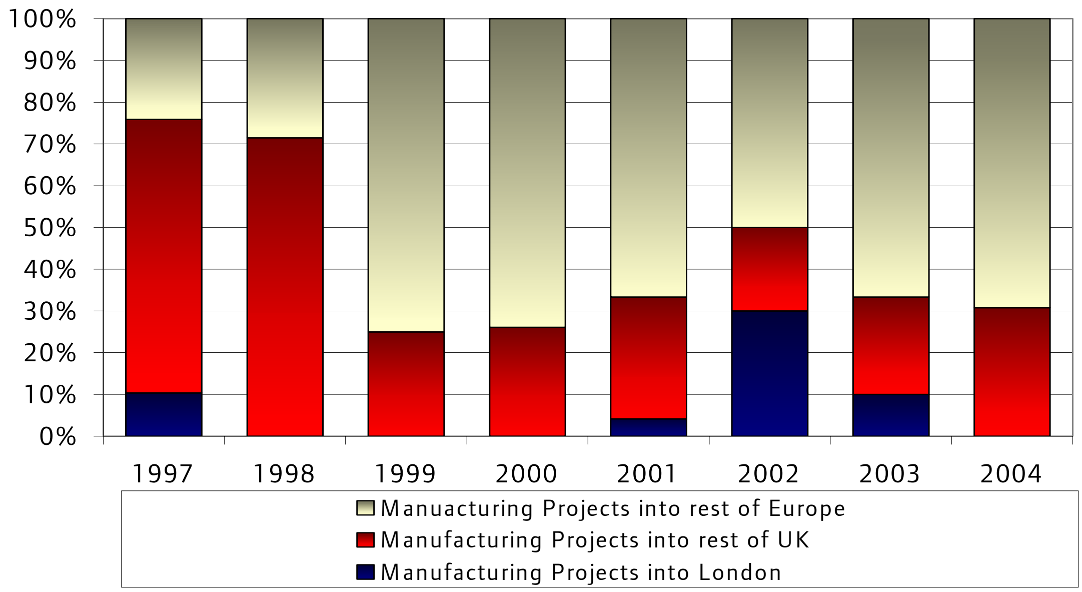
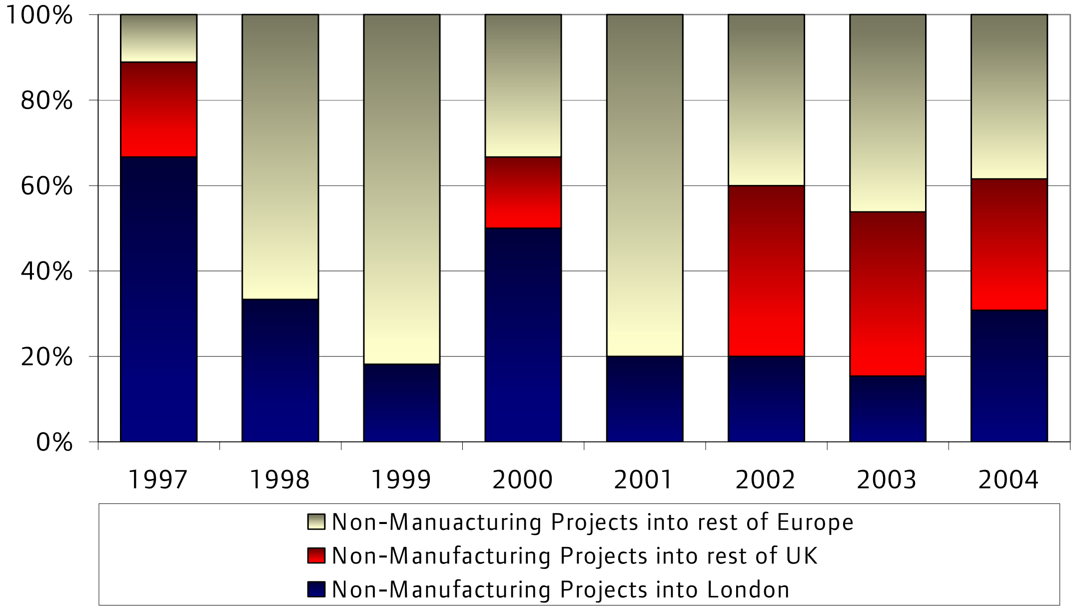


Figure 13 shows that in 1997 London's share of non-manufacturing projects was more than 60 per cent. London's share has declined since then but has generally been around 20 per cent each year. London's share in 2004 so far is 30 per cent.

Figure 13. Percentage of non-manufacturing projects from Chinese countries



Trends in Chinese FDI projects by activity

The trends in projects by activity looks at manufacturing, the combined activity areas of headquarters and sales and marketing, and the residual 'other' category.

Figure 14. All Chinese FDI projects by activity

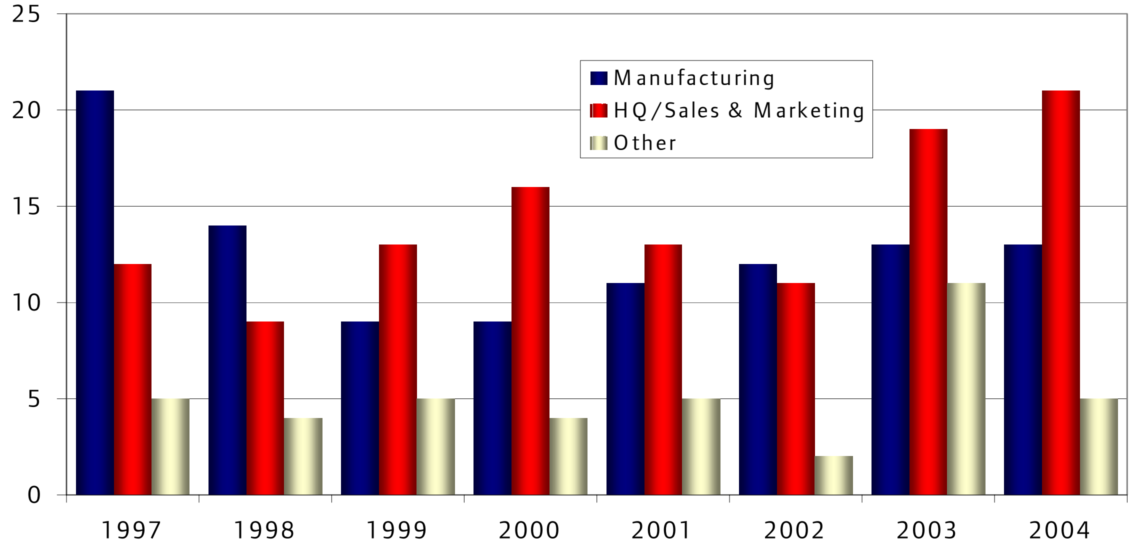
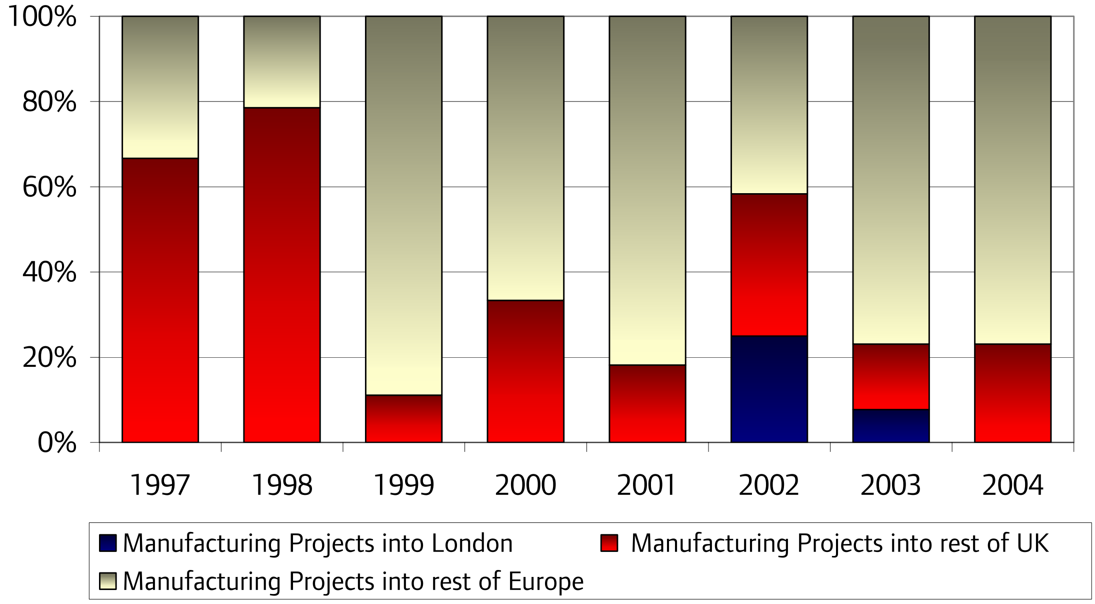


Figure 14 shows that though manufacturing activities are important for Chinese FDI, projects in headquarters and sales and marketing have been increasing. This increase should be advantageous for London as headquarters and sales and marketing activities are already more prominent in London than manufacturing.

Figure 15 shows the share of manufacturing activities by their destination to London, the rest of the UK, and the rest of Europe.

Figure 15. Share of manufacturing activity

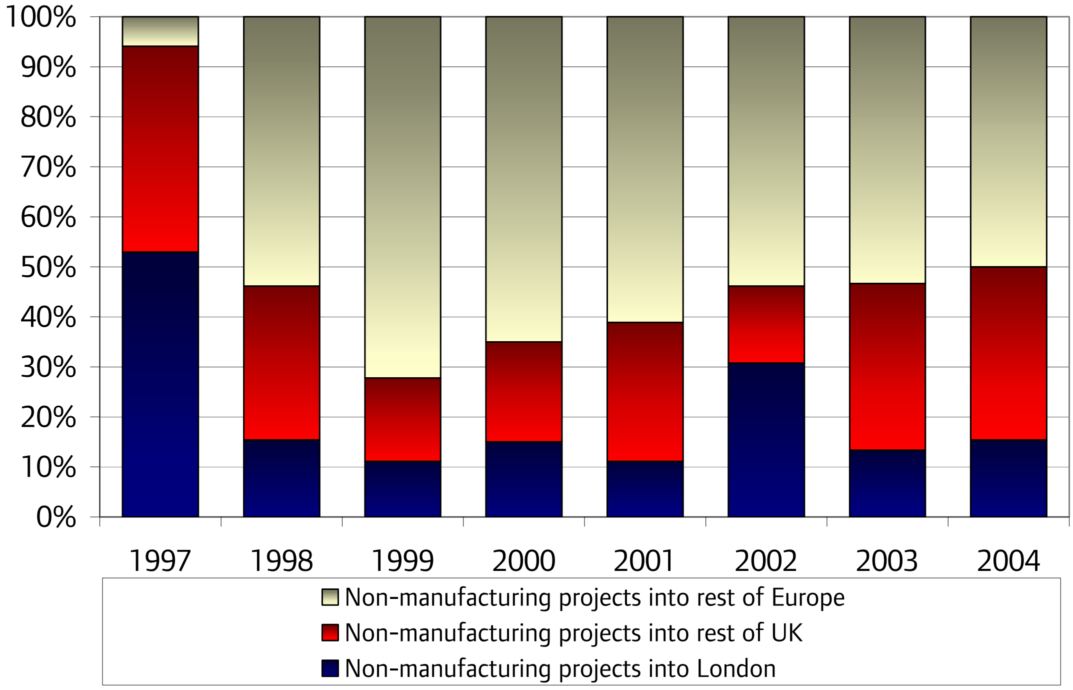


From Figure 15, the following can be seen:

- London only received manufacturing projects in 2002 and 2003.
- The rest of the UK's share of manufacturing projects reached its highest in 1998 at just under 80 per cent but since 1999 has remained consistent.
- The rest of Europe has taken the majority of manufacturing projects since 1999.

Figure 16 shows the share of non-manufacturing activity by destination to London, the rest of the UK and the rest of Europe.

Figure 16. Share of non-manufacturing activity



The following conclusions can be drawn from Figure 16:

- Since 1999 the rest of the UK has increased its share of non-manufacturing projects from 16 per cent to more than 30 per cent in 2003.
- Since 1999, the rest of Europe's share of non-manufacturing projects has been slowly decreasing.
- In 2003, almost half the non-manufacturing activity projects into Europe came to the UK.

5. Conclusion

The data available from EYEIM, although not comprehensive, provides a good indication of the trends in Chinese FDI into Europe. It allows an analysis of the broad patterns of London's success in attracting FDI from Chinese economies. London receives an impressively high share of projects for a single European city. According to EYEIM, the UK as a whole is the main destination in Europe for Chinese FDI. From 1997 to 2004, the UK received 117 projects from Chinese economies, while the second nearest was Germany with 29. However, this finding is not backed up by the 'on the ground' experience of Think London who report that Germany continues to be the favourite European destination for Chinese FDI.

Taiwan has accounted for the most investment projects into Europe with 42 per cent of all projects. China was second with 27 per cent. By analysing the trends from 1997 to 2004, evidence of changing characteristics is found. Investment from Taiwan is decreasing while investment from China is increasing. Taiwan accounts for most of the investment projects into Europe and the majority of these projects are concentrated in manufacturing industries.

There has been an increase in the number of projects in finance and business, headquarters, and sales and marketing from Chinese economies. The share of projects in manufacturing is becoming smaller, presenting a shift from manufacturing activities to more headquarters and sales and marketing.

This shift in investment from manufacturing to headquarters, sales and marketing, and business services should benefit London, which has a competitive advantage in these areas. However, this opportunity does not yet appear to have been fully grasped as London's share of Chinese FDI projects does not appear to be increasing, as might be expected. Therefore the challenge for London is to improve its attractiveness as a business location for Chinese investment. In part this will involve addressing issues that businesses in general have identified as a priority, for example improving intra-London transport infrastructure. In addition, it may require specific interventions or programmes aimed at meeting the particular needs of Chinese investors. The Greater London Authority (GLA) and Think London have entered into discussions with the Chinese business community to see what particular activities might assist in this regard.

6. Acronyms and key terms

Acronyms

EYEIM	Ernst & Young European Investment Monitor
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GLA	Greater London Authority
WTO	World Trade Organisation

Key terms

China	The People's Republic of China
Hong Kong	The Hong Kong Special Administrative Region of China
Taiwan	Taiwan, province of China
Singapore	Republic of Singapore

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