Economic Relations between
Germany and Mainland China, 1979 - 2000

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Introduction

In the course of the last twenty plus years the intensity of economic exchange between China and Germany has increased dramatically. This development was triggered off most of all by the economic policy changes introduced by Deng Xiaoping in 1978. Since then, China has freed itself from its former self-imposed isolation and gradually integrated with the world economy. The market-oriented transformation process initiated in China in the late seventies created the preconditions for the resumption of economic contacts that had been largely stagnant in the preceding years. The gradual establishment of a market-based economic framework has step-by-step contributed to an economic environment that has allowed economic actors to exploit the comparative advantages of the economies concerned and enlarge the scope of labor division with China.

In the period in question, however, major shifts have also occurred in the world economy as a whole which have left their mark on German-Chinese bilateral economic relations. The single most important event has been the reunification of East and West Germany, which has led to a significant reshuffle of Germany’s economic structure and its foreign economic relations. The pattern of Germany’s integration into the international division of labor, however, has been changed even more by (i) the evolution of a single European market under the auspices of the European Union\(^1\) and (ii) the breakdown of the Socialist Block and the ensuing transformation of the Central and Eastern European economies into market economies. Both events have opened markets in Germany’s neighboring countries that in terms of their comparative advantages and production capacities are to a certain extent similar to those in China and have resulted in the diversion of some economic interaction (especially investment and trade flows) that might otherwise have benefited China. This, however, could not stop the rapid intensification of economic relations between Germany and China. In the following the evolution of this economic partnership and its driving forces will be outlined. The paper is structured according to the various types of economic transactions: (I) exchange of goods, (II)

foreign direct investment (FDI), (III) lending operations and (IV) development aid. Chapter (V) will provide an outlook on the development of German – Chinese economic relations in the 21st century.

Up to the present day, economic transactions between China and highly industrialized countries, like Germany, have typically been of a two-way nature in respect to foreign trade, i.e. the exchange of goods only. All others, such as foreign direct investment, lending (commercial and governmental) and development aid, (transfer payments) have been marked by a one-way structure: capital, management and technological know-how is transferred from Germany to China, but not vice versa. The analysis of these different types of economic transactions is complicated, on the one hand, by the fact that they are interrelated. The amount and direction of developmental aid has a strong impact on foreign trade and plays a facilitating role in foreign direct investments. Foreign direct investment influences the volume and composition of export/import flows. Its net effect may be trade creation or trade substitution. In the long run it may function as a substitute for certain categories of developmental aid. Foreign lending has a facilitating role in foreign trade as well as in foreign direct investment, and is, in certain areas, closely related to developmental aid. On the other hand, it must be taken into account that bilateral economic transactions are subject to a wide range of factors that have an impact on their development. They are

- dependent on political and institutional developments as well as macro-economic cycles in China,
- influenced by political and economic developments (business cycle) in Germany,
- influenced by the progress of economic integration within the boundaries of the EC (EU),
- influenced by economically relevant developments in other parts of the world (e.g. the business cycle in the United States, East Asia etc., singular events, like the "Asian Crisis", the disintegration of Comecon and the transformation processes in Central and Eastern Europe and the successor states of the USSR, etc.).

As far as possible these parameters will be taken into account when discussing the development of economic relations between China and Germany. All statistical data
presented in the analysis refer to the PR China as defined by its customs territory. Hong Kong, Macao and Taiwan are not covered.

(I) German – Chinese trade relations

In general, the exchange of goods between Germany and the PR China has experienced tremendous growth during the last twenty plus years. This rapid quantitative development of bilateral trade has not been an isolated phenomenon, but goes in line with the rapid integration of China into the global division of labor which in turn is directly linked with the gradual replacement of existing command-economy structures by market-economy co-ordination mechanisms in the economy as a whole and in the foreign trade system in particular. In the last two decades China has massively increased the efficiency of its foreign trade situation and has also been able to adjust the structure of its goods trade to its own comparative advantages. This has made possible an expansion of goods trade that makes sense for all partners, and with the rapid growth of the Chinese economy, goods trade has received additional stimulus. These developments are mirrored in a general increase in the relative weight of China in world trade (Chart 1). The increasing share of China in world trade implies that China’s exports and imports have grown significantly faster than total world trade.

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3 Here, at the same time, is a countervailing causal relationship according to which the increasing opening of the Chinese economy to the international market has also stimulated the overall growth process.
A comprehensive overview about Germany's (FRG) trade relations with the PR China is presented in chart 2. With respect to the early days of modern German - Chinese trade relations it can be observed that trade relations intensified somewhat at the beginning of the reform era under Deng Xiaoping, but showed no dynamic growth until the mid-1980s. In fact, after 1980 trade stabilized again at a somewhat higher level. The short-lived boom at the end of the 1970s has to be attributed to the so-called “New Great Leap Forward” proclaimed by Beijing in 1977-1978. During that period China once again tried to boost economic development by importing turnkey plants in various strategic industries. After decades of stagnating economic relations, German exports to China picked up considerably as German suppliers managed to secure a large share of the projected plant imports for themselves and signed contracts valued a more than 10 billion German marks.4

Chart 2: Indicators of trade relations between Germany (FRG) and the PR China

Trade balance between Germany and the PR China
in Mio. US-

Germany's export and import with the PR China
in % of total German exports and imports

China's export and import with Germany
in % of total Chinese exports and imports

Source: International Monetary Fund, Direction of Trade Statistics Yearbook, Washington, various years.

Note: Until 1990 the data covers West-Germany’s trade relations with the PR China only.

From 1991 on the data refers to the re-unified Germany.
This boom, however, proved to be short-lived. Reluctance to widen the overall trade deficit beyond the 800 million Yuan that were to be reached in 1980 plus an unplanned for lack of foreign exchange due to unexpectedly low oil export revenues and, last but not least, the realization that China would not be able to make the complementary investments necessary to bring the projects on track all contributed to the decision to drastically scale down the program. In November 1980 the Chinese side informed its contract partners that it would not be able to adhere to its contractual obligations and cancelled numerous projects. German suppliers lost a project volume of more than 3 billion German mark.5

In Germany (and Europe as a whole) the late 1970s and early 1980s were characterized by a slow recovery from the shock of the second oil price crisis. Structural rigidities (“eurosclerosis”) and a general disintensification of world trade were no factors conducive to German activities in the slowly opening Chinese market – especially after the disillusionment caused by the Chinese cancellation of import contracts when the “New Great Leap Forward” failed. In addition, German export activities were hampered by the German government's unwillingness to provide soft loans to China for any other means than safeguarding Germany’s raw materials supply. As other nations, like France and Italy, were much more willing to promote the export activities of their enterprises by means of interest-subsidized loans, German suppliers were in a disadvantaged position.6

In China, this period was marked by intensive discussions of principles. After the previous decade, when cross-border goods trade was stigmatized as the rich countries' instrument of exploitation, it was necessary to arrive at a new understanding on the theoretical level, in order to bring the opening of foreign trade in line with the ideology of the Chinese leaders. This discussion of principles was concluded in the mid-1980s by adopting Ricardo’s theory of comparative cost advantages by which both trading partners profit, even if one partner is superior in every respect.7 Until then, only a very cautious revitalization of foreign trade relations

5 ibid, p. 192f.
was to be observed. Imports were tightly tied to the country’s ability to generate foreign exchange as trade deficits and debt financing were to be kept as low as possible.\(^8\) On the level of practical foreign trade policy, the ideological discussion was accompanied by an emphasis on import substitution. While active export promotion was only practiced in a few selected locations, such as the newly created special economic zones and diverse goods-specific export-production bases.\(^9\)

Despite the very slow unfolding of German – Chinese trade during the early 1980s, in the field of China’s institutional build-up an important decision was made that was to favor German suppliers for years to come. In 1979 both countries entered into an agreement that allowed China to study the German system of DIN norms and standards and transfer it to China. During the first half of the 1980s, China as a result introduced a wide range of norms and standards that followed German examples. German enterprises, which had designed their products in order to comply with these norms from the start, therefore, came to be in a favorable position against foreign competitors not used to this set of norms and standards.\(^10\)

The foundation for a transition to dynamic growth in cross-border goods trade was laid in 1985/6. At that point in time the group around Zhao Ziyang finally committed itself to a market-based economic system,\(^11\) and the ideological discussion of the character of foreign trade was concluded. In 1986 new reforms in the foreign trade system were announced, the official exchange rate was devalued, and China applied for (re-)admission to GATT. In 1987/88 Zhao Ziyang eventually announced a “Coastal Development Strategy” which was to promote the export economy in the coastal regions by assisting commission processing firms and the settlement of firms with foreign capital interest.\(^12\)

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Nevertheless, there was no substantial increase in German exports to China between the middle of the 1980s and 1992/93. The stagnation and even deterioration of German export volumes during the latter half of the 1980s, after it had risen nearly threefold between 1984 and 1986, is rather mysterious, as during that period overall German export experienced very dynamic growth (as mirrored in China’s decreasing share in Germany’s overall exports; see chart 2). An explanation may be found in the theory of the “missing middle” as brought forward by Bass. According to this line of argument, once the large multinational corporations had entered the market there were no companies left that would have been able to mobilize the resources necessary to penetrate the still very difficult Chinese market.\textsuperscript{13} Prohibitive transaction costs therefore may have prevented a further intensification of trade relations which would have had to be shouldered by Germany’s small and medium-sized enterprises.

The mystery however dissolves to a certain extent when taking into account China’s overall import development during the period under discussion. China’s share in world imports decreased during the 1985-1990 period (see chart 1). In absolute figures China’s overall import volume stagnated between 1985-1987. But it experienced a strong increase in 1988 and 1989 due to the promotion of export processing businesses in the context of Zhao Ziyang’s coastal development strategy. These export processing businesses however were not suited to boost European exports to China. Rather they diverted European import flows in China’s favour. Goods which until then had been procured from Hong Kong, Taiwan and South East Asia in general, now increasingly underwent value-adding processes in China, from where they were finally exported in the world.

In contrast, the reasons for the decrease in German exports to China from 1989 onwards are rather obvious. One important factor for this development lay in the reduction of export assistance programs, development aid, etc., adopted by

European countries in reaction to the Tian’anmen incident of 1989. A second negative effect was produced by the measures adopted by China for stabilizing the economy and consolidating (instead of completing) the previous reform measures after 1989. Of particular importance for bilateral trade relations was the administratively induced general reduction of China’s imports, which caused China’s overall imports to drop by 10% in 1990. As a matter of fact, until the early 1990s, China’s foreign trade transactions were subject to administrative guidance and strongly influenced by the governments’ planning and investment cycles. A third factor contributing to a low intensity of China bound export activities can, last but not least, be found in the collapse of the Socialist block. The newly arisen opportunity to enter the East European market diverted business from China.

It was only in 1992 that once again a significant increase in German exports to China could be observed. It coincided on the one hand with the resumption of the reform process in China when the reformers regained dominance over more conservative forces. On the other hand, a significant improvement in the bilateral political climate can be observed during that period. Germany did not only lift its sanctions against China – which until then she had upheld much more strictly than other Western industrial countries – but also refrained from selling submarines to Taiwan. All this contributed markedly to an improvement of economic relations, which, in addition, were promoted by German export subsidies targeting the Chinese market. German soft loans contributed greatly to the sale of container ships, wagons, and subway facilities to China. But Germany’s China-bound exports are perhaps most of all promoted by the German and eventually global FDI-commitment in China. In the middle of the 1990s about two thirds of Germany’s exports to China had been

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ordered by foreign invested enterprises which imported German capital goods (first of all machinery, automobiles, electro-technical products).\textsuperscript{19}

The rally, however, was only short-lived as a weak US-dollar gave German exporters a relative disadvantage against US-competitors during 1993-1996. The situation became even more difficult as, during the latter half of the 1990s, a prolonged cyclical decline of economic activity in China once again compromised German export activity. The impact of the Asian crisis from the middle of 1997 led to a further intensification of this slowdown.

In contrast to the comparatively moderate and quite volatile development of exports, Germany's imports from China clearly show a more dynamic growth. Since 1986 German imports from China have grown steadily, thereby ending the state of equilibrium in which the volume of bilateral export and import flows largely balanced out in the late 1970s and 1980s. This surge in imports has to a considerable extent been boosted by EU assistance measures. China was included in the EC's System of Generalized Tariff Preferences (GSP)\textsuperscript{20} in 1980 and has since then become one of its greatest beneficiaries.\textsuperscript{21} While China enjoyed about 5-6\% of the total GSP benefits

\textsuperscript{16} ibid., p. 65f.
\textsuperscript{20} The GSP scheme has been designed, in order to strengthen the export activities of developing countries in the markets of the developed industrialized countries. Its main feature are non-reciprocal tariff preferences granted to developing countries for selected goods and quantities thereof. The preferential rates are determined with respect to the developmental state of the beneficiary country (GDP per capita and other indicators), the countries’ efforts to combat the drug industry, the countries' share of total EU imports of a certain GSP-treatment eligible good, the classification of the good under consideration as 'very sensitive', 'sensitive', semi-sensitive' or 'non-sensitive'. Carzaniga, Antonia Giulia (1997): The EU's Trade Relations with China: anti-Dumping Policy and The New Generalized System of Preferences, CEPS Working Document No. 108, Brussels, pp. 3-6; Strange, Roger (1998): EU trade policy towards China, in: Strange, Roger; Slater, Jim; Wang Limin (ed.) (1998): Trade and Investment in China. The European experience, London - New York, pp. 59-80, here p. 63-66.
\textsuperscript{21} It should be noted that, while the GSP scheme was directed towards all developing countries, its terms were less generous than the concessions agreed upon under the Lomé Convention and the Mediterranean Agreements. Therefore, only countries not included in the latter preferential systems applied for GSP treatment.
granted by the EC in the early 1980s, this share rose to more than 25% in the middle of the 1990s, although the number of countries eligible for GSP treatment increased dramatically with the inclusion of the East European and the USSR successor states.\(^{22}\) The value of imports to EU member countries from China that fell under the GSP scheme in 1995 amounted to 53.6% of total EU imports from China.\(^{23}\) However, as a consequence of the dominating role China held in the mid-1990s, the EU has since been phasing out GSP preferences towards China.\(^{24}\) At the same time it has to be noted that export subsidies and a distorted price structure, at least until the middle of the 1990s, had enhanced the price competitiveness of some Chinese exporters in a way that warranted the label “dumping” and made China the target of numerous anti-dumping measures by the EU.\(^{25}\)

During the 1990s Germany built up a massive trade deficit with China. This deficit in the balance of trade reflects, on the one hand, the consistent implementation of an export-oriented foreign trade strategy and a catching-up process of the Chinese economy, which especially in the early 1980s was not in a position to offset her imports of German plant and equipment with export goods that would have found demand in Germany. This export weakness has now been overcome. On the other hand, the trade deficit in the 1990s was an expression of increasing sales from the production of German investment projects in China. Their on-site production is a partial substitute for German exports. In addition, the local production of German ventures has become more and more a source for German imports.

In the run of these developments the composition of Germany’s exports to and imports from China has gone through rapid changes. At the end of the 1990s, German exports to China were dominated by machinery and electronic equipment which commanded about 50%; automobiles had a share of about 10%. German

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25 Not all of this anti-dumping, however, can be accepted as warranted. There has also been a good deal of protectionist motives on the part of the EU. See: Strange, Roger (1998): passim.
imports from China embrace a broad range of goods. Labor-intensive products of lower price and quality ranges are still in the majority, but this trend has been decreasing over time. Textiles and apparel, which used to constitute the bulk of German imports in the past, are also losing in importance. In contrast to the typical export structures of developing economies, Chinese exports, and especially those to Germany, are characterized by a high content (about 90%) of finished products. This fact may be explained by the contribution of foreign invested enterprises to Chinese exports which have secured a share of more than 40% of China’s total exports.

The general trend of German – Chinese trade relations may be identified as follows:

- The volumes of bilateral imports and exports have risen dramatically, with the most dynamic development to be observed during the 1990s.
- As a trade partner Germany is more important to China than vice versa.
- China’s share in total imports to Germany has risen continuously over the past twenty years and has increased six fold. China has become an important source for German imports.
- From the Chinese perspective, the importance of Germany as an export destination has for the past twenty years been extraordinarily constant, at about 4% of total exports. Chinese exports to Germany thus grew at the same pace as total Chinese exports.
- The importance of Germany for total Chinese imports fluctuated greatly in the past two decades. Overall, Germany has lost in importance as a source of Chinese imports.

Trade relations between Eastern Germany (GDR) and China until 1990

While until now the discussion has concentrated on the FRG, i.e. Germany in the confines of West-Germany until 1990 and then in the borders of the re-unified country, the trade relations between Eastern Germany (GDR) and China shall now be focussed on.

The picture that unfolds is distinctly different from what could be observed in respect to West Germany. Not only were the absolute volumes of bilateral trade markedly
smaller than those that West Germany was running with China, but the mutual dependencies were also reversed: China was a much more important foreign trade partner for Eastern Germany than vice versa (see chart 3). And whereas the West German - Chinese trade relations were primarily determined by developments in China itself (in the sense that efforts by Western European companies to intensify business relationships were restricted mostly by problems that arose on the Chinese side), the restricting factor in the development of trade relations with Eastern Germany and the COMECON economies as a whole were the structural rigidities, political dependencies and ideological principles that these countries were subject to in the COMECON group.
Chart 3: Indicators of trade relations between Eastern Germany (GDR) and the PR China

Trade balance between Eastern Germany and the PR China
in Mio. US-$

Export and import of Eastern Germany with the PR China
in % of total Eastern Germans exports and imports

China's export and import with Eastern Germany
in % of total Chinese exports and imports

During the second half of the 1970s in Eastern Germany the rapidly increasing volume of goods trade with China gave rise to hopes for a profitable intensification of economic co-operation in the ensuing years. However, the volume of trade in the 1980s deteriorated dramatically. And although a bilateral trade agreement covering the period 1986-1990 resulted in a substantial increase in bilateral trade flows, the exchange of goods remained markedly below the quantities that were planned ex ante.

The primary cause was the limited ability of the GDR to adjust its export range to the rapidly increasing needs of the Chinese customers. Initially it had still been possible to sell goods in China that would have been difficult to sell elsewhere. But the technological and qualitative inferiority of the East German supplies quickly became evident during China's rapid economic development. With Chinese importers experiencing permanently improving access to suppliers from Western industrial countries during the course of the 1980s, China’s interest in East German products vanished and Eastern Germany came to occupy almost automatically an inferior position vis-à-vis her Western competitors.

On the other hand, China over the course of time became an increasingly interesting supplier of goods which Eastern Germany would otherwise had to buy in the West with hard currency. In contrast to the continuously weakening Chinese demand for East German products, there existed a remarkable interest in Chinese in East Germany. But given an insufficient export performance and the political maxim of a balanced bilateral trade balance this demand was not allowed to materialize in increasing trade volumes. The bilateral division of labor remained on a sub-optimum level. A situation which was further aggravated by the fact that the East German economic system made it impossible to enlarge the scope of economic co-operation to new fields like joint ventures etc., which might have provided a stimulus for bilateral trade development. The Chinese side made an effort to break up the unsatisfactory state of bilateral trade relations by proposing to eliminate the existing clearing system, which commended a strict congruity of export and import flows. Instead bilateral trade should be based on payment in hard currency, as was the case with transactions with Western countries. This would have been the only way to replace the constraints in the clearing system and to expand Chinese exports beyond
the extent of East German goods shipments. This request, however, was rejected. The East German – Chinese trade relations where therefore stuck in a rigid institutional framework that prohibited any further intensification. Without dramatic alterations of the East German foreign trade regime no improvement of this situation was possible.26

**Intensity of Trade Analysis**

In order to enlarge the scope of the analysis presented above, the results of an Intensity of Trade Index calculation are given in chart 4. The Intensity of Trade Index is applied to measure the relative importance of bilateral trade relationships in the context of world market integration of the economies concerned. It can be determined separately for export and import relations. In a formulation based on exports, it is defined as the share of exports of the country of origin aimed at the target country, divided by the share of the target country in world imports which theoretically could have their beginnings in the country of origin (an analogous definition holds for the import side).27 If the index assumes the value of 1, the export country directs precisely the portion of its exports to the target country as this country's share in world imports. Accordingly, a value above or below 1 indicates an above or below average intensity of goods trade.

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27 The Intensity of Trade Index \( I_{ij} \) takes the form:

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I_{ij} = \frac{X_{ij}}{X_i} \frac{M_i}{M_{w} - M_i}, \quad \text{respectively} \quad I_{ij} = \frac{M_{ij}}{M_i} \frac{X_j}{X_{w} - X_i}
\]

with \( X_{ij} \) denoting country i’s exports to country j, \( X_i \) total exports of country i, \( M_{ij} \) total imports of country j, \( M_i \) total imports of country i, \( M_{w} \) total world imports, and corresponding values for the second version of the index. For early applications of the Intensity of Trade Index see: Drysdale, Peter; Garnaut, Ross (1982): Trade intensities and the analysis of bilateral trade flows in a many-country world: A survey, in: Hitotsubashi Journal of Economics, Vol. 22 (1982), No. 2, pp. 62-84; and: Platte, Erika (1992): Germany-China trade: An empirical assessment, in: Asien, Vol. 42 (January 1992), pp. 66-79.
Chart 4 shows the corresponding values for the import and export relationships of West and East Germany with China.

A salient feature of this analysis is the wide divergence of the index values East and West Germany commanded during the early eighties. The high intensity of trade index values documented for East German – Chinese trade relations, however, are a reflection of the low volume of foreign trade between East Germany and economies outside the Soviet block. With the dissolution of the COMECON and the gradual integration of East Germany into the international economy during the eighties, the relative importance of trade relations with China declined accordingly. From 1985 the index has therefore remained below unity, indicating a below average trade intensity. With respect to West Germany, and later the re-united Germany, it is striking to note that while Germany’s imports from China came close to achieving unity during the 1990s, the index values for German exports are clearly below average. Despite the above-mentioned expansion of China’s share in Germany’s exports and imports, trade relations have not yet assumed the intensity that would accord with the relative world market shares of these countries. An explanation for the disparity can be found in Germany’s close regional ties to her European neighbors, i.e. the EU single market member states and the transformation countries of Eastern Europe, on the one hand, and China’s embeddedness in the Asian economy (most of all Hong Kong, Southeast Asia, Japan), on the other. Here, the forces of regional gravitation still seem to prevail over “globalization”.
Chart 4: Intensity of Trade between Germany (FRG, GDR) and the PR China

Exports to China

Imports from China

(II) German Foreign Direct Investment in China

The initial legal and institutional basis for an inflow of FDI to China was established only in the late 1970s and early 1980s. Since then China has taken a number of measures to intensify the flow of FDI to the country. Special economic zones and industrial parks have been established within which foreign invested enterprises (FIE) experience a better regulatory environment and infrastructure facilities than in other parts of the country. They have been given tax benefits, promised a relatively liberal foreign-trade regime, and granted diverse other special conditions under which the business activities of companies with foreign participation are subject to considerably different conditions than businesses that are financed purely by Chinese capital. But still seriously constricted by regional, sectoral restrictions and specific qualifications (concerning forex balances, local content regulations, access to the local goods and factor markets, etc.) motivated by ideological reservations that they might constitute an instrument of foreign capitalists exploiting the country, FDI inflows picked up only slowly in the 1980s. It was not before China’s strong commitment to a market economy in the early 1990s that the country was able to attract truly substantial amounts of FDI. Since then the development has been dramatic. Between 1995 and 1999 China absorbed 7.5% of global FDI flows and about one quarter of all FDI flows directed towards developing countries. In the years 1993 to 1996 China was even host to more than one tenth of global FDI.

The bulk of these massive FDI inflows did not, interestingly, stem from the world economy’s industrial growth centers. As documented in table 1, the triad economies of the EU, Japan and USA each accounted for only about 10% of all China-bound FDI, while Hong Kong, Taiwan and Singapore commanded about one half of all China-directed FDI flows. Even if potential misrepresentations arising through investments executed by affiliates of German companies registered in Hong Kong, Virgin Islands etc., and as a result not appearing as German FDI, are taken into...

30 It is interesting to note that in 1992, the first year of substantial FDI inflows to China, FDI-flows to South Korea and Taiwan dropped by 31% respectively 51%. See: United Nations (various): World Investment Report, New-York-Geneva.
consideration, the quantitative German FDI engagement in China was moderate when taking into account the size of the German economy.

Table 1:
China-bound FDI by country of origin as a percentage of total FDI inflows to China

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<tr>
<td>World (in billion US$)</td>
<td>1,661</td>
<td>3,487.11</td>
<td>37,805.69</td>
<td>45,462.75</td>
<td>40,714.81</td>
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<td>EU-12</td>
<td>8.4</td>
<td>4.5</td>
<td>--</td>
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<tr>
<td>EU-15</td>
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<td>5.7</td>
<td>8.8</td>
<td>11.0*</td>
</tr>
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<td>France</td>
<td>1.7</td>
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<td>0.8</td>
<td>1.6</td>
<td>2.1</td>
</tr>
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<td>Germany</td>
<td>1.2</td>
<td>1.8</td>
<td>1.0</td>
<td>1.6</td>
<td>2.6</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>57.6</td>
<td>60.7</td>
<td>53.8</td>
<td>40.7</td>
<td>38.1</td>
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<td>n.a.</td>
<td>14.4</td>
<td>9.0</td>
<td>7.5</td>
<td>7.2</td>
</tr>
<tr>
<td>Netherlands</td>
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<td>0.3</td>
<td>1.6</td>
<td>1.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>n.a.</td>
<td>1.4</td>
<td>4.9</td>
<td>7.5</td>
<td>5.3</td>
</tr>
<tr>
<td>S-Korea</td>
<td>n.a.</td>
<td>n.a.</td>
<td>2.8</td>
<td>4.0</td>
<td>3.7</td>
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<tr>
<td>Taiwan</td>
<td>n.a.</td>
<td>n.a.</td>
<td>8.4</td>
<td>6.4</td>
<td>5.6</td>
</tr>
<tr>
<td>United Kingdom</td>
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<td>0.4</td>
<td>2.4</td>
<td>2.6</td>
<td>2.9</td>
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<td>8.2</td>
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<td>Virgin Islands</td>
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<td>n.a.</td>
<td>0.8</td>
<td>8.9</td>
<td>9.4</td>
</tr>
</tbody>
</table>

* estimation based on data for the largest EU-15 member economies


This fact can be explained to a large extent by historical developments in Europe itself. The dynamic progress in the process of European integration and of German re-unification as well as the suddenly arising possibility to access the East European economies, has absorbed substantial amounts of capital and management capacities that otherwise might have been allocated to ventures in China. The moderate relative share of Germany, however, cannot hide the fact that the absolute volumes of German China-bound FDI flows have multiplied in recent years (table 2). The quantitative development of German investment in China follows the general trend of China’s market transformation and her opening to the world economy. The 1980s were characterized by a wait-and-see attitude reflecting the institutional deficiencies
in China’s FDI regulations\(^{32}\) and doubts about the commitment of China’s leadership to this mode of economic interaction. The watershed occurred only after there had been clear signals from the political realm that the party leadership was strongly committed to world market integration. With Deng Xiaoping’s travels to the southern provinces in spring 1992, and the subsequent Party Congress, internal Chinese resistance to a further intensification of the policy of opening was broken and foreign investors were reassured of the existence of a secure political environment. Coupled with the lifting of the austerity policy, which had been practiced up to 1991, and the beginning economic upswing, the overall conditions for foreign direct investment in China appeared to be more favorable than ever before. Global and German FDI flows towards China picked up markedly.\(^{33}\) The institutional factors have since then continued to improve and facilitated FDI inflows that find more and more reasonable investment projects. China’s entry to the WTO expected for late 2001 will provide further stimulus.

In terms of the intensity of the division of labour the FDI boom in the 1990s has come close to a quantum leap in the bilateral relations between most European economies and China. As FDI represent the simultaneous transfer of capital, capital goods, and human capital they embody a much broader range of exchange than ordinary goods trade. It is not only (fabricated) goods that are exchanged, but factor endowments, i.e. production capacities. New factor combinations and an improved exploitation of comparative advantages become possible, inducing a reconfiguration of relative

\(^{32}\) The evolution of China’s legislation on foreign invested enterprises has been a comparatively slow process, which for long periods of time left wide areas unregulated and open for negotiation. For a detailed account see Taube, Markus (1997): Ökonomische Integration zwischen Hongkong und der Provinz Guangdong, VR China. Der chinesische Transformationsprozess als Triebkraft grenzüberschreitender Arbeitsteilung, ifo Studien zur Entwicklungsforschung, Bd. 31, München-Köln-London, p. 442-449. On a bilateral level, however, an agreement covering the reciprocal protection of capital investments became effective in 1983, while an agreement dealing with the issue of double taxation (and its prevention) was concluded in 1985.

\(^{33}\) It should be noted that this upswing of FDI inflows to China coincides with a general increase in FDI flows to developing countries. Average annual flows directed towards developing countries in 1990-1993 were double those of 1987-1989. See Lardy, Nicholas R. (1995): The Role of Foreign Trade and Investment in China’s Economic Transformation, in: The China Quarterly, Vol. 144, pp. 1064-1082, here p. 1066.
prices, a redirection of trade flows – and mostly increasing trade volumes as well\(^{34}\), and eventually an acceleration of structural change.

Data on the sectoral distribution of German FDI in China are provided by the Deutsche Bundesbank and show a strong bias towards manufacturing, which commanded about 85% (90%) of the German FDI-stock in China at the end of 1998 (1995) (see table 3).\(^{35}\) The sectoral structure presented, however, is somewhat biased towards capital-intensive industries\(^{36}\), as only those companies have to report their FDI transactions to the Deutsche Bundesbank that hold at least 20% of capital shares or voting power in the venture concerned. As a second prerequisite the venture abroad must feature a balance sheet of at least 1 million DM. Table 3, therefore, represents only 483 enterprises in China having German capital interests.\(^{37}\) In 1998, these enterprises employed 93,000 people and had an annual turnover of 14.4 billion DM.\(^{38}\)

But despite the existing problems, with respect to the statistical representation of German and Chinese sources, it seems justified to claim that German FDI is more strongly directed towards manufacturing than the total of China-bound FDI on average. In 1998, only 56.3% of total FDI inflows were directed towards manufacturing.\(^{39}\)


\(^{35}\) The data of the Deutsche Bundesbank differ from those of Chinese sources, as not all German FDI transactions are required to be registered with the Bundesbank and the German statistical representation is based on stock values covering liquidations, return-transfers and other changes. In comparison the Chinese data are based on net-flows.


Table 3: Sectoral distribution of German FDI-stock in China as of 1995 and 1998

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mio. DM</td>
<td>%</td>
</tr>
<tr>
<td>All sectors</td>
<td>1,587</td>
<td>100.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1,431</td>
<td>90.2</td>
</tr>
<tr>
<td># chemicals and chemical products</td>
<td>380</td>
<td>23.9</td>
</tr>
<tr>
<td># machinery and equipment</td>
<td>172</td>
<td>10.8</td>
</tr>
<tr>
<td># machinery and apparatus for electricity generation and distribution</td>
<td>92</td>
<td>5.8</td>
</tr>
<tr>
<td># motor vehicles, trailers and semi-trailers</td>
<td>564</td>
<td>35.5</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods</td>
<td>47</td>
<td>3.0</td>
</tr>
<tr>
<td>Monetary intermediation</td>
<td>62</td>
<td>3.9</td>
</tr>
</tbody>
</table>


With respect to its regional distribution in China, German FDI is concentrated on the one hand in Beijing, which, with its role as political and administrative capital of China, attracts numerous representative offices with primarily liaison and lobby functions. Market considerations, on the other hand, have turned Shanghai and its neighboring regions as well as the South Chinese growth centers into the most attractive destinations for German FDI.

(III) Commercial lending to China

During the period of central planning, China categorically rejected borrowing from abroad for ideological reasons. At the beginning of the reform period, beginning in 1978, China had virtually no foreign debt and was free of the economic-policy restrictions resulting from such debt. From a macroeconomic point of view, great leeway existed for the use of foreign capital and to enter a “growth cum debt”

40 Hu, Yongliang, Zhongguo hongguan jingji guanli xue [China's macroeconomic administration],