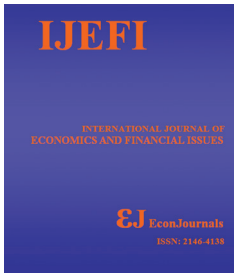

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Foreign Direct Investments and Gross Domestic Product Development in USA, European Union and China (1995-2014)

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ABSTRACT

European Union (EU) and China established diplomatic relations in 1975, and now became mutually indispensable economic partners, presenting both an opportunity and challenge. During that time, after the first market reforms which were introduced in 1978, China has transitioned from a predominantly agricultural to industrial and service-oriented economy. On 11 December 2001, China also became the 143rd member of the World Trade Organization. The aim of this research is to quantitatively compare the US, EU and Chinese gross domestic product from 1995 to 2014, the US and Chinese outward Foreign direct investments (FDI) from 1995 to 2013, and analyse the impact of the exponentially rising Chinese investments in the EU. We have found that while the US economy experienced a regression in general, and exhibited outward FDI exponential decrease in particular, the Chinese outward FDI sustained an exponential growth. There is also possible to expect continue of exponentially rising economic investment of China in the EU. The Chinese investment in the EU is estimated to peak during the next decade, when China will become by far the foremost economic partner of the EU.

Keywords: China, European Union, United States Gross Domestic Product, Foreign Direct Investment
JEL Classifications: F5, F4, O51, O52, O53

1. INTRODUCTION

During the past 70 years, the United States (US) has economic, political and military dominance over Europe. This dominance commenced with the post World War II US Marshall Plan which was one of the first elements of European integration that erased trade barriers and set up the Western European national and international institutions. This dominance continued with the post Cold War integration of the former Eastern Europe into the European Union (EU), created through the Maastricht Treaty. At that time, the end of the Cold War also concluded the bipolar world super-power competition between the United States and Soviet Union and marked the commencement of a new multilateral economic cooperation and globalization. This environment of globally changing economic relations and fresh market opportunities, combined with the well established technological, scientific and economic foundations of the EU provided China, after it emerged from a rural agricultural economy to industrial and service-oriented economy, with the needed platform to become the new economic power.

Despite being an emerging market, China's influence on the global economy and financial markets is continuously rising. In the last decade, it has contributed more than 30% to global economic growth. China's massive accumulation of foreign currency reserves has brought new opportunities, especially in the aftermath of the sovereign debt crisis in the EU, where the Chinese market became a positive contributor to economic growth. Primarily, China has become a welcomed EU investor, and secondarily, it has positioned the EU as an economic counterbalance to the US (McDonnell, 2014). With many EU major companies on the brink of shutdown, China provided the growth market for European exports.

The European Commission considers the EU - China economic relations as a pillar to the EU security in the post Cold War and Globalization era, when the definition of security, historically associated with military threats, has been replaced with that of an economic stability. The EU economic stability is directly affected by China's steady and environmentally sustainable economic growth (Casarini, 2006). Thus, the EU now defines its security as 'the long-term ability to protect its relative welfare position by ensuring access to resources and production capability, securing market outlets and maintaining macroeconomic stability' (Commission of the European Communities, 1993). Therefore, China's global economic integration became of a strategic importance to the EU.

The Sino-EU economic relations have been built on the basis of mutual interests, by promoting non-discriminatory, multilateral commercial practices (Kim, 2011). The main driver of cooperation between the EU and China are prospects of mutual economic benefit, interdependence and economic complementarity. Whilst the EU provided China with capital and technology, China became a source of cheap labor and low priced goods to the EU. This division of labor was at the basis of a solid and fast developing economic and trade relationship. Bilateral trade in goods has gone from €4 billion in 1978 to €395 billion in 2010. Three decades ago, China and the EU traded almost nothing. Now they form the second-largest economic cooperation in the world. In a relatively short time, the Chinese and EU economies have become highly interdependent. Currently, China is the world's largest economy and the EU second largest trading partner. The EU has been China's top trading partner for 10 years (O'Hara, 2010, Geeraerts, 2013, Beijing, 2014). However, bilateral trade in services only amounts to 1/10 of total trade in goods, and the EU exports of services only amount to 20% of EU exports of goods. As a result, the EU has a large trade deficit with China. Investment flows also show vast untapped potential, especially when taking into account the sizes of both the EU and Chinese economies. This inequality may be reduced in the near future, as China is currently broadening its market access to the service sector and further opening up the manufacturing sector to foreign investment. Also, China is promoting its infrastructure investment and construction along the "New Silk Road Economic Belt" and the "21st Century Maritime Silk Road" (KPMG, 2015). The EU-China trade has increased dramatically in recent years, and shall remain stable for years to come (O'Hara, 2010).

The purpose of our research was to quantitatively analyse the following economic indicators.

1.1. The US, EU and Chinese Gross Domestic Product (GDP) from 1995 to 2014

GDP is considered the broadest indicator of economic output and growth and represents the market value of all goods and services produced by the relevant economy during the period measured, including personal consumption, government purchases, private inventories, paid-in construction costs and the foreign trade balance. Generally, 2.5-3.5% annual growth in real GDP is the desirable range for a well-functioning economy. During the last decade, Chinese GDP has been rising 7-13% quarterly. If this trend continues, or even if the Chinese GDP growth slows down from the highest average of 13% to the lowest average of 7%, we believe that the Chinese GDP is going to be the largest in the world, outgrowing both the EU-28 and US in the foreseeable future, which in turn will drive up the Chinese foreign investments, impacting both regional and global economies in general, and the EU economic growth in particular.

1.2. The US and Chinese Outward Foreign Direct Investments (FDI) from 1995 to 2013

FDI is a key driver of global economic growth, and indeed of globalization. FDI is an important source of development financing, and contributes to productivity gains by providing new investment, better technology, management expertise and export markets. There has been increasing reliance on the market forces and private sector as the engine of economic growth. In the neoclassical growth model, FDI promotes economic growth by increasing the volume of investment and its efficiency (Sahoo, 2006). Over the past three decades, the flow of FDI worldwide has generally outpaced growth in global GDP and in exports. FDI outflows open access to foreign markets and promote deeper integration into global supply and value chains, making an economy's firms more efficient and competitive. Considering the economic benefits and importance of FDI for promoting economic growth, the EU continues to formulate changes in national policies to attract more FDI, especially as means of recovery from the global recession. Recently, China has become a major source of OFDI. Although both the US and EU OFDI is much greater than that of China, the US and EU OFDI have exhibited great vacillations in the past, while the Chinese OFDI has been growing steadily over time. If this trend continues for the next decade, China may soon hold the largest share of OFDI in the world.

2. DATA AND METHODS

2.1. Data

The data on The US, EU and Chinese GDP from 1995 to 2014 and on The US and Chinese outward FDI from 1995 to 2013 were obtained from the United Nations Conference on Trade and Development (UNCTAD). UNCTAD annual data reports, as of 31 December each year. The obtained data are summarized and employed the customary regression analysis for the US, EU and Chinese GDP from 1995 to 2014 (Figure 1 and Tables 1-3 respectively). The US and Chinese outward FDI from 2014 to 2013 (Figure 2).

The US, EU and Chinese GDP from 2015 to 2014 comparisons among the groups for each variable were done using analysis of variance - ANOVA (Table 2), and the Fisher's Exact Test (Table 3).

2.2. ANOVA

Source of variation:

Total:

$$SStotal = \sum_{i=1}^{k} \sum_{j=1}^{n_i} \left(X_{ij} - \bar{X} \right)^2 \quad (1)$$

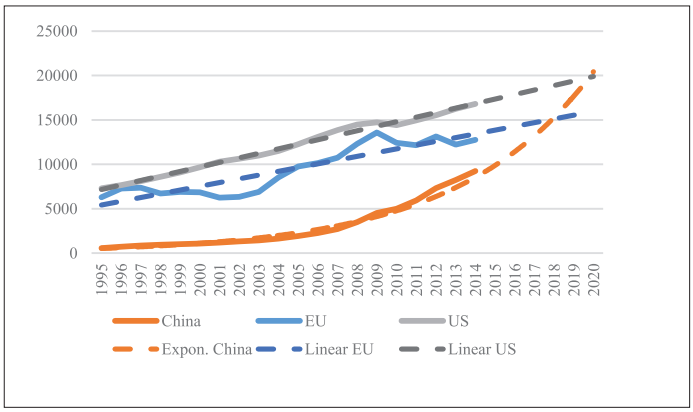
Where the volume of freedom is $N-1$

Between:

$$SSb = \sum_{i=1}^{k} n_i (\bar{X}_i - \bar{X})^2 \quad (2)$$

Where the volume of freedom is $k-1$ and variance is equal to:

Figure 1: The gross domestic product of China, European Union-28 and US (in billions USD, 1995-2020)



Source: Authors, UNCTAD, 2015

$$S_B^2 = \frac{SS_b}{k-1} \quad (3)$$

And F statistics can be expressed in following formula:

$$F = \frac{S_B^2}{S_W^2} \quad (4)$$

Within:

$$SSw = \sum_{i=1}^{k} \sum_{j=1}^{n_t} \left(X_{ij} - \bar{X}_i \right)^2 \quad (5)$$

Where the volume of freedoms is $N-k$ and variance is equal to:

$$S_w^2 = \frac{SS_w}{N-k} \quad (6)$$

2.3. Linear Regression

$$Y' = b_{yx}X + a_{yx} \quad (7)$$

Where:

Table 1: Descriptive statistical analysis for the GDP of China, EU-28 and US (1995-2014)

GDP in billion USD (1995-2014)	China	EU	USA
Minimum	559	6253.08	7308.7
Maximum	9240.27	13581,63	16800
Range	8681.27	7328.55	9491.3
Count	20	20	20
Sum	61,426.27	188,663.2	240,229.1
Mean	3071	9433.2	12010
Median	1785	9146.8	11890
SD	2710	2741.2	3026
Variance	7,345,000	7,514,400	9,156,000
Mid range	4899.635	9917.355	12,054.35
Quartiles	Q1>1050	Q1>6877.27	Q1>9377.4
	Q2>1785	Q2>9146.755	Q2>11,894.6
	Q3>4755	Q3>12,266.115	Q3>14,600.3
IQR	3705	5388.845	5222.9
Sum of squares	139,600,000	142,770,000	174,000,000
Mean absolute deviation	2222	2490.3	2627
RMS	4051	9804.2	12,370
SEM	606	612.96	676.6
Skewness	1.046	0.18308	-0.03965
Kurtosis	2.682	1.2893	1.598
Coefficient of variation	0.8824	0.2906	0.2519
Relative SD (%)	88.24	29.06	25.19
99% CI	1510≤×≤4632	7854≤×≤11,012	10,267≤×≤13,753
95% CI	1883≤×≤4259	8232≤×≤10,635	10,684≤×≤13,336
90% CI	2074≤×≤4068	8425≤×≤10,441	10,897≤×≤13,123

Source: Authors, UNCTAD, 2015. RMS: Root mean square, SD: Standard deviation, IQR: Interquartile range, CI: Confidence interval, GDP: Gross domestic product, SEM: Standard error of mean, EU: European Union

Table 2: ANOVA for the GDP of EU, China and US (1995-2014)

Source of variation	SS	df	MS	F value	P value
Between	846,821,387.20	2	423,410,693.60	52.893	0
Within (error)	456,284,115.36	57	8,004,984.48		
Total	1,303,105,502.56	59			

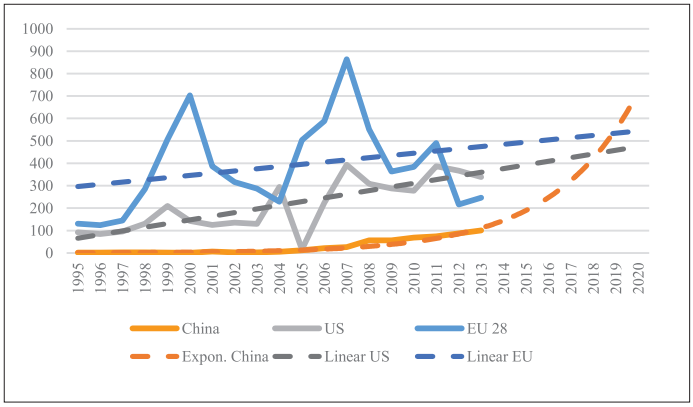
Source: Authors, UNCTAD, 2015. MS: Means of squares, GDP: Gross domestic product, SS: Sums of squares, EU: European Union

Table 3: The Fisher's exact test for the GDP of EU, China and US (1995-2014)

Variable	Value
P (F=52.893)	<0.0001
Critical value (α=0.05)	3.16
P (F≤52.893)	1
P (F≥52.893)	<0.0001

Ho is rejected. Source: Authors, UNCTAD, 2015. EU: European Union

Figure 2: The outward Foreign direct investments of China, US and European Union-28 (1995-2020 in millions of USD)



Source: Authors, UNCTAD, 2015

$$b_{yx} = r_{xy}\frac{\sigma_y}{\sigma_x} = \frac{N\sum XY - (\sum X \sum Y)}{N\sum X^2 - (\sum X)^2} \quad (8)$$

$$a_{yx} = \bar{Y} - b_{yx}\bar{X} \quad (9)$$

2.4. Exponential Regression

There is no linear parameter for exponential function. The type of exponential function can be following:

$$\eta = \beta_0 \beta_1^{f_1^{(x)}} \beta_2^{f_2^{(x)}} \ldots . \beta_p^{f_p^{(x)}} \quad (10)$$

Where if $f_1^x = x$

Then $\eta = \beta_0 \beta_1^x$

Regards the function there is no possible to use ordinary least square method to estimate the parameters of the function. But the equation can be adjusted to the linear form.

2.5. Coefficient of Determination

Coefficient of determination is used to find the most appropriate function for given time series.

$$R^2 = \frac{SSR}{SST} = \frac{\sum(\hat{y_i} - \bar{y})^2}{\sum(y_i - \bar{y})^2} \quad (11)$$

SSR = Sum of squared residuals

SST = Total sum of squares

3. RESULTS

3.1. The US, EU and Chinese GDP from 1995 to 2020

There has been calculated linear function for US and EU absolute GDP development and exponential function for Chinese GDP. The forecast of future development is based on the US, EU and Chinese GDP data for years 1995-2014.

There have been found linear function for EU and US GDP development and exponential for Chinese GDP. The estimated future values are based on the following functions.

US GDP linear function: Y=6666.9+509X

Where coefficient of determination is: R^2=0.9904 (12)

EU GDP linear function: Y=5007.2+421.52X

Where coefficient of determination is: R^2=0.8276 (13)

Chineese GDP exponential function: $Y=465.84e^{0.1454x}$

Where coefficient of determination is: R^2=0.9795 (14)

According to the Figure 1 the forecasted development of China GDP will be overcome the EU GDP in absolute values in 2018 and the US in 2020 ceteris paribus. And the descriptive analysis of observed values is summarized in the Table 1.

Using UNCTAD in Figure 1 and Table 1, our experimental sample consisted of twenty sets of data (N = 20) for each variable, the GDP of China, EU-28 and US, respectively, from 1995 to 2014. The Mean for China GDP was 3071 billions of USD, but the Median was 1785 bill. USD. This Mean is almost 1.7 times larger than the Median, because of the unusually steep rise in the GDP of China. The Mean for EU GDP was 9433 billions of USD, and the Median was 9147 billions of USD. The Mean for US GDP was 12010 billions of USD, and the Median was 12054 billionns USD. The Standard Deviation is the determination of the data spread out from the mean, and for China GDP was 2710, for the EU GDP 2741, and for the US GDP 3026.

The ANOVA analysis is summarized in the Table 2 and shows significant differences in observed data during the given period. The Significance has been proved by using Fischer's exact test in Table 3 to test the hypothesis about the statistical significance of differences between means of data.

The Fisher's exact test in Table 3 shows the F ratio, which is the ratio of two mean square values. Our F-ratio is not close to one, and the null hypothesis (H0) is rejected. Furthermore, the P ≤ α: The differences between the means are statistically significant. The P-value is less than the significance level, the group means are not equal, and the null hypothesis (H0) is rejected.

3.2. The US and Chinese outward FDI 1995-2020

Data represented by the Figure 2 shows the development of outward FDI for EU, USA and China in current prices in millions

of USD during the period 1995-2013 and there were estimated functions for all observed values for prediction until 2020.

There have been found linear function for EU and US outward FDI development and exponential for Chinese OFDI. The estimated future values are based on the following functions.

US GDP linear function: Y=49.053+16.35X

Where coefficient of determination is: R^2=0.6235 (15)

EU GDP linear function: Y=286.12+9.94X

Where coefficient of determination is: R^2=0.0771 (16)

Chinese GDP exponential function: $Y=0.7054e^{0.2663x}$

Where coefficient of determination is: R^2=0.8665 (17)

According to the Figure 2 and predicted values can be expected increasing Chinese FDI in the other countries. The total amount of Chinese FDI is supposed to overcome the US FDI in 2018 and the EU in 2019, ceteris paribus. The value of coefficient of determination for EU linear function is weak. There is obvious big fluctuation in amount of out warding FDI for EU, resp. USA.

4. DISCUSSION AND CONCLUSION

Our Research has analysed the following Economic Indicators.

4.1. The US, EU and Chinese GDP from 1995 to 2014

China's GDP consists of three broad sectors; the primary industry (agriculture), secondary industry (construction and manufacturing) and tertiary industry (the service sector). Primary industry accounted for 10% of GDP, while secondary industry accounted for 44% and tertiary industry 46% in 2013 (UNCTAD, 2015). Our quantitative analysis of the GDP for China, EU and US between 1995 and 2014 showed an overall upward trend for all three economies. Chinese GDP showed the most dramatic growth, followed by the US and EU GDP. China's economy, after experiencing double-digit growth for decades, is beginning to mature now. Since 2008, the average quarterly GDP growth remains at over 8% (WorldBank, 2013). Our research analysis suggests that the Chinese GDP may outgrow the EU GDP around the year of 2019, and the US GDP around the year of 2021. There has been proven relationship between GDP structure an economic development (Tomšík et al., 2015).

4.2. The US and Chinese outward FDI from 1995 to 2013

Historically, China has been one of the major recipients of FDI, and, until recently, only a minor contributor to global investment flows (UNCTAD, 2015). Inward FDI was a critical aspect of China's post 1978 growth reforms, but few Chinese firms went abroad during the 1980's to 1990's (Hanemann and Rosen, 2012). The introductory formal policy reference to the Go-Global strategy occurred in the Chinese Communist Party Central Committee (CCPCC) Opinion on the Formulation of the 10th National Economic and Social Development Five Year Plan adopted on 11 December 2000. This was the first formal call for the implementation of the Go-Global Policy. As a result, the concept was subsequently included in the 10th Five Year Plan. After its inclusion in the 11th Five Year Plan, the policy became a part of the annual economic development plans passed by the National People's Congress (Freeman, 2008).

By the 2005, Chinese demand sent global commodity import prices soaring and state-owned enterprises ventured abroad to buy stakes in extractive projects to increase supply security and profits. This push for natural resource investments boosted Chinese total outward FDI from less than USD $1 billion in 2000 to more than USD $20 billion in 2006, and more than USD $50 billion in 2008. A clear surge in Chinese OFDI was seen from 2008 onwards, when the targets were innovation technology firms of the EU. A sizable part of Chinese OFDI was made in the form of cross border M&A. During the global financial crisis, Chinese companies accelerated their purchase of distressed foreign assets globally. This is reflected by the peak in 2008 (Figure 2). Our quantitative analysis of the OFDI for China between 1995 and 2013 showed a steady rise, while the US OFDI reflected a downward trend. The first veritable upswing in the Chinese OFDI flows occurred after 2003. We have determined that the Chinese OFDI may overcome the US OFDI around the year of 2018. The OFDI exponential forecast for China, the US and EU, between 1995 and 2013, showed increase for all three. Considerable rise has been noted for China, outpacing both the US and EU.

4.3. Impact on the EU Economy

FDI: Chinese FDI present in the EU has risen dramatically since 2009. FDI increased the welfare of both producers and consumers (UNCTAD, 2015). FDI allowed for prices that are more advantageous for those looking to divest assets, due to a bigger and more competitive pool of bidders. For consumers, foreign investment increased choices, lowered prices and introduced innovation. We estimate that through 2020 Chinese firms will put to work $1-2 trillion in FDI, the EU could get more than $250 billion, or $20-30 billion annually. This investment yields the same benefits as FDI from other countries: Fresh capital, jobs, taxes and innovation spill overs. Chinese firms already employ more than 100 000 people and these figures are expected to further increase (Hanemann and Rosen, 2012, Zhang et al., 2013; Zhang, 2014).

New capital: Due to the global economic recession, OFDI from traditional investors has fallen off severely, but Chinese OFDI grew rapidly. We have projected $1-2 trillion in global OFDI from China over 2015-2020, based on an extrapolation of historical outbound investment growth for other nations, China's current position, and its expected GDP performance. If Europe maintains an average intake of global FDI flows around 25%, then it may gain a cumulative $250-500 billion in new Chinese M&A and greenfield investment between now and 2020. We expect these figures to rise further, given the mutually beneficial complementarity between China's needs and EU workforce. Even if either the Chinese global average in OFDI becomes lower and the EU fails to attract new global flows, our estimate still remains at least at about $20-30 billions.

Employment: By injecting capital into the EU economy via new or existing greenfield projects, Chinese investment generated employment, promoted understanding through a diversified workforce and collaboration between different cultures. There is a link between GDP and employment growth.

Consumer welfare: Chinese firms have delivered European consumer welfare in the form of lower prices, product diversity and selection, and faster innovation cycles. These gains extended beyond traditional goods to product segments that require more active presence in consumer markets, and especially to services. Further removal of cross-border obstacles would reduce trade costs, provide better access to foreign markets and assure fair economic competition and balance, both for China and the EU (Anagnostou et al. 2013).

Shareholder value: Greater investment interest from China increased competition for assets, and thus raised prices for EU sellers. While more efficient pricing is always desirable, this is especially important as Europe has been undergoing its broad debt restructuring.

When Chinese and European trade relations have begun in 1975, trade volume between China and the EU reached $2.4 billion. In 2014, the European Commission data recorded more than $615 billion worth of goods traded between the EU and China equivalent to $1.68 billion every day. This marked a 9.9% year-on-year increase. Chinese investment provided the EU with more opportunities to engage China on bilateral and multilateral levels, besides only helping to build Chinese political and economic influence in the EU and allowing the diversification of Chinese currency holdings, which, until recent times, were USD dominated (Zhang, 2011). When the EU opened its door to Chinese investment, it also encouraged China to keep its door open to EU investment.

China accounts for <5% of European investments abroad, whereas FDI from China represents <3% of the total FDI inflows into the EU, despite the fact that total value of trade flows of goods and services between the EU and China now exceeding about €1 billion every day (UNCTAD, 2015). Yet, Chinese investments have provided the EU with more opportunities to engage China on a bilateral and multilateral level, and both the EU and China hope that with a comprehensive Bilateral Investment Treaty (BIT), together with the domestic economic reforms in China, and the EU efforts to overcome the financial crisis, may alleviate the clear discrepancy between the levels of trade and investment and will give a new impetus to the existent mutually beneficial cooperation. This new BIT should improve the legal certainty for investors in the host country, expand the existing standards of protection of investment, reduce barriers for investors when investing in the host country, and increase the flow of FDI.

4.4. The EU Identity in the Context of the Sino-EU Relationship and Economic Policy

Identity became a subject of study of foreign policies and international relations from the 1990s. China's rise and mounting influence will not only affect EU future objectives and positions in the global distribution of forces, but may also constitute a challenge to Europe's very identity (Geeraerts, 2013). The fragmented EU nations, especially those with weak economies, instead of unifying their national policies to the established EU standards, have been competing between each other in attracting the greatest share of Chinese investments for their own national economic benefit, and sometime, even their individual local communities enrichment, therefore giving China another bargaining advantage over the EU, in regards to its choice of investments. If the EU nations remain unable to normalize its institutional policies to the Chinese flow of investments, the EU nations will continue losing its future negotiating power *viz*. China (Erixon and Messerlin, 2009). Only an EU with a well-functioning economy, political stability, and clear vision for the future will be able to attract foreign investors that contribute to the EU long-term prosperity.

5. CONCLUSION

The EU and China have now become mutually indispensable partners whose relations are based on mutual commercial interests. Our analysis supports the view that Chinese investments in the EU will continue to rise. This surge represents both opportunities and challenges for the EU. The combination of the US commenced global recession, the massive accumulation of currency reserves, and the sovereign debt crisis in the EU has been projecting China as a potential rescuer. At the same time, this massive Chinese investment is modifying EU institutional processes, integration and identity as well as transatlantic relations and global power redistribution. To make this transition process advantageous and prosperous, the EU needs to abandon its economic strife between own national members and develop a well-established and legally predictable policies with integrated and stable economy. This would not only diminish the EU unfounded but existing fears of strong Chinese economy swallowing the fragmented EU national industries, but would also attract other foreign investors and contribute to the EU long-term prosperity. Still, a complete analysis of the impact of the Exponentially Rising Economic Growth of China in the EU is difficult to decisively establish because of the novelty of this phenomenon, and the fact that its full potential is still waiting to be fully realized during the next decade, when China becomes by far the foremost single economic partner of the EU. What transpires today, however, is the changing dynamic of the Sino - EU - US relations, in the aftermath of the US originated global recession and the weakened US dollar, the EU sovereign debt crisis, and the exponentially growing economic prosperity and rising global influence of China. These global forces now continue to transform the EU transatlantic relations.

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