

China's Capital Flight: Pre- and Post-Crisis Experiences*

Yin-Wong Cheung
City University of Hong Kong

Sven Steinkamp
Osnabrueck University

Frank Westermann
Osnabrueck University &
CESifo

Draft: August, 2015 – Please do not circulate

Abstract: We study China's illicit capital flow and document a change in its pattern. Specifically, we observe that China's capital flight, especially the one that is measured by trade mis-invoicing, exhibits a weakened response in the post-2007 period to the covered interest disparity, which is a theoretical determinant of capital flight. Further analyses indicate that the post-2007 behavior is influenced by quantitative easing and other factors including exchange rate variability, capital control policy and trade frictions. Our study affirms that China's capital flight pattern and its determinants are affected by the crisis event. Further, both the canonical and additional explanatory variables have different effects on different measures of capital flight. These results highlight the challenges of managing China's capital flight, which requires information on the period and the type of capital flight that the policy authorities would like to target.

JEL Classification: F3, F32, G15.

Keywords: World Bank Residual Method, Trade Mis-Invoicing, Quantitative Easing, Capital Controls, Covered Interest Disparity

* We thank Joshua Aizenman, Bertrand Candelon, Steve Cecchetti, Valentina Corradi, Pierre-Olivier Gourinchas, Katharina Panopoulou, Eli Remolona, Matthew Yiu, and participants of the 2015 CityU-DNB-JIMF Conference on "The New Normal in the Post-Crisis Era," and the 3rd Workshop on "New Financial Reality." Also, we are grateful to Kenneth Chow, MingMing Li, XingWang Qian, and Fengming Qin for providing some of the data used in our exercise.

Corresponding addresses

Yin-Wong Cheung - Hung Hing Ying Chair Professor of International Economics, City University of Hong Kong, Kowloon Tong, Hong Kong, E-mail: yicheung@cityu.edu.hk.

Sven Steinkamp, Institute of Empirical Economic Research, Osnabrück University, D-49069 Osnabrück, Germany, E-mail: sven.steinkamp@uni-osnabrueck.de.

Frank Westermann, Institute of Empirical Economic Research, Osnabrück University, D-49069 Osnabrück, Germany; E-mail: frank.westermann@uni-osnabrueck.de.