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The Economic Impact of FDI in the Case of China

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Abstract: Since the reform and opening, Foreign Direct Investment (FDI) is crucial to China's economic development and has greatly improved China's economy. China has also made great achievements in the field of import and export trade. However, foreign direct investment has also brought some negative effects. Therefore, this paper will comprehensively analyze the economic impact of FDI in China. This paper will directly support our views through data and charts, and deeply research the trends and characteristics of FDI. This paper also discusses the determining factors of foreign direct investment through case analysis. This paper deeply analyzed the positive and negative effects of FDI. Through our research, it found and gave some effective suggestions and methods for the negative effects.

Keywords: Foreign Direct Investment (FDI), foreign trade impact, export import

1. Introduction

The phenomena of gaining foreign direct investment in the case of China has become much more popular.

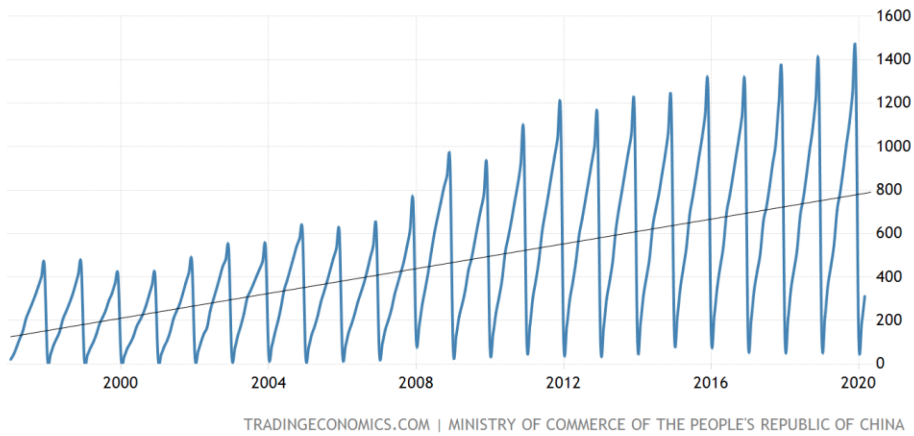

Figure 1: China FDI inflows, 2000-2020. Trading Economics. (2023) China Foreign Direct Investment.

Figure 1 shows that since China's reform and opening up in the 1970s, foreign direct investment in China has shown a substantial increase. During the reform period, it can be seen that the proportion of FDI inflow in China's GDP has been increasing gradually since 2000, which rose more rapidly in 2008 and reached a new peak in 2020. It can be clearly seen that China's foreign investment is increasing constantly, and China is the second largest foreign direct investment country. In addition to the United States, many would choose China, which also accounts for about 27 percent of investment flows to developing countries.

Table 1: China: Sources of FDI, 2021.

Characteristic	FDI inflow in billion U.S. dollars
Hong Kong	131.76
Singapore	10.33
Virgin Islands	5.28
Korea	4.04
Japan	3.91
United States	2.47

China：Sources of FDI，2021

Table1 shows the main investment countries of FDi flowing into China in 2019. Firstly, it is obvious that it comes from mainland China (about 69.66 percent), followed by Singapore (about 5.45%). However, there is a big gap between the number of investment in Mainland China, which ranks first, and that in Singapore, which ranks second. Then there is south Korea (about 4 percent) and Singapore with similar amounts of investment.

The figure 2 shows that the distribution of foreign direct investment is actually more concentrated in the manufacturing industry (accounting for about 25.6%). The enterprises with the least FDI investment are those related to construction (accounting for 0.8%). Real estate is also relatively popular with foreign enterprises, accounting for approximately 16.9% [1]. However, it can also be seen that China's low labor costs have contributed a lot to foreign enterprises. For example, foreign enterprises' labor costs can be very low because China has a strong labor force that allows them to pay low wages, and foreign enterprises can also earn more benefits.

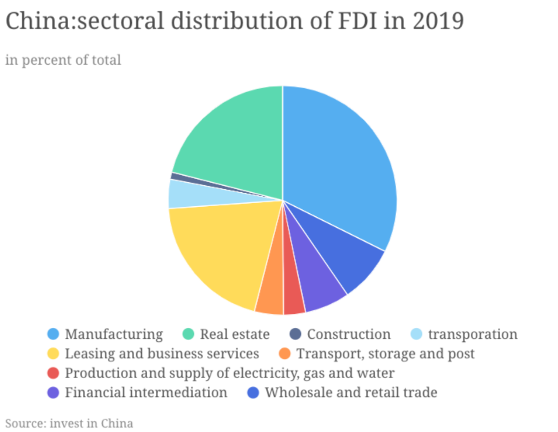

Figure 2: China: sectoral distribution of FDI. Santander Trade Portal (2023) China: Foreign Investment.

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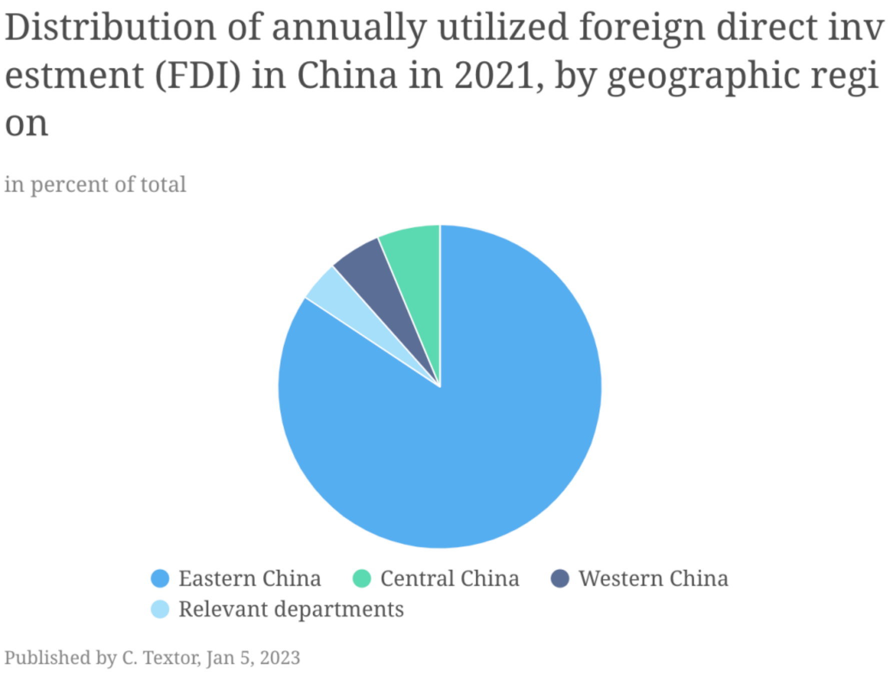

Figure 3: Distribution of annually utilized foreign direct investment (FDI) in China in 2021, by geographic region. Statista (2022).

The figure 3 shows that FDI is basically concentrated in the eastern region of China, as the inflow of FDI from the Middle East accounts for almost 86% of the total FDI. Far surpasses the other two regions [2]. The central region even accounts for only 10.5%, and even worse, the western region of China only accounts for about 4% of total FDI [1]. There are different reasons for this huge gap, but dating back to the early 1970s, because most of the economically developed regions were built in the Middle East, foreign direct investment quickly flowed into the economically developed regions [3], while the remaining two regions had very few FDI inflows. This situation is actually not optimistic.

2. Several Factors Affecting China's FDI

There are several factors that affect China's FDI. The first is the structure of China's economy. For example, China's cheap labor force is very attractive to foreign investment. Secondly, there are loose policies, such as incentives for foreign enterprises to invest or reducing the requirements for them to enter China to do business (generally, the requirements for foreign enterprises to enter China far exceed the requirements for domestic enterprises). Another point is the setting of cultural environment and policies [1].

Reduced barriers and preferential policy refer to preferential treatment for foreign investors and the establishment of economic cooperation, tax incentives for foreign-invested enterprises are mainly to reduce corporate income tax rates and tax exemptions (box 3), these preferences are efficient for most companies, and the companies of the Economic Cooperation Organization also have a relatively high autonomy in operation and management. As well as some less control over the movement of goods, even free import and export. Some high-tech foreign companies can use land and labor more freely. This means tax exemptions for some profits, additional incentives, and a greater reduction in land use fees.

More importantly, foreign companies like to invest in China because relatively loose laws allow them to do things that cannot be done in other countries. For example, when people encounter conflicts, they generally solve them themselves rather than ask the government for help, so many

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foreign companies also take advantage of the situation and try to obtain more benefits from local people.

3. Negative and Positive Impacts

It is said that Foreign Direct Investment is a drive for economic globalization, particularly in today's interdependent and interconnected world. Hence, it is crucial to realize how specifically FDI can contribute to the economic activities within the host country.

Foreign direct investment is often associated with positive economic benefits. Indeed, many empirical studies and models have indicated that FDI is positively correlated with economic growth. For instance, in Zhang (2006)'s research, in the case of China, FDI promoting capital and output creation and higher employment and increased tax revenue is identified as one vital impact [4]. FDI has created many new jobs and promote the economy of China. Because investors have created new companies and created opportunities for people. Investors' money makes up for the lack of funds of enterprises, which can lead to the growth of employment [5]. Generally, there are two main ways for foreign direct investment to enter the country. The first is mergers and acquisitions. Two or more independent enterprises merge into one enterprise and enter the country through this way. The other is to build a new enterprise in this country. Investors will build a new enterprise in other countries, which will lead to a large number of employments in the short term. FDI has played a great role in promoting employment in China. In 2021, China will establish 61000 new foreign-invested enterprises, an increase of 23.3 percent year-on-year, 25 percent more than 2019. With the increase of jobs and wages, people's income will increase, which highly promotes the domestic economy. Through this way, government can also gain an increased tax revenue. Through this way, government can also gain an increased tax revenue. As evidenced by, By the end of 2004, FIEs were responsible for 23 million Chinese jobs, or 10% of manufacturing jobs in total. With a growth in FDI, FIE tax contributions increased, and their proportion to total tax collections in China increased from 4% in 1992 to 21% in 2004 [6].

Apart from that, China's exports, valued at $18 billion and comprising nearly half of manufactured items, were at a lower ranking worldwide in 1980; nevertheless, by 2005, they were ranked third. 93% of $762 billion. Nearly all the $444 billion in exports made by FIEs in 2005 were manufactured items, accounting for about 60% of China's overall exports [6].

Furthermore, it encourages the export of manufactured goods. From a negligible figure in the 1980s, the proportion of foreign direct investment to total domestic investment kept increasing to approximately 20% in 1996. FIEs' percentage of overall industrial output increased from 7% in 1992 to 36% in 2004 [6].

Most importantly, FDI brings scientific and technological progress. To be more specific, it allows the transfer of resources and mutual communication, as well as the exchange of technology and knowledge, so that all countries can acquire new technology and skills [5]. In addition, the technology and equipment provided by foreign direct investors can effectively improve national productivity. This will make a great contribution to the country's long-term economic growth. The technology of FDI can realize the technological progress of other enterprises. When enterprises absorb the technology of FDI, it is to improve their own innovation ability and technology, which will benefit the whole economic system [7].

The quantity of China's foreign trade has grown very rapidly. As figure 4 shown, in 1978, the quantity of import and export in China was only 20.5 billion dollars. However, in 1990, China's import and export quantity reached 115.44 billion dollars. In 1998, there was a negative growth in the total import and export volume due to the shrinkage of imports, but there was a strong rebound in 1999, and the quantity of import and export volume reached 360.65 billion dollars, an increase of 11.3%. After that, with the growth of foreign trade, quantity of China's total import and export continued to increase. Until 2003, China's total imports and exports reached more than 800 billion dollars which more than forty times that of 1978. The increase rate of China's total import and export has reached 15%. The total import and export trade has significantly improved China's position in world trade, and the growth of foreign trade has strongly promoted China's economic growth [8].

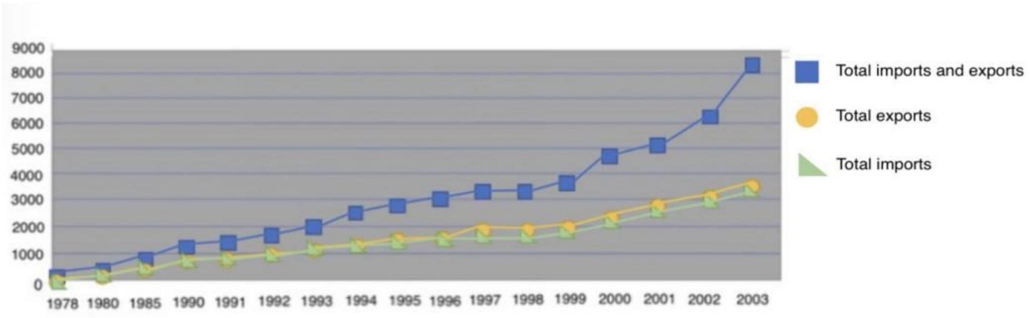

Figure 4: China's import and export data chart.

4. Limitations and Suggestions

Today's China's enormous potential in the world economy has also attracted a large number of foreign enterprises. For example, in 2011, China's foreign direct investment increased by around 7%, ranking among the top ten in the world. At the end of 2011, the total amount reached approximately \$7119 [9].

However, although many people have mentioned that foreign direct investment has made a great contribution to China's economic development, some limitations are slowly showing up. According to Zhang, some behaviors in China that encourage foreign companies to inflow funds may lead to some negative impacts, and the intrusion of multinational enterprises may bring a lot of pressure to domestic enterprises [4].

Therefore, in the years of reform and opening up, it should not neglect issues in China's use of FDI. First and foremost, the role of FDI in improving China's core technology level is limited [10]. At present, according to the industry imported from China, most of the products are stuck at a relatively low level, basically labor-intensive, low-tech content and processing. So, most of the imported technologies are second-rate technologies, and there may be a small probability that foreign companies will provide some high technologies, but in fact, they do not provide the real key technologies to China. The implementation of the four elements, some foreign capital into China, is to transfer the industry that has lost its comparative advantage in their own country to China, resulting in China not only losing the market but also in exchange for advanced technology, being unable to compete with foreign companies, so it will endanger China's industrial security and economic development.

Secondly, some FDI projects will cause ecological pollution. Because most of the FDI projects are pollution-intensive industries, they will cause great pollution to China's soul crystals [10]. At the beginning of China's reform and opening up, some multinational companies took advantage of their loose understanding of environmental pollution, regarded China as a "pollution refuge", and transferred their already polluting industries to China, bringing serious pollution to China's ecological environment and bringing many obstacles to sustainable economic development. As a country with a large population, China's own environment is not optimistic, and foreign investors use this method to transfer a large number of serious polluting industries to China, which will inevitably aggravate China's environmental pollution situation and increase the difficulty of environmental pollution control.

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Another point is that the proportion of FDI in the central and western regions is too low. At present, the inflow of FDI into China is mainly concentrated in the Middle East [10]. As can be seen from the previous chart, FDI is mainly concentrated in the eastern part of China, which is the economically developed region, while few people in the central and western regions care about it. Most of the new foreign capital has also flowed into the Middle East, so the regional structure of foreign direct investment is very unbalanced.

Turning to some possible suggestions, with regard to science and technology, China should strive to attract FDI that can provide China's scientific and technological level. That is to make fundamental adjustments to the way FDI is introduced. The government should also encourage foreign enterprises to purchase domestic enterprises, and give some policy support, so that the advanced operation and management mode can be widely used in China. It is also necessary to change the traditional saying that "more foreign capital introduction is a good deal". It is necessary to set up some policies to make rational use of them. New enterprises developed by using FDI should also increase the innovation ability of local enterprises and improve human resources. For the environment, the government should set some policies to stop the abuse and destruction of China's natural resources. For example, set a threshold. When foreign investors want to enter China, they will check their pollution level, and they will be rejected after passing the standard.

Furthermore, increase the "pollution tax", that is, when the pollution emissions of foreign enterprises exceed the limit, they will be required to pay to prevent them from randomly discharging a large amount of sewage and causing environmental pollution.

Lastly, the central and western regions should develop characteristic industries to attract FDI by taking advantage of resources. The central and western regions are rich in natural resources and cheap labor, so this paper should correctly guide industrial development. The government should take some measures to support the central and western regions and expand the industries in need. Because the resource-based industries loyal to the west need to speed up the industrial upgrading, otherwise it will affect the economic development, so only by giving full play to the advantages of resources and hot industries can better attract FDI.

5. Conclusion

Through data analysis and research, this paper concludes how foreign direct investment affects China's economic development. For example, after the reform and opening up, more foreign capital poured into China to invest, including the regional distribution of FDI and the chart analysis of the enterprises to which FDI flows, as well as the advantages and disadvantages of FDI for China. For example, FDI has created employment opportunities for more Chinese people, and China's technological development and rapid development of trade. Finally, this paper have come to the conclusion that FDI has obviously played a significant role in the surge of China's economy. Unfortunately, China has not mastered how to use FDI in the best interests. There are always some misunderstandings here. For example, the entry of MNC or FDI will bring great pollution to China's environment. However, some companies set up in China did not grant the essential technical skills to China, which also blocked the development of China's science and technology at one level. So, for these problems, this article also finds suggestions one by one. For example, for environmental pollution, the government can set up "pollution tax" to prevent foreign enterprises from discharging toxic chemicals at will. This study analyzes in more detail the close relationship between FDI and China's economic development, introduces more comprehensively what is FDI, the distribution of FDI in all aspects of China, the advantages and disadvantages of FDI, as well as China's deficiencies and suggestions in controlling FDI On the other hand, this study is very helpful for those who are learning more about FDI and its importance in the economic field. Then, the inadequacy of this study

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is that there is more information, so it is more difficult to analyze the structure of this article. In the future, the main structure of this article will be clearly displayed and obvious.

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