

# Analysis on the Development Process and Economic Impact of China's Foreign Direct Investment

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## Abstract

Since the founding of the new China, especially since the reform and opening up, the development of China's foreign direct investment has opportunities but also faces challenges. Based on previous studies, this paper summarizes and analyzes China's foreign direct investment into six stages: blank, exploration, start, adjustment, rapid development and comprehensive development, and analyzes its economic impact. In the phased development process of China's foreign direct investment, it is also affected by multiple factors at home and abroad, showing the characteristics of wave evolution and periodic fluctuation. At the same time, China's foreign direct investment has a positive economic impact on itself, the host country and even the world from the micro level to the macro level. In the future, China's foreign direct investment should move towards a higher quality and level with the joint efforts of the government, enterprises, the market and society.

## Keywords

foreign direct investment, development stage, economic impact, China

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## 1. Introduction

Global transportation and communication technologies are continuously optimized and upgraded, and the degree of convenience is continuously improved. At the same time, economic globalization is becoming an irresistible trend of the times. As the largest developing country in the world, China actively complies with the tide of economic globalization, always adheres to the concept of a community with a shared future for mankind, proposes the concept of jointly building the "belt and road", promotes the implementation of the "going out" strategy[1], and further promotes its own development while driving the development of surrounding regions. In recent years, China's economic strength has steadily improved, its scientific and technological innovation ability has been significantly enhanced, and the quality of economic development has continuously improved. In this context, China's foreign direct investment is flourishing, ranking among the top three in the world for 13 consecutive years [2].

Gao and other scholars (2019) analyzed and studied the five stages of China's foreign direct investment from a policy perspective: difficult exploration, trying development, adjustment development, rapid development and comprehensive development[3]. Yang and Ke (2019) researched China's foreign direct investment from five periods: blank period, exploration period, starting period, development period and deepening period[4]. Based on the above research, this paper makes a further analysis of China's foreign direct

investment, which mainly makes up for the lack of data analysis of China's foreign direct investment in recent years.

Through the research on China's foreign direct investment, this paper analyzes the current situation and existing problems of China's foreign direct investment, which has practical guiding significance for Chinese enterprises' foreign direct investment, and provides direction guidance for the formulation of China's foreign direct investment policy. This paper also provides a reference for other developing countries, which is conducive to exploring their own development path of foreign direct investment, and also contributes Chinese wisdom to global economic governance.

This paper focuses on the six stages of China's foreign direct investment blank, exploration, start, adjustment, rapid development and comprehensive development and the specific characteristics of each stage, and analyzes its economic impact in all aspects on this basis.

## **2. Analysis on the Development Process and Economic Impact of China's Foreign Direct Investment**

### **2.1 Blank Stage: 1949-1978**

At the beginning of the founding of the People's Republic of China, all aspects of China were still in a state of waste waiting for prosperity. Internationally, the United States and other Western countries have implemented economic blockade policies against China. The completion of the first Five-Year Plan marks that China has begun to change its backward industry, but its production capacity is still at a low level and foreign exchange is scarce[4]. Before the reform and opening up in 1978, China implemented a highly centralized planned economic system and public ownership of the means of production. All these indicate that China lacks the economic conditions for foreign direct investment at this stage, but this stage has laid the foundation for the development of China's foreign direct investment.

In terms of diplomacy, in the early 1960s, the Sino Soviet relations deteriorated, the European economy recovered, China's legal seat in the United Nations was restored in 1971, and Sino-US relations improved. China's international status improved. There were two climaxes of establishing diplomatic relations with China. At the same time, China's economy is gradually on track to establish an independent and relatively complete industrial system and national economic system. In this case, the conditions for China's foreign direct investment were improved, the demand for foreign direct investment was increased, and many overseas branches of foreign trade companies were set up in international metropolises such as Paris and London[4].

### **2.2 Exploration Stage: 1979-1984**

During this period, China's economy accelerated development, and China's economic strength and comprehensive national strength reached a new level, providing an economic basis for foreign direct investment. In 1978, the Third Plenary Session of the Eleventh Central Committee put forward the historic decision of reform and opening up, and China has the basic policy conditions for foreign direct investment. In 1979, the State Council explicitly proposed to allow enterprises to set up abroad. Since then, Chinese enterprises can participate in international activities with foreign direct investment[3].

At this stage, although the economy developed to a large extent, foreign direct investment is still limited by it, and the scale is small; The main investors are state-owned enterprises; The scope of investment is also very limited, mainly for surrounding countries and regions; In terms of management, the central government implements a highly centralized unified management[5]. Initial stage: 1985-1992

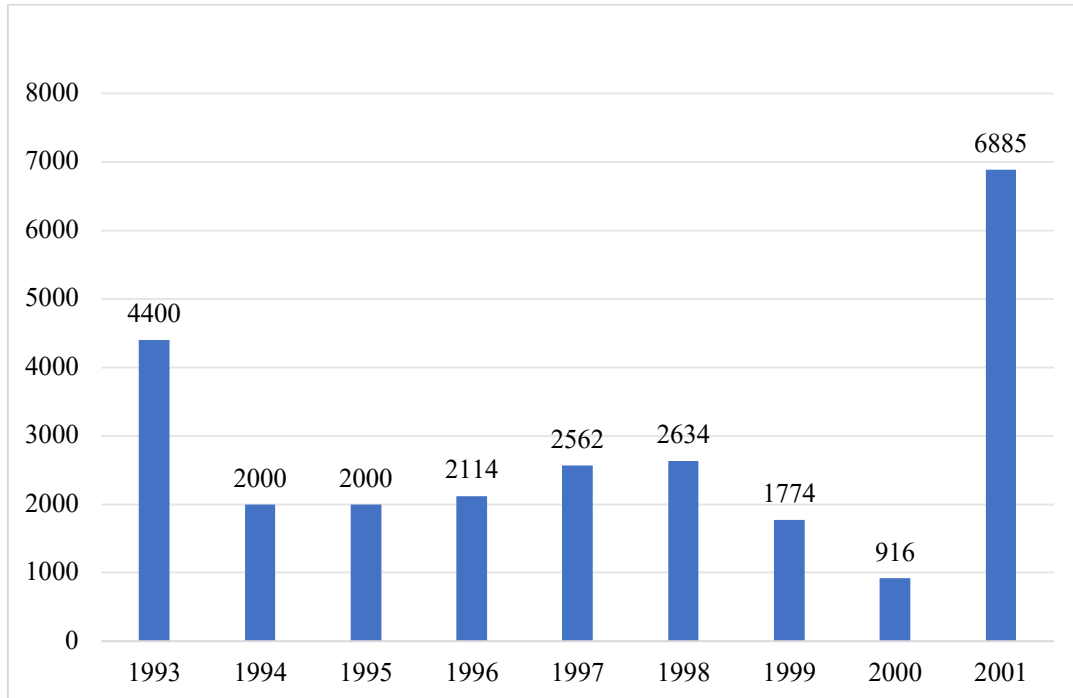
With the development of China's economy, the government's restrictions on foreign direct investment are gradually relaxed. From 1985 to 1992, China witnessed its first peak of foreign direct investment[5].

During this period, the characteristics of foreign direct investment were that the scale of investment was still small and mainly relying on foreign trade, and the number of participating enterprises was small and mainly concentrated in Beijing, Shanghai and Guangzhou; The main body of foreign investment expanded within the scope of state-owned enterprises; The investment industry gradually changed from foreign economic and trade enterprises to multi industry enterprises; The investment industry is further expanded on

the previous basis; While the establishment of corresponding supporting policies takes regulation and management as the main function[3]; The coverage of investment areas was also further expanded.

### 2.3 Adjustment Stage: 1993-2001

Figure 1: 1993-2001 China's OFDI (unit: US \$million)



Data source: from UNCTAD data

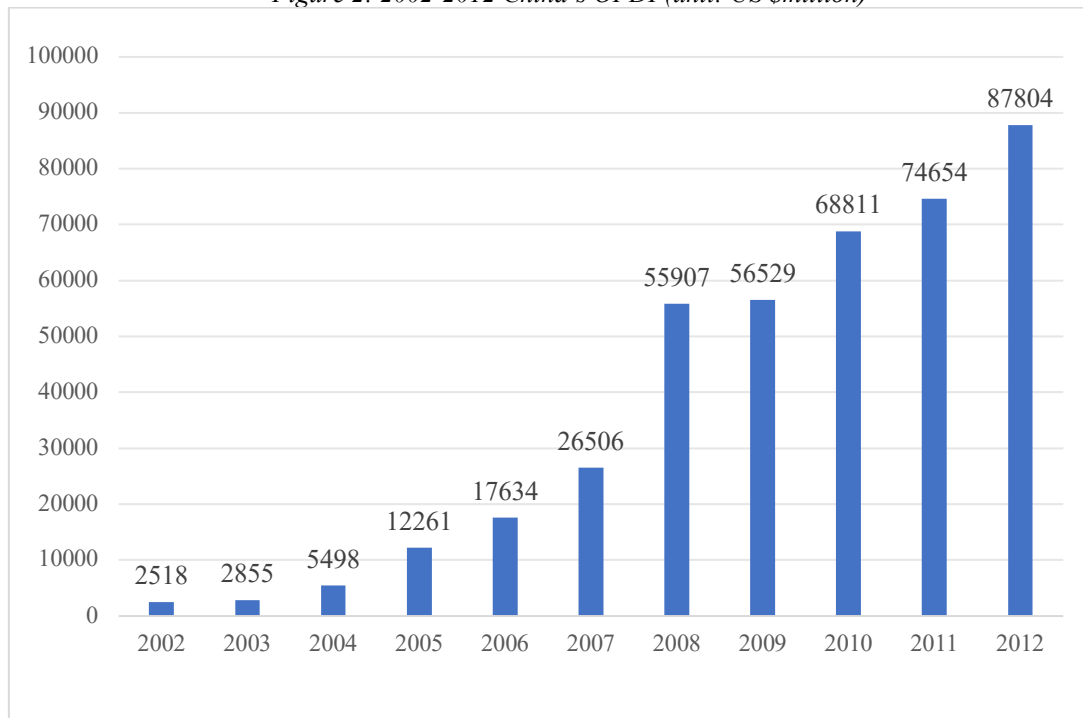
At this stage, China's foreign direct investment showed a tortuous development trend, and the development of foreign direct investment at this stage was obviously affected by the policy. In 1992, Deng Xiaoping issued a speech in the south, which had a far-reaching impact on accelerating the reform and opening up. In the same year, the 14th National Congress of the Communist Party of China proposed to build a socialist market economic system.

From Figure 1, it can be seen that there was a large fluctuation in 1994 compared with 1993, from 4400 million dollars to 2000 million dollars. Since 1993, China's domestic and international environment has changed, and foreign direct investment has been greatly affected. Internationally, Western developed countries imposed a new round of economic sanctions on China[3]. In China, the "overheating economy" triggered inflation, and the government adopted policies to reduce and control the scale of investment and credit to curb inflation[3]. In addition, some state-owned enterprises' blind investment led to losses and capital flight[3]. Therefore, at this stage, the government strengthened the control of foreign direct investment and began to comprehensively clean up and rectify overseas investment enterprises[3].

In 1997, the 15th CPC National Congress clearly put forward the "going out" strategy. Compared with 2000, there was a big fluctuation in 2001, rising from 916million US dollars to 6,885 million US dollars, showing a rapid growth. In 2001, China joined the World Trade Organization and participated in the process of economic globalization at a deeper level.

## 2.4 Rapid Development Stage: 2002-2012

Figure 2: 2002-2012 China's OFDI (unit: US \$million)

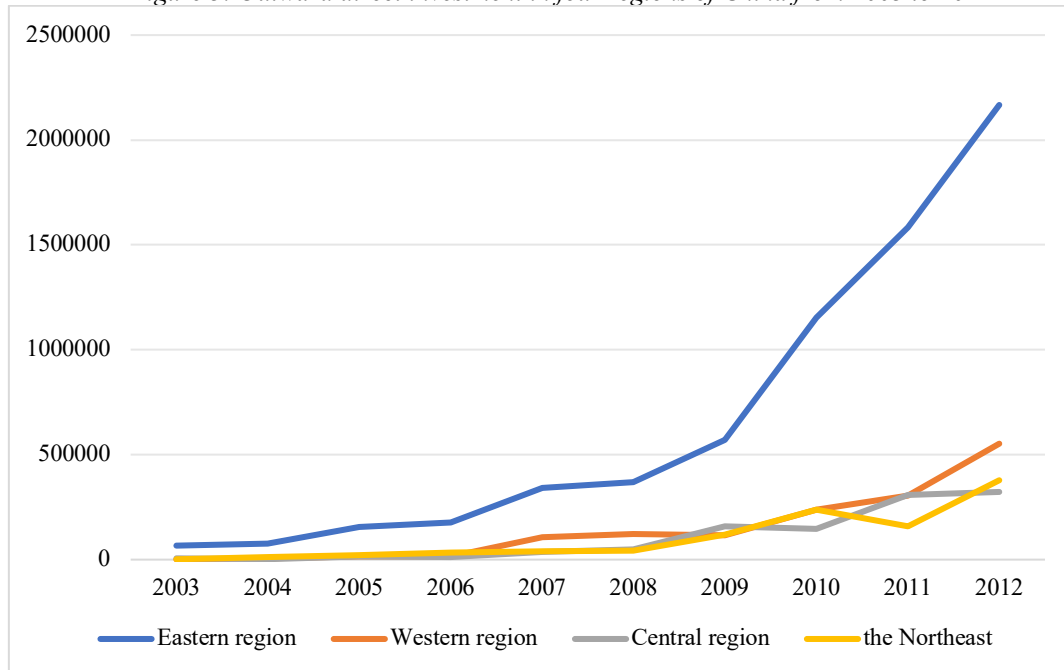


Data source: from UNCTAD data

At this stage, China's outward direct investment generally maintained a growth trend, but with 2008 as the boundary, it grew rapidly in the early stage and slowed down in the late stage.

As can be seen from Figure 2, China's foreign direct investment gradually increased from US \$2518million in 2002 to US \$87804million in 2012, an increase of more than 30 times. In 2002, the 16th National People's Congress put forward the strategy of adhering to the combination of bringing in and going out to comprehensively improve the level of opening-up, and issued and implemented a series of policies and regulations conducive to the development of foreign direct investment from 2003 to 2012, providing a convenient policy environment for the development of foreign direct investment. At the same time, the reform of RMB exchange rate and the gradual relaxation of foreign exchange control provided the monetary base and policy convenience for foreign direct investment [4]. At this stage, in addition to domestic support, the overall improvement of the global economy also provided a good external environment for the development of China's foreign direct investment.

The international financial crisis in 2008 brought both challenges and opportunities to China's foreign direct investment. China's successful response to the global financial crisis doubled its foreign direct investment in 2008 over the same period last year[4]. After the international financial crisis in 2008, it had a huge impact on the world economy, coupled with the short-term adjustment of China's foreign direct investment strategy, since then, the growth rate of China's foreign direct investment slowed down.

*Figure 3: Outward direct investment in four regions of China from 2003 to 2012*

Data source: CNRDS database

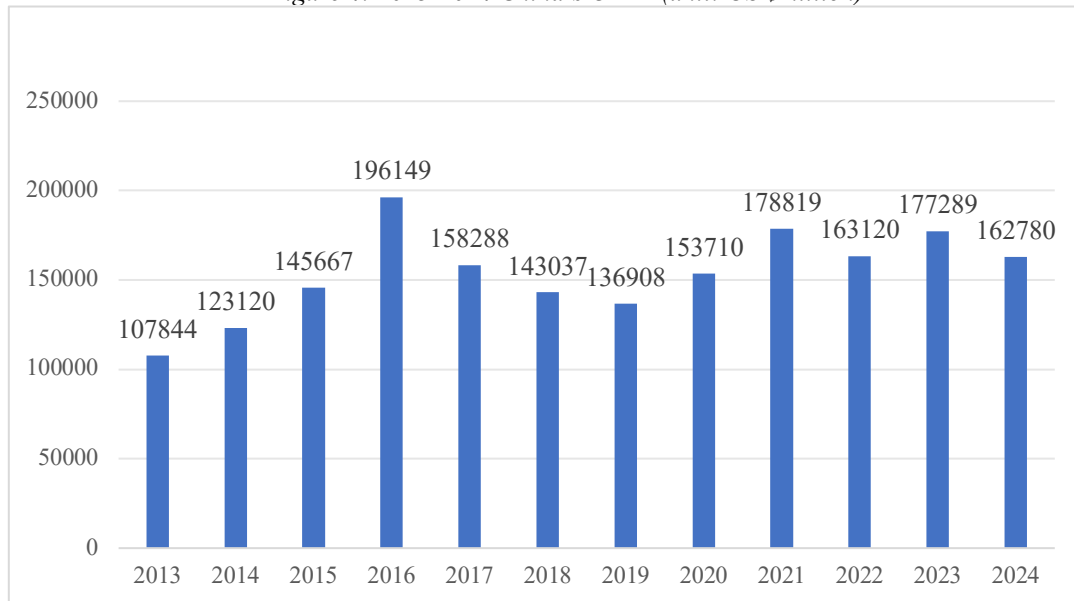
This paper mainly divides China into four regions, the eastern region mainly includes Beijing, Tianjin, Hebei, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong and Hainan, the central region includes Shanxi, Henan, Hubei, Hunan, Anhui and Jiangxi, the western region includes inner Mongolia, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang, Tibet, Sichuan, Chongqing, Guizhou, Yunnan and Guangxi, and the northeast region includes Liaoning, Jilin and Heilongjiang.

As can be seen from Figure 3, the outward direct investment of the four regions shows an upward trend. China's outward direct investment is mainly concentrated in the eastern region, and the gap between the eastern region and other regions is gradually widening.

China's foreign direct investment in this period fully showed the characteristics of Chinese characteristics, and all aspects showed the characteristics of diversification. First of all, in terms of the main body of investment ownership, non-state-owned enterprises play an important role, and private enterprises are widely involved; Secondly, in terms of investment motivation, market, efficiency and resource seeking motivation coexist; In terms of investment location, it is widely distributed with Asia as the focus; In terms of investment mode, cross-border MandA gradually became the main investment mode; Finally, in terms of investment industry, the manufacturing industry is the first, showing diversified development [3].

## 2.5 Comprehensive Development Stage: 2013 to Present

Figure 4: 2013-2024 China's OFDI (unit: US \$million)



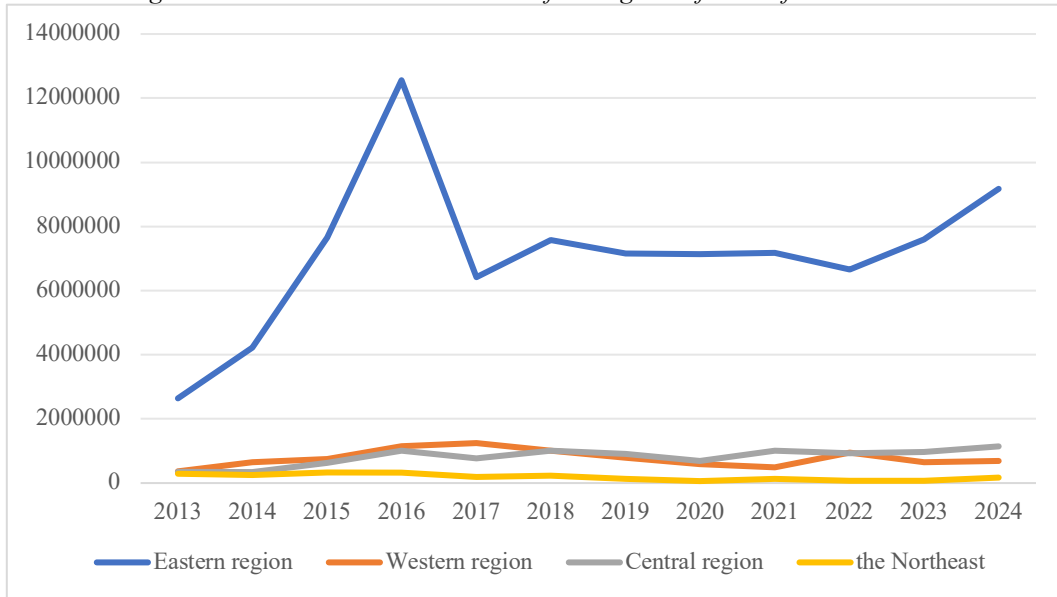
Data source: from UNCTAD data

As shown in Figure 4, at this stage, the overall development of foreign direct investment shows an upward trend, but there are fluctuations in this stage. Since the 18th CPC National Congress, foreign direct investment has entered a stage of all-around development. In 2013, the “Belt and Road” initiative expanded the development path of foreign direct investment.

The fluctuation of China's foreign direct investment during this period was caused by a variety of reasons. From 2013 to 2016, with the rapid development of China's foreign direct investment, there were also hidden risks. As the growing non-real economy's foreign direct investment is accompanied by greater financial risks, the government issued relevant policies and regulations to regulate and restrict it in 2017 [3]. At the same time, trade frictions between China and the United States occurred in 2018, resulting in a downward trend in China's foreign direct investment from 2016 to 2019.

Similarly, the growth from 2019 to 2021 is the result of the comprehensive effect of many reasons. Affected by the new crown epidemic in 2020, after the epidemic, there was a “retaliatory growth” in foreign direct investment, and China's policy support for economic recovery after the epidemic. Secondly, the government's policy support and guidance for foreign direct investment and China's continuous optimization and adjustment of the industrial structure are effectively promoting the high-quality development of foreign direct investment.

However, the development of China's foreign direct investment after 2021 is not ideal, which can be analyzed from both domestic and international aspects. From the perspective of China itself, on the one hand, the downward pressure on China's economy has increased. On the other hand, China's foreign direct investment has been adjusted reasonably, and the pursuit of quantity has gradually changed to the pursuit of quality. Internationally, the global economy has been weak in recent years; Regional conflicts continue and global instability increases, etc. These factors have a direct or indirect impact on the development of China's foreign direct investment.

*Figure 5: outward direct investment in four regions of China from 2013 to 2024*

Data source: CNRDS database

As can be seen from Figure 5, the development trend of foreign direct investment in various regions is basically synchronized with that of China as a whole. The outward direct investment of the four regions increased, but the gap between the eastern region and the other regions further widened.

In the comprehensive development stage of China's foreign direct investment, the role of non-state-owned enterprises is further highlighted; The investment area is more widely distributed, and the "belt and road" is playing a key role at this stage; The scale of China's foreign direct investment is huge and has a far-reaching impact on the world; At the same time of scale expansion, quality improvement; The impact of international factors on China's foreign direct investment deserves attention.

### 3. The Economic Impact of China's Foreign Direct Investment

This paper mainly analyzes the economic impact of China's foreign direct investment from the macro, meso and micro levels.

#### 3.1 Macro Level

China's foreign direct investment undoubtedly promotes the economic growth of the host country, solves the local employment problem, and improves its infrastructure construction. More importantly, it is conducive to the sustainable and long-term development of the host country. China's foreign direct investment in the host country promotes its demand and attraction for foreign capital through economies of scale and technology spillover effects [6].

From the perspective of China itself, the most basic is that OFDI has a technology reverse spillover effect [7], that is to say, OFDI promotes China's technological progress. Foreign direct investment is also conducive to improving China's resource mismatch. Through the participation of foreign direct investment in the international division of labor and the global allocation of resources, we can improve the efficiency of resource allocation and the mismatch of resources, which will further promote China's supply-side structural reform, resolve overcapacity and transform the mode of economic development [8]. Foreign direct investment promotes China's green innovation process [9] and plays an important role in achieving sustainable development.

For the whole world, China's foreign direct investment injects vitality into the recovery of the world economy. Since the international financial crisis in 2008, the world economy has been weak, and the sustained growth of China's economy has become an important driving force for world economic growth. China's foreign direct investment is making important contributions to promoting international economic cooperation, promoting the process of economic globalization and improving the imbalance of global development.

### 3.2 Meso Level

China's foreign direct investment is not only conducive to China's own but also to the host country's industrial restructuring, industrial transformation and upgrading, enhancing the trade potential of both sides [10], and plays an important role in promoting the development of the host country's financial industry [6].

### 3.3 Micro Level

From the perspective of enterprises, whether Chinese or host enterprises, China's foreign direct investment has a significant positive impact on the innovation vitality of enterprises and is sustainable [11]. Enterprises can effectively enhance their competitiveness by obtaining advanced technology and management experience through foreign direct investment in developed countries. In addition, foreign direct investment can also help enterprises develop markets, build a global brand image, reduce costs, improve profit margins, and so on.

## 4. Conclusion

This paper mainly analyzes the development background, stage characteristics and regional distribution of China's foreign direct investment from six stages: blank, exploration, start, adjustment, rapid development and comprehensive development. Since the founding of the People's Republic of China, especially since the reform and opening up, China's foreign direct investment (FDI) is booming, but it is also facing challenges. Especially in recent years, some domestic and foreign factors have made the development of China's FDI face severe challenges. This paper also analyzes the economic impact of China's foreign direct investment from the macro, meso and micro levels. China's foreign direct investment plays an important role in promoting the economic development of both sides, promoting the industrial transformation and upgrading of both sides, encouraging enterprise innovation and improving the imbalance of global regional economic development.

In the future, China's foreign direct investment should develop in the direction of higher quality and level, actively comply with the trend of digitalization of the world economy, actively invest in the digital economy, optimize the structure of foreign direct investment, and transform to technology-intensive and capital intensive industries. The state should increase its support for foreign direct investment and introduce relevant policies to further promote the development of foreign direct investment. Enterprises should respond to the call of the state, actively carry out foreign direct investment, learn advanced management experience and technology, so as to promote their own management system reform and technological innovation, and enhance their competitiveness in the world. Only through the joint efforts of the state and enterprises can we inject new impetus into China's foreign direct investment and promote the sustained and healthy development of China's foreign direct investment.

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