Saint Petersburg State University

Department of World Economy

**Foreign direct investment in China during Xi Jinping’s era**

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for the degree of

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Introduction

The global economic system is characterized by a high level of capital movement in its various forms. Over the past years, foreign direct investment has steadily been growing, therefore, attracting foreign capital has become a major trend in current international financial policy. Most countries are trying to establish the auspicious policy environment for attracting foreign direct investment.

The role of developing countries has been keeping enhancing, as emerging markets become more and more involved in international economic processes. Foreign direct investment, in this case, is one of the easiest and favored method for developing countries to improve its economic framework. Countries liberalize their investment regimes, modernize infrastructure, and attract foreign investors with global projects.

There is no doubt that today the People’s Republic of China is one of the fastest growing economies around the world and one of the most successful examples of economic development through attracting foreign investment. At the moment, foreign direct investment is one of the main tools for economic growth, development of country and improvement of living conditions in many countries, including China. The PRC is currently demonstrating how a growing economy can achieve high growth rates through sound economic reforms combined with FDI attracting policies.

The relevance of the research topic. Over the past decade the People’s Republic of China has attracted the record amount of foreign direct investment into its economy. China proved its status as one of the most stable economies in the world with huge prospects for foreign capital. Since Xi Jinping’s inauguration in 2013, China has been focusing on a modification of investment regime, therefore, there are some policy changes that needs to be analyzed more carefully. Despite the theoretical and practical significance of previous studies, the question remains open, as contradictions and different opinions about this topic continue to systematically arise.

The main goal of the research project is to investigate inward foreign direct investment in China since Xi Jinping’s inauguration in 2013, and to access changes in FDI inflows and its impact on China’s economy. Besides, it is necessary to identify factors of China’s attractiveness in terms of foreign investment and the impact of the liberalization of the FDI regime on its inflow into such sectors as automotive manufacturing and banking service.

The main goal of the research made it necessary to descry the following research objectives:

1. To determine the theoretical background of foreign investment;

2. To explore the determinants of foreign direct investment in China;

3. To consider FDI policy during Xi Jinping’s era;

4. To analyze the performance of foreign-invested companies in various sectors (automotive and banking industries) since 2013.

The research hypothesis is based on the assumption that China’s GDP has been growing fast during Xi Jinping’s era, with inward FDI also increasing exponentially. Presently, there is a switch from a manufacturing industry to a service sector. It can be supposed that the Chinese government does a lot in order to attract more foreign capital into service industries. Even though the available research today regarding Chinese inward foreign direct investment is quite extensive, it does not provide all the details of what can be the contributing factors to the success or failures of FDI’s impact on China’s economy, as in the last decade researchers’ attention has shifted to Chinese outward FDI. Therefore, it is still quite important to analyze inward foreign direct investment into the People’s Republic of China.

The degree of knowledge. Despite the popularity of the topic of China’s foreign direct investment, there are not many works devoted to the analysis of FDI during Xi Jinping’s era. In foreign studies, such researchers as K. H. Zhang, X. Liu, A. F. Aysan, etc., dealt with the topic of FDI. The specific features of FDI regard automotive manufacturing and bank services have not been widely considered, we can highlight such reserahcers as P. J. Buckley, L. Wang, and A. N. Berger. Among Russian scientists, the following researchers can be distinguished: L. V. Popova, V. Y. Portyakov, S. I. Nikulina and others.

In order to gain the research goal a combination of two research methods will be deployed. Firstly, through data collection from relevant databases that provide insights regarding China’s FDI inflows and the macroeconomic situation of the country. The data collection is aimed to explore the affection of foreign investment on the country. Furthermore, the usage of such general scientific methods as systematic, comparative and structural analyses, and economic and statistic methods of information processing will help to understand and analyse the different types of given statistical data (observations, reports, and documents). Additionally, it gives the opportunity to identify and study various trends that are important for the research.

The research material is the literature in English, Russian and Chinese languages on the research topic. Namely, articles on a given topic, news columns and statistical data related to foreign direct investment, and investment decrees and laws.

The research structure. The paper includes an introduction, three chapters with three parts in each, where the research objectives are sold, conclusion, and the list of references. In the first chapter, we consider the theoretical framework of foreign direct investment, namely FDI types and theories. Therewith, we review some scientific studies on the topic of foreign investment, especially works on Chinese FDI. In the second chapter, we focus on Xi Jinping’s FDI policy and its features. Specifically, we examine foreign investment trends, reasons why China is a preferential host country through reviewing state regulation, improvement of legal framework and various benefits of the Chinese investment policy. In the third chapter, we analyze the differences between foreign direct investment in manufacturing and service sectors. We explore the background and present situation of such industries as automotive manufacturing and banking service, by observing and investigating how changes in FDI environment, which are discussed in the second chapter, influence the development of these industries.

Chapter 1. Theoretical perspective on foreign direct investment

1.1. Theoretical concepts and main theories of FDI

Foreign direct investment (abbr. FDI), as defined by UNCTAD, “an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy (foreign affiliate)”[[1]](#footnote-1). As for OECD, it defines FDI as “a category of cross-border investment in which an investor resident in one economy (home country) establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy (host country)”[[2]](#footnote-2). The IMF suggests 10% of foreign ownership as a minimum standard of foreign direct investment, the less percentage is considered to be portfolio investment in the form of shareholdings[[3]](#footnote-3). In case of holding 10% or more of ownership, any capital transfer is dated as direct investment.

The first moment that needs an explanation is what foreign direct investment exactly is, and how it differs from indirect investment. Firstly, FDI includes intangible as well as tangible assets. Secondly, direct investment does not include a change of assets ownership. Thirdly, the main aim of FDI is to acquire control of management of affiliate abroad, rather than to acquire a profit of financial assets, which is the leading aim of indirect investment. Lastly, it should be also mentioned that direct investment is classified as “tangible and intangible assets in the balance sheet”[[4]](#footnote-4).

In the scientific literature foreign direct investment is considered as a factor that has a positive impact on the economic performance through the introduction of new technologies and foreign products between markets. Therefore, foreign direct investment transfers capital and financial funds, as well as technologies, management, quality control and other related knowledge.

Scientifically, there are different classifications of FDI types. Foreign direct investment takes two forms, depending on whether the transaction involves newly-created assets or just a transfer of existing ones. Firstly, greenfield investment means the establishment of a new facility in a host country by using FDI[[5]](#footnote-5). Greenfield investment takes the form of financial transfers, namely equity or loan financing, from a parent company to its subsidiary[[6]](#footnote-6). As advantages of greenfield investment we can indicate the following ones: an expansion of the capital stock, directly generating new economic activity and jobs[[7]](#footnote-7). Secondly, brownfield investment (cross-border merger or acquisition, M&A) describes a company that purchases or leases existing production facilities to launch a new production activity[[8]](#footnote-8). According to it, it is easier to enter foreign market swiftly. Nevertheless, there can be some problems because the facility may require major upgrades[[9]](#footnote-9).

As well, FDI can be divided into horizontal and vertical investment. Horizontal FDI means company’s investment into the same activities abroad – the business expands by opening foreign affiliates. As for the vertical FDI, a company invests into a foreign firm that supplies or sells products necessary for the main business activities – investment into the product chain. Vertical foreign direct investment also consists of two types, which are forward and backward vertical FDI, and it depends on the investor’s motives for going abroad. When it comes to forward investment, a firm invests abroad because of seeking for natural resources, whereas backward investment is terminated for acquisition of sale markets. Furthermore, some economists highlight two more types, conglomerate and platform FDI. In conglomerate investment a firm acquires an unrelated business abroad, and in platform investment a company expands abroad for exporting products to a third country[[10]](#footnote-10).

In order to understand foreign direct investment, first of all, it is necessary to understand the underlying motives that force firms to invest abroad. Over the past years there have been evolved various theories, explaining the concept of FDI. Foreign direct investment theories show the motives for the behavior of investors in the world market, and also make it possible to determine the FDI’s influence on the dynamics and process of economic development in various countries. Even though all theories have huge impact on describing foreign direct investment, V. Denisia (2010) assumes that, while all of these theories have made some contribution to the field, there is no single generally accepted theory of foreign direct investment[[11]](#footnote-11).

The theoretical foundations of FDI began to take shape in the late 50s – early 60s of the 20th century[[12]](#footnote-12). Economists assume that the theory of comparative advantage by D. Ricardo (1817) was the first attempt to describe foreign direct investment. However, V. Denisia (2010) notes that this particular theory cannot define FDI, because it explains the achievement of foreign investment in portfolio, but cannot be used in direct investment[[13]](#footnote-13).

There are four theories that are considered more common:

Figure 1.1. The Main Foreign Direct Investment Theories

Data Source: Denisia, V. (2010) 'Foreign Direct Investment: Overview of Main FDI Theories’, European Journal of Interdisciplinary Studies, no. 3, pp. 53-59.

URL: <https://ejist.ro/files/pdf/357.pdf>

Starting with the internalization theory, it was out-forwarded by P. J. Buckley and M. C. Casson in “The Future of the Multinational Enterprise” (1976). The theory explains the motivations of multinational enterprises in gaining foreign direct investment. According to the theory, large firms can expand their activities in the presence of a coherent internal structure, excluding competitors on their innovations. The authors reproached an overemphasis on the production function and neglect of other unique advantages that allow companies to become leaders and expand their operations to other markets and industries. Restrictions applied in a number of recipient countries are forcing companies to internationalize their activities. Export becomes less profitable than investment, especially if the selected markets are strategically important[[14]](#footnote-14). Internalization occurs, therefore, companies’ benefits are able to exceed the costs. Thus, internalization of the firm is seen as a process of increasing a company’s international involvement, and its activities occur incrementally and are influenced by increased market knowledge and commitment[[15]](#footnote-15).

Figure 1.2. Motives for internalization by Dunning

Data Source: Narula, R. (2015) ‘Internalization motives: sell more, buy better, upgrade and escape’, Multinational Business Review, 23 (1), pp. 25-35.

URL: <https://www.researchgate.net/publication/275154554_Internationalization_motives_sell_more_buy_better_upgrade_and_escape>

According to internalization theory, foreign direct investment is highly attracted to knowledge-intensive industries in the markets with weak intellectual property rights as internalization gives more benefits in such conditions[[16]](#footnote-16). The main benefits in the theory are defined as the large size of the market, and consequently the increasing size of the firm, as well as profitability. These indicators maximize shareholders value and, furthermore, affect wages. Thus, the decision to internalize leads to increased foreign direct investment[[17]](#footnote-17).

Production cycle theory, also known as the product life cycle theory, was formulated by R. Vernon (1966). The theory considers the dynamics of the interaction of international trade and foreign direct investment, a characteristic feature of which is a combination of the international economy with the theory of marketing, namely with the product life cycle curve[[18]](#footnote-18). According to the theory, an innovative product from advanced country can be seen as the new transferred technology to the less advanced nations, consequently comparative advantage shifts from one nation to another[[19]](#footnote-19).

Recently, the production cycle theory is more focused on production transfer through foreign direct investment, rather than through trade. It is believed that FDI is the main source for introducing technologies to South markets. The whole model is usually lined up according the North-South opposition, where North is the advanced countries with R&D capabilities and the needs to locate production, and South is the developing countries with low wages, large labor capability and necessity of new production.

Eclectic paradigm theory, also known as OLI theory, was developed by J. H. Dunning (1976) and explains all types in accordance with the advantages for a foreign investor. The volume of foreign assets of transnational corporations is determined by three objectives called O-L-I:

* “O” stands for ownership – it is a set of competitive advantages for a foreign investor. F. Denisia (2010) recognizes three types of these advantages: monopoly advantages (privileged access to natural resources and patents), technology knowledge (innovations), and economies of large size (greater access to financial capital)[[20]](#footnote-20).
* “L” stands for location – it is a set of local factors and markets, that also can be divided into three types: economic benefits (factors of production, cost of transportation, etc.), political advantages (policies that affect FDI flows), and social advantages (distance between countries, cultural diversity, etc.)
* “I” stands for internalization – it is the maximum possible degree of internalization of companies. This objective analyzes if there are more benefits in engaging into foreign production rather than selling rights by franchises.

Figure 1.3. Eclectic theory of FDI

Data Source: Dunning, J. H. (1980) ‘Toward an Eclectic Theory of International Production: Some Empirical Tests’, Journal of International Business Studies, 11 (1), pp. 9-31.

URL: <https://www.jstor.org/stable/154142>

It is necessary to highlight that OLI theory shows that parameters and advantages can differ because of high dependence on the political, cultural and economic context. Besides, the theory also presents the idea of a so-called “seeker”, a company or an individual that is seeking for investment and is driven by different motives. J. H. Dunning and S. M. Lundan (2008) highlight four types of “seekers”: natural resource seekers, market seekers, efficiency seekers, and strategic assets seekers[[21]](#footnote-21). However, one of the main criticisms of the eclectic paradigm notices that the theory includes too many variables and loses its operational practicality.

Some economists also identify other theories that can explain foreign direct investment. For instance, P. Fisher (2000) recognizes three more important theories[[22]](#footnote-22). Firstly, oligopolistic theory, authored by F. Knickerbocker (1973), is based on the hypothesis of the imperfection of the market structure. The decisions of one firm are influenced by the behavior of other firms. Therefore, the decision of the firm affects the behavior of its rivals[[23]](#footnote-23). The economist proposed that there are three motives why companies seek for investment to a host country and setting up its affiliate there: larger access to a foreign market, utilization of different factors, or matching rival’s moves. According to the theory, FDI can be considered as a company’s attempt to follow its competitor’s internalization[[24]](#footnote-24). Thus, the oligopolistic theory is hugely connected to the motivations of internalization theory.

Secondly, “Flying Geese” paradigm, proposed by K. Akamatsu (1930), can also explain foreign direct investment. The theory suggests the existence of a hierarchy with a dominant country acting as a center of growth followed by other developing economies. Therefore, it is frequently associated with product-life cycle theory, where companies strive to relocate its “mature” products to the less-developed countries[[25]](#footnote-25). The regional group as a whole industrial complexity gradually develops as each of the region’s economies benefits[[26]](#footnote-26). The scientist recognized three phases that explain the development process of economies – import, development of domestic industry, export. Thus, foreign direct investment transfer technologies and product cycles to host countries[[27]](#footnote-27).



Figure 1.4. Flying geese model

Data Source: GRIPS Development Forum

URL: <https://www.grips.ac.jp/forum/module/prsp/FGeese.htm>

Finally, yet importantly, M. Porter (1985) suggested the theory about foreign direct investment and the competitive advantage of nations. The author concluded that there are some factors, improving investment attractiveness: the ability to form an effective strategy and determine management benefits, the factors of production and the efficient use of it, the nature of demand and its growth rate (as well as the standard of living), and the presence of developed industries that allow profitable cooperation with local companies[[28]](#footnote-28). Furthermore, Porter’s diamond model also considered as the motivation of FDI.



Figure 1.5. Porter’s diamond model

Data Source: Yue, C. S., Lim, J. (2003) ‘Singapore: A Regional Hub in ICT’, Towards a Knowledge-based Economy: East Asia’s Changing Industrial Geography, pp. 259-298.

URL: <https://www.researchgate.net/figure/Government-Influences-in-Porters-Diamond-Model_fig4_237451841>

Economists agree that there is no unified theoretical explanation for foreign direct investment, its types, theories and motives. It is very unlikely that it will be possible to emerge one standard theoretical framework, explaining all the parameters that differ from company to company. Additionally, nowadays firms seek for new possibilities for FDI flows, so the conceptual basis is only going to expand.

While examining FDI theories, it is possible to find out various motives for foreign investment. However, it should be highlighted that there are lots of different FDI incentives, which make companies choose one or another host country. It is possible to divide these incentives in the following groups[[29]](#footnote-29):

1. Fiscal policies (e.g. various tax deduction and holidays, exemptions, reductions, etc.);
2. Financial support (e.g. grants, subsidies, loans, etc.);
3. Usage of free zones (special economic zones and export processing zones, which give additional benefits);
4. Other types of support (e.g. R&D support, derogation from state regulations, real estate, etc.).

It is well-known that FDI, in accordance with the comparative advantage principal, brings benefits to both countries. Furthermore, foreign direct investment has a huge potential for development as it comes with positive spillovers, namely it affects countries by increasing the availability of factors of production. L. Alfaro and J. Chauvin (2017) state that on the macro level, FDI develops economic sectors, introduces technological innovations and diversify exports. As for micro level, foreign direct investment increases technology transfer, enriches labor skills, and raises investment incentives[[30]](#footnote-30). Therefore, we can highlight the main positive spillover effects of foreign direct investment. FDI generates employment, raises productivity, transfers skills and innovations. It helps developing countries to get a direct access to advanced technologies and provide learning opportunities[[31]](#footnote-31). Besides, foreign direct investment enhances exports and contributes to the long-term economic development of countries.

Furthermore, attracting foreign direct investment can inject other benefits. Foreign firms increase competition that makes local companies of the host country upgrade their own production. This process usually touches only companies of the same industry, who directly compete with foreign firms, whereas spillover effects can be both horizontal and vertical (in association with FDI types). Nevertheless, foreign investment also influences forward linkages – foreign firms are able to supply local firms of a host country with more high-quality production. It also upgrades the production of local companies by using better materials.

Nonetheless, it should be considered that foreign direct investment can result negative effects as well. The consequences of FDI depend on particular characteristics of each country, and cannot be predicted. As for negative outcomes, they can affect both home and host countries, independently of each other. Firstly, the technology gap between countries. For example, technologies and know-hows from more advanced states can be inappropriate for host countries. Some developing countries are not ready for high-tech innovations and they cannot be used there. It complicates the whole process and may result in problems rather than positive spillovers.

Frequently, the attraction of foreign investment slows down the local economy as domestic firms are not ready to compete with MNCs. Therefore, sometimes the domination of foreign companies leads to the worse productivity of a host country. Besides, MNCs can leave local companies uncompetitive by attracting more skilled and productive workers from them. Therefore, it should be highlighted that even though foreign direct investment mostly generates positive effects on economies, it also can be a destroying factor.

For achieving positive effects, the process of investing through FDI should be carefully regulated. The traditional instruments of state regulation are national legislation, international investment law, and investment arbitrage, which disputes arising between foreign investors and host countries. However, it is noted that there are some problems with lacking of regulation tools at multilateral level[[32]](#footnote-32). Host economies vary greatly in terms of FDI regulation, so it is worth taking a closer look at the country’s investment policy.

1.2. Global and Chinese FDI: literature overview

Speaking about theoretical framework, numerous studies have examined various aspects of foreign direct investment. While examining this particular object, scientists recognized the impact of FDI on different countries and sectors. Furthermore, the relations of foreign investment and other economic factors were investigated as well. Lots of Russian and Chinese researchers, as well as researchers from other countries, dealt with various aspects of foreign direct investment.

L. Alfaro et. al. review the impact of FDI inflow on economic growth and inferred that foreign capital plays a great role in enhancement of economic growth[[33]](#footnote-33). M. Blomstrom et. al. (1994) highlight that FDI is a very critical key in a growth of developing countries, along with education and labor force participation rates[[34]](#footnote-34). Furthermore, it is concluded by J. Choe (2003) that FDI leads to a quite rapid economic growth, so it can be the most convenient method for the least-developed and developing countries to improve their economic activities[[35]](#footnote-35).

T. Buthe and H. V. Milner (2008) review the role of foreign direct investment in developing countries, and came to a conclusion that there are more benefits rather than in other markets. They also believe that political factor is the main driver of foreign capital, therefore, they recognize the necessity of governmental policies for attracting FDI[[36]](#footnote-36). M. Wang and M. C. S. Wong (2011) share their opinion and write that such policies as tax breaks are the main point for FDI attraction[[37]](#footnote-37).

Economists also considered the reasons for attracting foreign direct investment, and the ways to do it. Benassy-Quere et.al. (2007) distinguish that there are lots of institutions which influence FDI inflows. Authors indicated such objects as legal system, bureaucracy, and banking sector, as most impactful reasons for foreign investors to introduce their capital[[38]](#footnote-38). A. Q. Khachoo and M. I. Khan (2012) recognize a size of market size as the main reason of attractiveness of developing states for foreign investors[[39]](#footnote-39). Some researchers, such as R. Vinit and A. Gaurav (2011)[[40]](#footnote-40) and Vijayakumar et. al (2010)[[41]](#footnote-41), believe that labor cost is the main factor in attracting FDI.

When it comes to motives for host countries to encourage foreign direct investment, Borensztein et.al. (1998) suggest that foreign direct investment is the significant way of technology transfer, and helps to introduce advanced high-tech innovations into host countries[[42]](#footnote-42).

The theme of China’s foreign direct investment has been interesting for many scientists as China became the most attractive host country for foreign capital. K. H. Zhang and S. Song (2001) consider how China has become the largest recipient of FDI and which role inward foreign investment plays in country’s development[[43]](#footnote-43). A similar study was carried out by W. Tseng and H. Zebregs (2002). Authors analyze the history of foreign direct investment in China[[44]](#footnote-44). F. Lin (2011) believes that labor quality, along with the inexpensive costs, is one of the main factors which affect the attraction of foreign capital into China[[45]](#footnote-45).

It is concluded by many researchers that foreign direct investment helped China to enhance its economic growth. K. H. Zhang (2003), using a growth model, proves this hypothesis and implicated that China’s transition to an economically stable country was largely due to the attraction of huge amount of foreign capital[[46]](#footnote-46).

Recently, China has started paying more attention to the greening of foreign direct investment. Thus, lots of research papers are devoted to this topic. Wang et. al. (2022) evaluate the role of FDI in air pollution[[47]](#footnote-47). Liu et. al. (2021) review China’s latter goal of carbon neutrality and its influence on development of green investment[[48]](#footnote-48). Additionally, Wang et. al. (2021) study the impact of foreign direct investment on urbanization, while addressing the topic of combating environmental pollution[[49]](#footnote-49).

The Covid-19 pandemic has changed the global economy in many ways, while affecting the flow of foreign direct investment and other aspects. This issue has been acutely critical, so lots of economists devote their work to the topic. For instance, Aysan et. al. (2020) observe the impact of Covid-19 pandemic on Chinese inward FDI[[50]](#footnote-50).

The legal aspect of FDI policy in China was examined by T. Fan (2020), who considered the work of juridical acts in conjunction with each other[[51]](#footnote-51) and X. Li (2019), who examined how the changes of legal aspects affect the distribution of investment by industries[[52]](#footnote-52). S. Zhang analyzed the Foreign Investment Law and highlighted how it changed the performance of foreign investors and protection of FDI in China[[53]](#footnote-53).

Many Internet resources also highlight the framework of foreign direct investment in China. Researchers of Bloomberg, Statista, FDI Intelligence, etc., examine the changes of FDI, considering the performance of various industries. The automotive sector is one of the most reviewed industries, when it comes to FDI in China. S. O’Farell (2021) explores the possibilities of China as the main host country for NEV production[[54]](#footnote-54).

Foreign direct investment in the banking service, in its turn, is not as discussed as the automotive manufacturing, therefore, the literature on this topic is quite limited. Y. Wang and R. Chenavaz (2016) observed the introduction of foreign presence in the industry[[55]](#footnote-55), whereas Liu et. al. (2021) analyzed benefits and drawbacks for foreign investors in the banking sector these days[[56]](#footnote-56).

The amount of studies devoted to the topic of China’s FDI and global FDI is quite huge, however, there is still a necessity to examine this topic as economic indicators change.

Chapter 2. Xi Jinping’s policy regard foreign direct investment

2.1. The determinants of foreign direct investment in China

There is no doubt that this theoretical basis is investigated, reviewing its distinctions in different countries. The People’s Republic of China is one of the most interesting states, when it comes to foreign direct investment. There have been lots of studies that express ideas about Chinese economy and its FDI. Y. Huang (2003) interprets why, in his opinion, China attracts high levels of foreign direct investment. He believes it is the result of “political pecking”, through which private firms are discriminated, whereas SOEs are highly favored. He also points out economic fragmentation, consequently, FDI is the only way for private companies to gain capital[[57]](#footnote-57).

China’s increasing openness to foreign direct investment helped an astonishing growth performance of the country. The attraction of foreign capital not only plays an important role in the economic modernization of China, but also determines the China’s involvement in the world economy[[58]](#footnote-58). FDI took an important place in China’s economy since the pursuing the reform and opening up policy in 1978, which caused lots of changes in political, economic and social terms. Years of the policy led to the rapid growth of country’s economic power, that elevated China in international arena, making it the fastest-developing country with a stable economy. As a result, after opening to foreign investment the country became the largest recipient of FDI among developing states within two decades[[59]](#footnote-59).

Acceptance of foreign direct investment in China is generally associated with Deng Xiaoping’s policies, which were the part of reform and opening up policy’s plan. Years of reform and opening up policy led to the rapid development of social productive forces and the growth of the country’s economic power. Many researchers believe the policy is the engine that has elevated China in the international arena, making it the fastest-developing country with a stable economy. There is no doubt that there are many different reasons for China’s success in the economic arena, and, in fact, the policy results show that China has been able to find the right path in the socio-economic development.

Initially, the government set the main goal for the policy – it was the creation of a socialist market economy. The socialist market economy is based on the economic system where public ownership plays a dominant role and several forms of ownership develops jointly. As a matter of fact, this system has the basic characteristics of a market economy. It solidly adheres the socialist direction, therefore the system is a blend of socialism and a market economy. Thus, despite all the specifics, the policy remains to be market-oriented. Currently, the improvement of the socialist economic system remains to be the principal unchanging goal for the People’s Republic of China within the policy. Foreign direct investment, in that case, was considered as a development tool, which helps to reach the main goal. Hence, the specifics of the socialist economic system still influence the development of FDI policy in the country.

Traditionally, researchers distinguish four main phases of the reform and opening up policy, which determine the state’s main goals for certain period of time. The first phase started with the beginning of the policy in 1978 and lasted until 1984. This period was characterized by an increase in the share of the primary industry in gross domestic product (GDP) and an improved development of agriculture. According to X. Liu, at that time the major initiative was “the start of the household responsibility”.[[60]](#footnote-60) Furthermore, enterprises with foreign capital were officially encouraged as sources of new technologies and scarce foreign exchange even. Hence, the foreign policy was opening up, as the PRC allowed international trade and foreign direct investment. It, as a matter of course, helped the domestic economy of the country as well by raising the standard of living of the majority of population.

During the second phase, which lasted for eight years, the Chinese government was focused on the revival of enterprises and the development of secondary and tertiary industries. In this way, China began actions to transform from an agrarian country into an industrial one – the share of the primary industry in GDP fell by 6%, whereas the share of tertiary industry increased by 6% (from 28 to 34%) and the share of secondary industry remained the same (43%)[[61]](#footnote-61). The third phase, which started in 1992, continued the growth of the secondary and tertiary industries. This particular period is distinguished by its rapid development in the field of infrastructure – mass construction started throughout the whole country, including the construction of roads, which led to an improvement in the issue of transport and communication. In addition, China began to make progress in more complex industries such as chemical and heavy ones.

At present, the People’s Republic of China is in the fourth stage of the reform and opening up policy, that started in 2001, when China joined the World Trade Organization (abbr. WTO). Since the start of the phase, some of the significant objectives have been urbanization and industrialization of the country. China is still developing secondary and tertiary industries, while trying to get away from the image of an agricultural country. Furthermore, the WTO accession pushed the country to liberalize more, that also meant the liberalization of foreign direct investment. The weakening of trade barriers, the development of investment policies let various foreign companies enter China. Such a move, certainly, increased FDI inflow, more than by half in five years. The number of barriers for FDI also decreased – the WTO accession resulted in more open industries (from 186 to 262) and less closed ones (from 112 to 72). The Chinese authorities significantly liberalized the service sector, and opened some previously permitted industries, such as finance and insurance, etc. Furthermore, it was supposed to gradually expand the areas that attract foreign direct investment[[62]](#footnote-62).

The current President of the people’s Republic of China, Xi Jinping continues expanding the goals and objectives of the fourth stage of the reform and opening up policy. Xi Jinping was elected as General Secretary at the 18th Congress of the Communist Party of China in 2013. The vote was unanimous – Xi Jinping’s share of the vote was 99.86% (2952 out of 2956 voters was for Xi Jinping)[[63]](#footnote-63). The election of Xi Jinping, according to many experts, meant that the country’s leadership was aware of the need for new decisive socio-economic changes. It was necessary to eliminate distortions in economic policy, to solve the growing environmental problems, and to eradicate existing corruption. Xi Jinping believes that the reform and opening up policy is the “path” that leads Chinese people to go forward and develop according to the trends of the times. Hence, in order to remove the aforementioned problems, at least the two of them, Xi Jinping turned the policy in the direction of development in global economic market.

Xi Jinping believes the reform and opening policy is the “path” that leads Chinese people to go forward and develop according to the trends of time. Furthermore, understanding the transformation of economic world due to globalization, President Xi turned the policy in the direction of development in global economic market. Hereby, foreign direct investment started to play even greater role in the China’s economic plans. In the age of globalization, foreign direct investment plays quite an important role in any economic system, being the driving force of the socio-economic development and the guarantee of effective functioning for any economy.

It should be mentioned that scientists highlight two stages of China’s foreign economic openness. It is believed that Xi Jinping’s inauguration started the preparation for the second stage, which officially started in 2018. Xi Jinping’s policy further involved China into the process of globalization, as the government introduced a number of changes[[64]](#footnote-64). For instance, the creation of free trade zones and the implementation of the Belt and Road Initiative, which will be discussed later.

The second stage started in 2018, which was the 40th anniversary of reform and opening up policy. Xi Jinping highlighted that the policy creates the better conditions for China’s economy, as it led to high-quality development of the country. During his speech, the President pointed up the necessity of international cooperation and improvement of the investment environment, thus, China’s commitment to opening up was brought up again[[65]](#footnote-65).

Foreign direct investment was recognized to be one of the key factors in China’s economic growth. Thus, Xi Jinping began a huge and hard work in increasing FDI flow into the country. At the very beginning, China made inexperienced attempts to attract investment from foreign countries, the measures were partly experimental. However, after several years of such experimental actions, the government was able to find the right set of measures, the results of which led to increase of FDI in future.

There are various motives for multinational companies (abbr. MCs) to use foreign direct investment as a tool of development. First and foremost, countries with rich natural resources attract investment. Moreover, the size of the market, productivity, labor intensively, and tariff regulations likewise play a big role in FDI attraction. In case of China, MCs mainly have been looking for an enormous local market with quite skilled inexpensive labor costs and great infrastructure quality. Therewith, China has always been highly export-oriented country, and with the creation of special economic zones and lower tariff rates, foreign companies decide it is better to go ahead with foreign direct investment, rather than continue importing. Furthermore, China’s economic development is known as miraculous stable growth, as “since China began to open up and reform its economy in 1978, GDP growth has averaged over 9 percent a year”[[66]](#footnote-66). All these factors create an overall successful business climate that attracts foreign firms. Let us examine the most determinant components in sequence.

Market size, definitely, the first factor that comes to mind, when considering China as a host country for foreign direct investment. China is the second-largest economy in the world, with population of 1,411.75 million (mainland China), and the GDP of US$ 17,881.30 billion (RMB 121,020.7 billion)[[67]](#footnote-67). It is believed that this one seems to be the most decisive for FDI inflow for all host countries, especially in developing economies[[68]](#footnote-68). A. Q. Khachoo and M. I. Khan (2012) also consider that a market size is crucial for developing states[[69]](#footnote-69). Furthermore, China is a country with a growing upper middle-class population, and it makes the country even more attractive for foreign investors as there is a potential growth in number of consumers with purchasing power.

Table 2.1. China’s Middle Class as Percent of Urban Households

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Affluent** | **Upper middle** | **Mass middle** | **Poor** |
| **2012** | 3% | 14% | 54% | 29% |
| **2022** | 9% | 54% | 22% | 16% |

Data Source: China Briefing

URL: <https://www.china-briefing.com/news/chinas-middle-class-5-questions-answered/>

Labor cost seemed to be the most attractive factor in China for foreign investors[[70]](#footnote-70). R. Vinit and A. Gaurav (2011) highlight that foreign investors seem to be looking for quite cheap labor costs, therefore China as a country with originally lower labor cost is highly attractive for foreign direct investment. They also write that economic stability of the country is appealing for investors as well[[71]](#footnote-71).

The past years there is a trend of China’s labor force shrinking (see Appendix 1). It is believed that the reason for such a decline is the hit of Covid-19 pandemic, that led to unemployment, triggering the decrease of workforce in the whole world. Furthermore, some scientists highlight the problem of population aging – there is a less number of working-age population. It is known that 1960s were the years of baby-boom in China, and the retirement age is 60 for men and 55 for women, consequently, a huge part of population retires[[72]](#footnote-72). Therefore, the importance of labor force as FDI factor is declining at present.

China is known to be a state with economic and political stability, which is tends to trade openness, and it definitely draw foreign investors’ attention[[73]](#footnote-73). Economic stability gives foreign investors a guarantee that a country is a good environment for FDI projects. China is one of the most economically stable countries as it performs the great GDP growth, even though it has been slowing lately.

Figure 2.1. China’s GDP growth

Data Source: The World Bank

URL: <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2021&locations=CN&start=2013>

Besides, China is viewed to be quite a stable state politically (see Appendix 2). According to political stability indices by the World Bank, China has an indicator -0,48, which is quite a good indicator, even though it is negative, as -2,5 is considered to be weak, and 2,5 – strong.

Infrastructure also plays quite important role in FDI attraction as it can improve business effectiveness, so countries with advanced infrastructure surpass other states in foreign investment[[74]](#footnote-74). For instance, good transportation and communication facilities are considered to be exceedingly appreciated by foreign investors[[75]](#footnote-75). Last but not least, governmental preferential policies and laws are considered to be very important as well.

For China, as it was already mentioned, the main motive for attracting foreign direct investment, because it is a way to develop its capabilities[[76]](#footnote-76). Mainly, FDI is the main tool for attracting know-how and high technology with long-term benefits. Surely, the development of exports and foreign investment inflow has led to attraction and improvement of new technologies. It changed the economic situation throughout the whole country, not only in developed areas[[77]](#footnote-77). As a consequence, the development of the technical component improved infrastructure, which led to the better quality of life for Chinese population.

The importance of foreign direct investment is also maintained by introduction of Belt and Road Initiative, as it opens new possibilities for China’s cooperation[[78]](#footnote-78). Belt and Road Initiative, also known as One Belt One Road and New Silk Road, was introduced in October 2013 by Xi Jinping as his first enormous China-led infrastructure project. At the moment, 147 countries, that account for about 40 percent of global GDP, have signed to the BRI projects[[79]](#footnote-79).

Figure 2.2. FDI Inflows to China from the BRI countries

Data Source: Statista

URL: <https://www.statista.com/statistics/1346776/china-inward-fdi-flows-from-bri-countries/>

The amount of FDI is quite unstable as it depends on the number of projects. Nonetheless, it still attracts big amount of foreign capital, even though China usually acts as an investor and produces more outward FDI. In 2021, inward FDI keeps the amount of 8,27 billion $US, whereas the outward FDI considerably more – 24,15 billion $US[[80]](#footnote-80).

Therefore, it can be concluded that these days China is more focused on outward FDI, rather than on inward. However, it does not mean that the PRC government has stopped evolving policies that attract foreign direct investment. The next chapter we are reviewing some policies that are formed for creating and developing favorable conditions for foreign investors.

2.2. Specific features of FDI policy since 2013

Globalization made foreign direct investment greatly important economic feature, both advanced and developing countries attempt to be involved in the FDI framework. Therefore, the amount of foreign direct investment keeps increasing. The increase in FDI flows have led to a notable expansion of international production by TNCs, which seek for maximum benefits from the production process.

Graph 2.3. Global FDI flows

Data Source: UNCTAD

URL: <https://unctad.org/data-visualization/global-foreign-direct-investment-flows-over-last-30-years>

Scientists believe that foreign direct investment is more important for developing economies, rather than for developed ones, as it is an important source of external finance[[81]](#footnote-81). Formerly, the problem was that FDI was concentrated in fairly advanced countries, as emerging markets were not able to attract favorable amount of foreign investment[[82]](#footnote-82). Nevertheless, the last couple of years developing countries has been exceeding the amount of FDI inflows by advanced economies.

Figure 2.4. Global FDI inflows by economic grouping

Data Source: UNCTAD

URL: <https://worldinvestmentreport.unctad.org/world-investment-report-2022/chapter-1---global-investment-trends-and-prospects/#growth-all-regions>

China has always been the most attractive host country for foreign investors, but for the past two years China attracts the largest amount of FDI, surpassing the US. Due to liberalizing and improving of FDI regime in the country, China keeps attracting big amounts of foreign investment, even in the past difficult years of Covid-19 pandemic and political uncertainties. This study interprets which factors influenced the foreign direct investment inflow in China.

According to the World Bank data, during Xi Jinping’s era there has been a rise in foreign direct investment inflow into China. Comparing 2013 and 2021, indicators increased, even though they fluctuated over the years. It can be assumed that fluctuations happened due to changes in policies, namely the movement from a quantity to a quality of incoming investment.

Figure 2.5. Annual FDI inflow to China

Data Source: Statista

URL: <https://www.statista.com/statistics/1016973/china-foreign-direct-investment-inflows/>

The FDI inflow has been remaining high during all the years of Xi Jinping’s rule. Consequently, it can be said that the Chinese government has come up with a number of effective actions to keep attracting high amount of foreign capital into the country. FDI inflows has continued growing even in the years of Covid-19 pandemic and growing geopolitical tension, while the rest of the world struggles with keeping up. The pandemic of new coronavirus infection has affected the global economy, including the distribution of foreign investment. As specified by UNCTAD, in 2020 global FDI shrank by 42%, falling to about $859 billion, which is 30% below the low since the 2008 global financial crisis. However, in 2021 the situation has stabilized – the flow of foreign direct investment around the world increased by 77% to $1.65 trillion[[83]](#footnote-83). Nevertheless, FDI is a more stable option than portfolio investment, since in this case more attention is paid to the long-term development of the country.

Despite the difficult epidemiological situation in the world, China remained one of the largest destinations for foreign investment, as China is the only state which economy has not affected by the Covid-19 pandemic. Even though in 2020 the economic growth of China was the lowest in 45 years, the inflow of FDI continues to grow. According to the Ministry of Commerce of the People's Republic of China, in 2020, FDI inflows reached $14.38 billion (999.98 billion yuan), in 2021 foreign direct investment increased by 14.9%, reaching $173.48 billion (1.15 trillion yuan). According to preliminary data for 2022, one can note an upward trend in FDI inflows, despite slight fluctuations in indicators. Besides, UNCTAD points out that the outlook for 2022 is also positive, but notes the possibility of lower growth rates due to the protracted health crisis, as well as problems in the labor market, supply chains and inflationary pressures.

Although the Chinese government has chosen a fairly rational way to deal with the socio-economic consequences of the coronavirus, some negative indicators remain still – the protracted health crisis has changed the distribution of FDI, both by sectors and regions. Firstly, in order to contain the spread of the infection, many countries introduced the interruption in transmission chain, which have largely changed the flow of FDI due to the difficulty of cross-border investment activities. Secondly, the pandemic reduced the costs of foreign companies, which affected the scale of global investment. Additionally, the epidemic affected various economic sectors differently and it changed the balance of investment between sectors. Furthermore, there are problems in the labor markets – the growth of unemployment, difficulties with the payment of wages and sick leaves also hit companies hard, which, as a result, forced them to reconsider their investment policy.

The pandemic also decreased the introduction of new greenfield FDI projects. In 2020, the number of greenfield projects dropped to the indicator of 359. In 2020, the situation improved, the number rose to 410 projects[[84]](#footnote-84). However, there is still a slowdown in attracting greenfield foreign direct investment in China. As well as the number of projects, the value of them also collapsed.

Figure 2.6. The value of greenfield FDI projects

Data Source: Statista

URL: <https://www.statista.com/statistics/1286909/china-value-inward-greenfield-fdi-projects/>

Nevertheless, even despite the many problems that have affected the country, China still reserves the prospects for development and sustainability in the foreign direct investment sector. However, Aysan and et al. (2020) note the main problem for the Chinese government is that the companies started to relocate their investment out of China[[85]](#footnote-85). For that reason, China continues to improve conditions for foreign investors in order to maintain the economic growth and to sustain the inflow of FDI. Although, some researchers believe that it is the right time for the Chinese government to begin focusing on the outward FDI more.

However, pandemic Covid-19 was not the first problem China had to face, while dealing with foreign direct investment. The US-China trade war, the economic conflict between two countries that started in July 2018, definitely, affected FDI inflow to China, but not severely. Many economists mark that US-China trade war interfere outward investment more, but investment inflow remains relatively stable. Furthermore, Xinjiang cotton controversy also added its changes in FDI structure. In 2020, the allegations about human rights abuse started to appear about Xinjiang region, where produces about fifth of the world’s cotton. Many clothing brands declared that they refused using cotton from Xinjiang, due to concerns upon the Uyghurs, an ethnic minority living in the region. Such large brands as H&M, Zara, Adidas, Nike, New Balance, etc. Due to all issues, some of foreign companies have shut down their affiliates. All these allegations around China also slightly deteriorate its image in front of possible foreign investors.

When analyzing foreign direct investment in China, it is important to recognize major foreign investors. Most of foreign direct investment in China comes from Asian countries, due to geographic and cultural proximity. In 2018 (the latest available data), the overall amount of actually utilized FDI was US$ 134,9 billion, 79 percent of which were from Asian countries (see Appendix 3). The biggest investors were: Hong Kong (US$ 89,9 billion), Singapore (5,2 billion), and Virgin Islands (4,7 billion). It proves that a large amount of foreign investment comes from offshore zones.

The amount of foreign direct investment coming from Hong Kong is quite stable and grows over time:

Figure 2.7. FDI inflows by regions

Data Source: Bloomberg

URL: <https://www.bloomberg.com/news/articles/2022-09-05/china-round-tripping-inflates-foreign-direct-investment-data>

Furthermore, the percentage of Hong Kong’s participation in FDI inflow increased. Therefore, it can be said that the diversity of home countries is deteriorating, and it creates monopoly among foreign investors.

Figure 2.8. The percentage of FDI by regions (2013)

Data Source: Bloomberg

URL: <https://www.bloomberg.com/news/articles/2022-09-05/china-round-tripping-inflates-foreign-direct-investment-data>

Figure 2.9. The percentage of FDI by regions (2021)

Data Source: Bloomberg

URL: <https://www.bloomberg.com/news/articles/2022-09-05/china-round-tripping-inflates-foreign-direct-investment-data>

The great amount of foreign direct investment from Hong Kong is explained by so-called “round-tripping investment”, the returning of money to the country of origin. China has always been one of the country with the high level of round-tripping, and Hong Kong is the main destinations, along with Singapore and off-shore centers as Virgin Islands, Bermuda, and Cayman Islands. It is believed that there are frequent cases of round-tripping because of preferential tax policies, better protection of property rights, and other benefits[[86]](#footnote-86). Besides, companies may seek for locations with better opportunities to access financing, which means the necessity to do business in more developed international markets[[87]](#footnote-87). Therefore, such regions as Hong Kong and Singapore, which are global financial centers, are chosen to be a good location for round-tripping investment. Therefore, it can be seen that the US and European countries are not the main investors, as Asian countries occupy most of the FDI share. However, the further improvement of FDI policy is one of the main factors of China’s attractiveness as a host country.

In order to upgrade its image as a FDI recepient, Xi Jinping has gradually been improving China’s conditions for foreign investors. These conditions include lots of amendments, such as creation and constant reformation of free trade zones in the most infrastructure-rich areas, and improvement of laws and regulations, namely formation of a more transparent legal basis. Reviewing all the benefits of China as a host country, it could be easier to understand the motives of foreign investors to invest in this country. Besides, it is possible to review all the enhancement that was done by the Chinese authorities in order to attract more FDI.

Special economic zones (abbr. SEZ), first of which were created back in July 1979, play a significant role in attracting foreign capital. Special economic zones are geographically delimited areas, which are designed to promote export and import, and to attract foreign capital and technology into the country, while upgrading the labor skills. These areas have a distinct regulatory regime and large infrastructure support, that makes them so attractive for foreign capital. In general, special economic zones play a huge role in the formation of the country’s GDP and the rational redistribution of financial resources. Thus, SEZ contribute to the integration of the economic, trade and innovative potential of the country. In 2013 China opened its first pilot free trade zone (abbr. FTZ) in Shanghai. Free trade zones are the parts of SEZ policy, and they have been designated as experimental zones for implementing liberalization measures, including relaxed restrictions on foreign ownership, simplified investment procedures, and increased market access.

Nowadays Chinese special economic zones include 14 open coastal cities (Shanghai, Tianjin, Fuzhou, Guangzhou, Zhanjiang, Beihai, Qinhuangdao, Lianyungang, Nantong, Dalian, Qingdao, Yantai, Ningbo, and Wenzhou), 5 special economic cities (Xiamen, Shantou, Shenzhen, Zhuhai, and Kashgar) and one special economic province (Hainan province)[[88]](#footnote-88). These areas were chosen due to the closeness to trade routes, so Chinese special economic zones linked foreign direct investment with trade[[89]](#footnote-89).

The Chinese government has taken some measures for effective operation of special economic zones in attracting foreign direct investment. To start with, foreign enterprises and enterprises attracting foreign capital, located in these economic zones, are subject to a reduced taxation. Currently, the corporate income tax in some SEZ, exactly in Shanghai, Shenzhen, Zhuhai, and Fujian, is levied at a rate of 15%, whereas throughout China the rate of the same tax is 25%[[90]](#footnote-90). The personal income tax is levied at a lower rate than throughout the country too. In addition, foreign direct investment inflows into SEZ are driven by cheap labor costs and good infrastructure, as well as open door policies combined with various incentives. Thus, special economic zones usually more than third of foreign direct investment[[91]](#footnote-91). It should be also mentioned that the entry of foreigners in special economic zones is simplified, in order to attract more personnel and enterprises to China.

However, the existence of such special economic zones leads to the problem of regional inequality. Focusing on development of individual regions, the foreign investment policy contributes growing income gap between coastal and inland provinces. To deal with this problem, the Chinese authorities started to relocate funds and attract foreign investment into western and central regions by implementing preferential policies[[92]](#footnote-92).Even though China has been paying a lot of attention to the reduction of this regional gap, the inequality problem is still concerning the Chinese government, and investment gap between coastal and other regions continue increasing. As for 2021, eastern region of China accumulated 84,4% of utilized FDI, whereas central and western regions gathered only 6,2% and 5,3% respectively[[93]](#footnote-93). Thus, the issue needs further consideration and resolution, but as long as there are lots of provincial differences it is slightly complex to even out FDI distribution.

Table 2.2. FDI Inflow to China’s regions (2019)

|  |  |  |
| --- | --- | --- |
| **Region** | **Number of FIEs** | **Realized FDI (100 million US$)** |
| East | 36613 | 1191,1 |
| Central | 2138 | 97,3 |
| West | 2137 | 92,9 |
| Others | 22 | 30,9 |

Data Source: China Briefing

URL: <https://www.china-briefing.com/news/investing-in-chinas-western-provinces-how-to-read-the-new-encouraged-catalogue/>

China, as well as other Asian states, is a country with high domestic saving rates and careful management of foreign investment[[94]](#footnote-94). Historically, Chinese government restricted the key sectors of its economy, potential foreign investors were preferred by state-owned companies[[95]](#footnote-95). One of the reasons for such preferment is the fact that the socialist market economy was chosen by the Chinese government as the economic development, and it implies “favoritism” to state-owned companies. Due to the strict investment regulations, the most favorable way for foreign businesses to operate in China is to create a joint venture. Nevertheless, the Chinese government created special favorable conditions for foreign investors, while limiting their scope of activities to those industries that need development. However, during all these years, restrictions and prohibitions on foreign direct investment have the tendency to reduce or minimize.

On January 1, 2020, the Foreign Investment Law of the People’s Republic of China came into force. It is a basic law for attracting foreign investors and improving the legal investment climate. This law replaced its predecessors, which were the Laws on Chinese-Foreign Equity Joint Ventures, on Sino-foreign Cooperative Joint Ventures and on Wholly Foreign-Owned Enterprises.

The Law of People’s Republic of China on Chinese-Foreign Equity Joint Ventures was adopted in 1979. According to it, the proportion of the foreign joint venture’s investment should be not less than 25% of the capital. Besides, the Law contained foreign exchange control regulations and rules about the production and business operating plans[[96]](#footnote-96). The Law on Sino-foreign Cooperative Joint Ventures was adopted in 1988, and it regulated processes of economic cooperation and technological exchange with foreign parties. Hence, the Law accommodated opinions on different questions as business management, investment, and accordance with Chinese regulations[[97]](#footnote-97). The Law on Wholly Foreign-Owned Enterprises was adopted in 1986 and contained rules for enterprises with sole foreign investment, including conditions and limit for business management. The Law consists of 24 articles with detailed regulations of different procedures[[98]](#footnote-98).

The 2020 Foreign Investment Law combines these previous acts in order to create a stable, transparent competition and fair business environment for foreign investors, as well as to provide reliable legal guarantees for opening up. It is also worth noting that the Chinese government provides an equal legal status for all businesses with foreign investment – it grants national treatment in advance, if the investment industry is not included in the negative list. According to the Foreign Investment Law, foreign investors can use benefits in the field of finance, taxation, land resources, but only in accordance with the rules and regulations of the Council of State. In addition, foreign investors, who expand investment in China through their investment income in the country, are entitled to preferential treatment and are not subject to taxation without special circumstances. In general, by this document China established the principle of equality between foreign and domestic investors. Thus, the Chinese government adopted the following model – “provisional national treatment plus negative list”[[99]](#footnote-99).

According to the Chapter 1, it is said that the Law is formulated in order to, first and foremost, promote foreign investment in the country and standardize the regulations. Thus, the Chinese government promises the rights and interest of foreign investors. Overall, the Law contains six chapters (42 articles), which declare such points as investment promotion, protection, management, etc. It should be highlighted that the project of the Foreign Investment Law was firstly brought up back in 2015. However, scientists believe that the Law was put aside because there was still a necessity of a further liberalization of the foreign direct investment[[100]](#footnote-100).

The Chapter 3 (Articles 20-27) of the Law deals with an important issue of the protection of intellectual property of foreign investors and enterprises with foreign participation. These articles project the rights and interests of investors, improving relevant public policy measures by addressing business complaints, maintaining confidentiality, and resolving issues related to income from sales. Ensuring the protection of the rights of foreign investors is a necessity for creating a favorable investment climate[[101]](#footnote-101). Thus, China creates agreeable environment and helps to attract more foreign direct investment into high-tech and knowledge-intensive industries. As a consequence, the Foreign Investment Law aims not only to increase the amount of foreign direct investment, but also to improve its quality.

However, the protection of certain sensitive areas from foreign investment remained an important factor for Xi Jinping. Therefore, starting with 2018, China has annually been releasing negative lists, which highlight the restricted and prohibited sectors for foreign investment. According to the WTO trade-policy review, while investing in China, a foreign investor must first meet the requirements of the Negative List for the Access of Foreign Investment, and then those of the Market Access Negative List[[102]](#footnote-102). Many researchers note that these lists shorten from year to year, liberalizing foreign direct investment. The last list, Special Administrative Measures (Negative List) for Foreign Investment Access 2021, was unveiled on December 27, 2021 and took effect on January 1, 2022. This list consists of 31 items, that is two fewer than in the list before. The measures concerning automobile manufacturing and satellite television broadcast ground receiving facilities were reduced.

In general, the valid negative list for this year consist of the following sectors:

1. Agriculture, forestry, animal husbandry, and fishery (number of measures – 4);
2. Mining (number of measures – 1);
3. Manufacturing (number of measures – 2);
4. Production and supply of electricity, heat, gas, and water (number of measures – 1);
5. Wholesale and retail trade (number of measures – 1);
6. Transportation, warehousing, and postal industries (number of measures – 4);
7. Information transmission, software, and information technology services (number of measures – 2);
8. Leasing and business service (number of measures – 3);
9. Scientific research and technical services (number of measures – 3);
10. Education (number of measures – 2);
11. Health and social work (number of measures – 1);
12. Culture, sports, and entertainment (number of measures – 7)[[103]](#footnote-103).

Special economic zones also have a negative list, which guides foreign direct investment. The 2021 version consists of 27 items, which is three fewer than the year before[[104]](#footnote-104). Therefore, it is definitely easier to operate in special economic zones, due to more liberalized regime there.

In general, there has been a tendency of the reduction of both negative lists in China. The publication of such lists mostly increases the transparency and understanding of state restrictions on foreign investment, and on top of that, it takes into account the mechanism for further reducing the number of restrictions. Definitely, such an improvement of conditions is a great help for attracting foreign investment into the country. Since the inauguration of Xi Jinping in 2013, negative lists lessened more than five times. Therefore, there is a fast liberalization of sectors that are open for foreign investment.

Figure 2.10. China’s Negative Lists

Data Source: National Development and Reform Commission

URL: <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202112/P020211227540591870254.pdf>

Besides, the Chinese authorities annually publish Catalogue of Encouraged Industries for Foreign Investment, which contains industries China encourages foreign firms to invest in. The latest one, published in 2022, includes 1474 items. According to it, it can be seen that China stimulates foreign investment into industries with high-tech and green manufacturing production. In addition, the Catalogue maintains the idea of investment transition to production-oriented service industries. Beyond everything mentioned, the PRC government also points out rural revitalization, trying to increase urbanization growth[[105]](#footnote-105).

The catalogue consists of two parts, which are national catalogue (encouraged industries for a whole country) and regional catalogue (favorable sectors by regions). Over the years, the catalogue seems to have a tendency to lengthen, so it can be said China tries to attract more foreign investors this way. Besides, the regional catalogue has more encouraged industries, especially provinces that usually attract less foreign investment, so the PRC government makes an effort in reducing regional inequality.

Figure 2.11. China’s FI Encouraged Catalogue: number of items

Data Source: China Briefing

URL: <https://www.china-briefing.com/news/china-2020-fi-encouraged-catalogue-effect-january-27-2021/>

The tendency of negative lists reduction can be also seen in the “14th Five-Year Plan for the Utilization of Foreign Capital” for 2021-2025, which was issued by the Ministry of Commerce (abbr. MOFCOM) in October 2021. According to the document, China is continuously going to liberalize foreign investment by opening more sectors and allowing foreign investors to have more control. Furthermore, MOFCOM highlights the necessity of IPR improvement and also giving the equal opportunities for all investors, domestic and foreign. Thus, it suggests such measures as government procurement for creating business-friendly environment. Besides, the Plan emphasizes the sectors, which the Chinese government is willing to attract more foreign capital into, they are: biomedicine, digital economy, R&D, logistics, etc.[[106]](#footnote-106) Analyzing the Plan, it becomes clear that China upgrades the capabilities of its FDI policy by perfecting management system and advancing facilitation.

However, the promotion of FDI happens not only through legal acts, but also by various events. The China International Fair for Investment & Trade (abbr. CIFIT) promotes both outward and inward foreign direct investment, there have already been 21 sessions of investment trend discussions, which became an important platform for attracting foreign capital into various sectors of the Chinese economy, as the CIFIT attracted organizations and companies from different countries[[107]](#footnote-107). The Central China Investment and Trade Exposition, also known as Central China Expo, is also aimed at FDI promotion through symposiums, forums, and exhibitions. However, it is designed especially as a platform for regional and international cooperation among foreign countries, the central region of China, and its other provinces[[108]](#footnote-108).

There is no doubt that all these legal acts and regulations lowered entry barriers and, therefore, helped China to attract huge amounts of foreign investment into the country, even in difficult times. Additionally, China seeks for more foreign capital, therefore, it keeps liberalizing its FDI policy. Nevertheless, it is important to note that while China has pursued openness to foreign investment in some sectors, it has also maintained strict controls in sensitive or strategically important areas, and foreign investment is still discreetly regulated in these industries. Telecommunications, media, and internet services remain subject to tighter regulations and restrictions on foreign ownership and investment. China's national security concerns and the desire to protect domestic industries have influenced the decision to keep these industries comparatively closed.

Currently, the Chinese government sees the great importance to regulate FDI when it comes to the ecological situation in China. As a result of many studies, it was found that foreign direct investment has a huge negative impact on the environment, in fact, on the state of air and water sources. For example, F. Wang, J. He and Y. Niu in “Role of foreign direct investment and fiscal decentralization on urban haze pollution in China” (2022), by using econometric model, found a direct connection between investment and air pollution in the country. Initially, the authors considered the hypothesis that the level of pollution may vary depending on the degree of fiscal decentralization in different regions of China. Nevertheless, the study proves that pollution tends to spread and negatively affect the environment, regardless of the development of the region. Thus, the article offers solutions to fix the ecological problems through the introduction of improved governmental regulation. The authors are sure that the state measures of environmental protection are the best way to improve the current situation. In addition, they propose to increase the financial autonomy of local governments in order to limit the attraction of polluting FDI. They believe financial autonomy of regions has a positive effect on the fight against smoke in small towns[[109]](#footnote-109).

Since most of the foreign investment has commonly been attracted to sectors of the economy that been contributed to pollution, many researchers have concluded that China should increase its control over FDI by attracting more green investors with high technologies, low energy consumption and low pollution to the country. Q. Wang, M. Zhang and W. Wang (2021) highlighted that FDI through environmental regulation can promote China’s urbanization and achieve efficient and sustainable development[[110]](#footnote-110). Consequently, we can conclude that state regulation regarding environmental friendliness can improve the impact of investment on the development of the country.

However, it is still worth emphasizing the fact that China has already started working on improvement of this issue and is not only developing but already promoting a green investment plan. First and foremost, one of the biggest goals for the PRC government these days is the “decarbonization” of the economy. Presently, China is leading in carbon dioxide (CO2) emissions with the value of 9899,3 million tons of dioxide, which accounts for 31% of all global carbon dioxide emissions, that is twice the indicator of the United States, the second largest carbon emitter. Other countries, except of China, US, India, Russia and Japan, which are the largest CO2 producers, account for only 40% of all emissions.

Thus, in compliance with the latest 14th five-year plan of the PRC for 2021-2025, that was approved on March 2021, the Chinese government has set a course to reduce carbon intensity of the economy and to peak CO2 emissions before 2030 and to reach carbon neutrality by 2060[[111]](#footnote-111). For that reason, the PRC government is actively encouraging foreign and domestic enterprises to invest in eco-friendly industries and companies. Besides, China is making great efforts to improve the attractiveness of energy and other polluting industries for investors with eco-friendly technologies. In accordance with the calculations of Chen et al. (2020), “green” investment will account for more than 2% of GDP by 2050, and, in fact, will have a material benefit to cover the costs of implementing the plan to reduce carbon emissions[[112]](#footnote-112).

Nowadays more and more scientists are convinced that there is a positive relationship between FDI and the reduction of carbon emissions. For instance, researchers in “China carbon neutrality target: Revisiting FDI-trade-innovation nexus with carbon emissions” has proved the positive impact of foreign investment on CO2 emission, but the effect is different throughout provinces, depending on the level of innovative development[[113]](#footnote-113). The results of this study prove that environmental regulation adopted by China is quite functional. Additionally, we should bear in mind that recently China’s labor-intensive production has been moving to other developing countries, mostly to the countries of Southeast Asia and the countries of Africa, through capital exports, which also promotes “greening” of the economy and “decarbonization”. The state supports Chinese corporations which export their capital to other countries, ultimately realizing the importance to develop not only inward FDI, but the outward investment as well. Remarkably, the process of investing into the economies of other countries plays an important role for China at the present moment.



Figure 2.12. National strategy for decarbonization

Data Source: China Association of Automobile Manufacturers

URL: <http://en.caam.org.cn/Index/show/catid/21/id/1819.html>

In regard to the environmental state regulation, it is impossible not to mark down that recently China began to develop its “green” investment policy. The Catalogue for Guiding Industry Restructuring (updated in October, 2019 and entered into force on 1 January, 2020) also reflects China’s efforts to close out heavily polluting industries. According to this document, all industries are divided into three categories: encouraged (advanced high-quality technologies), restricted (technologies that need to be reformed) and obsolete (technologies that waste resources and pollute the environment). Industries that are not represented in the Catalogue are considered permitted. The latest version of the document includes 821 encouraged items, 215 restricted items, and 441 obsolete items – overall, 1477 industry items and 48 industries[[114]](#footnote-114). The WTO points out: “Encouraged items shall be examined, approved, or filed in accordance with relevant regulations. Restricted items shall not be newly built, and the existing production capacity is allowed to be upgraded within a certain period of time. Items to be phased out shall be prohibited from investment and shall be phased out within the prescribed time-limit. In principle, this provision applies to all types of enterprises in China.”[[115]](#footnote-115)

To conclude, it can be said that Xi Jinping’s policy regard FDI is quite precise. China keeps liberalizing FDI, creating more acceptable business environment and improving the quality of inflow. Through such changes as creating FTZs and establishment of various legal acts, China demonstrates its commitment to being an attractive destination for foreign capital. However, we should also notice that there are strict regulations, which maintain the control over all sectors, not only strategically important ones. Overall, Xi Jinping’s policy reflects a balance between attracting foreign direct investment and protecting domestic industries.

Chapter 3. The key features of China’s FDI by sectors during Xi Jinping’s rule

3.1. China’s FDI in automotive sector

Certainly, China continues developing its secondary and tertiary industries, as it tries to get away from the image of an agricultural country. The share of primary industry in GDP keeps decreasing, whereas the percentage of secondary and tertiary ones raises. Since 2013, the shares of agriculture and industry continue reducing, and services – enlarging.

Table 3.1. China’s distribution of the GDP across economic sectors

|  |  |  |  |
| --- | --- | --- | --- |
| **Year** | **Agriculture** | **Industry** | **Services** |
| 2013 | 8,9% | 44,2% | 46,9% |
| 2014 | 8,6% | 43,1% | 48,3% |
| 2015 | 8,4% | 40,8% | 50,8% |
| 2016 | 8,1% | 39,6% | 52,4% |
| 2017 | 7,5% | 39,9% | 52,7% |
| 2018 | 7,0% | 39,7% | 53,3% |
| 2019 | 7,1% | 38,6% | 54,3% |
| 2020 | 7,7% | 37,8% | 54,5% |
| 2021 | 7,2% | 39,3% | 53,5% |
| 2022 | 7,3% | 39,9% | 52,8% |

Data Source: Statista

URL: <https://www.statista.com/statistics/270325/distribution-of-gross-domestic-product-gdp-across-economic-sectors-in-china/>

Along with the change in the composition of the GDP, the sectoral structure of foreign direct investment also undergoes changes. Foreign direct investment in China has been mostly attracted into the manufacturing industry. However, nowadays foreign investment is more diversify, more than half of FDI goes to the service sector[[116]](#footnote-116). By 2010, foreign direct investment in services exceeded investment in manufacturing, and by 2013, the volume of FDI in services surpassed 50 percent of all direct investment[[117]](#footnote-117). Thus, the proportion of FDI in the tertiary industry keeps increasing, whereas the amount of investment in primary and secondary industries declines.

Table 3.2. China’s utilized FDI by sector (2022)

|  |  |  |  |
| --- | --- | --- | --- |
| **Sector** | **Enterprises** | **Increase over 2021 (%)** | **Actually Utilized Value (100 million yuan)** |
| Agriculture, Forestry, Animal Husbandry and Fishery | 420 | -14,5 | 80 |
| Manufacturing | 3570 | -19,9 | 3237 |
| Production and Supply of Electricity, Heat Power, Gas and Water | 523 | 12,5 | 276 |
| Transport, Storage and Post | 602 | -13,1 | 347 |
| Information Transmission, Software and Information Technology Services | 3059 | -24,5 | 1548 |
| Wholesale and Retail | 10894 | -18,6 | 961 |
| Real Estate | 581 | -48,4 | 914 |
| Leasing and Business Services | 7473 | -19,6 | 2148 |
| Services to Households, Repair and Other Services | 411 | -21,3 | 19 |
| **Total** | **38497** | **-19,2** | **12327** |

Data Source: National Bureau of Statistics of China

URL: <http://www.stats.gov.cn/english/PressRelease/202302/t20230227_1918979.html>

Today, the Chinese government has set the task of attracting foreign direct investment to more advanced industries, because “higher-quality” growth was highlighted as the next five-year plan. Therefore, foreign direct investment will tend to be attracted to more high-tech industries, such as e-commerce and R&D. Furthermore, cause of environment policy, which was chosen as one of the most important ones for China, the authorities encourage FDI growth in energy-efficient technologies, environmental protection, and energy saving[[118]](#footnote-118). Hence, even though services are getting bigger in terms of the FDI share in China, manufacturing remains the most important and sought-after sector for foreign investors.

Manufacturing sector has been dominating in China’s FDI since the implementation of the reform and opening up policy. K. Liu and K. Daly (2011) highlight that until 2008 China attracted larger amount of foreign investment into low-tech manufacturing, and then started its transition to more high-tech manufacturing stage[[119]](#footnote-119). Historically, China is known as a country with high FDI into such manufacturing sectors as light and textile industries, however, the percentage of FDI to high technology manufacturing industries, such as chemicals, machinery, etc., kept increasing over the years.

Automotive industry is one of the most important sectors for foreign investment in developing countries, as it generates growth of other linked manufacturing industries. Innovations in automotive sector stimulates the growth of related industries, and it can lead to the growth of the whole country’s economy. Over the past decade, the FDI inflow in the automotive industry has drastically changed as the center of the industry has shifted from advanced to developing countries, such as India, China, and South Korea. Nowadays China is the largest vehicle market in the world, which accounts for more than 32% of worldwide vehicle production[[120]](#footnote-120). The output of vehicles in China is about 30-35 million units[[121]](#footnote-121).

Figure 3.1. Global vehicle production by source

Data Source: FDI Intelligence

URL: <https://www.fdiintelligence.com/content/feature/chinas-car-market-is-electrifying-79655>

Consequently, there is no breakdown that China is the largest recipient of foreign investment in the automotive industry – between 2003 and 2020 foreign investors injected about US$ 225 billion in the Chinese automotive sector[[122]](#footnote-122).

Since the start of reform and opening up policy in 1978, Chinese automotive industry has been rapidly evolving. The attraction of foreign investment in this sector let China to establish its own strong domestic automotive industry we can witness today. First and foremost, the demonstration-imitation effect played the important role, it helped to create the worker training effect and also to develop all the necessary processes in creating new products[[123]](#footnote-123). Even though the domestic companies are quite advanced, due to the huge population and great demand, a large quantity of foreign brand automobiles are still necessary to satisfy requests.

Figure 3.2. Annual vehicle sales in China

Data Source: Carsalebase

URL: <https://carsalesbase.com/china-car-sales-data-market/>

The first foreign project was the cooperation of the American Chrysler and Beijing Automotive Works in 1984, in the following year two joint ventures were opened – a cooperation between the German Volkswagen and the Shanghai Automotive Industry Corporation, and between the French Peugeot and the Guangzhou Automotive Company. In 2002, Asian companies also entered the Chinese FDI – the Korean company Hyundai and the Japanese Toyota opened their plants[[124]](#footnote-124). To date, the Chinese automotive industry includes 23 joint ventures and 19 domestic automakers, 12 of which are associated with joint ventures.

Previously, foreign direct investment in the automotive sector was heavily regulated. The Chinese government strictly controlled the volume of foreign investment in this area, and also established rules for location of affiliates and setting prices. It was allowed only to create joint ventures with a significant limitation of the share of foreign capital in 50%. However, the 2020 Foreign Investment Law removed all restrictions on foreign ownership in the automotive industry. This change allows foreign automotive brands to fully own car companies in China, freeing them from the need of setting up joint ventures. Thus, the new law let foreign brands to take full ownership of their joint ventures. In addition, foreign investors can open more than two joint ventures in China, which was previously prohibited[[125]](#footnote-125).

German companies stand out among foreign investors into China’s automotive industry, and they were the first ones to enter the Chinese market. Additionally, the presence of German manufacturers has been supported by the Chinese government, as technological progress as a positive spillover was clearly encouraged. Thus, there is a positive impact of the presence of German companies on the development of the automotive sector in China. Among German firms, the leaders are Volkswagen, BMW, and Daimler, which account for almost 30% of all European FDI in China.

However, currently there is a trend of European brands’ investment relocating. China’s demand as a location for manufacturing facilities has driven up costs. Thus, the cost of labor increases by about 15-20% per year[[126]](#footnote-126). In addition, the Covid-19 pandemic and the zero-Covid policy, adopted by the Chinese authorities, were slowing down production processes, so some foreign companies have been trying to find other markets for FDI. As an example, BMW is investing nearly 2 billion US$ to build an electric vehicle plant in the US.

Furthermore, a new problem for foreign investors is the rapid growth of domestic automobile companies. Domestic firms are developing very fast, and have very high-quality production. High competition between firms complicates the productivity, therefore, some companies look at other possible markets for relocating FDI. The Czech manufacturer Skoda, which is a part of the Volkswagen Group, noted the strong competition as a possible reason for the closure of factories in China. At the moment, the automaker is focused on India, so it can be assumed that India is considered as a new recipient of direct investment.[[127]](#footnote-127)

The problem with protecting intellectual property rights is still one of challenges. Even though China is creating convenient for foreign investors, it is quite difficult to stop unwanted technology transfer. Nonetheless, it can be said that the Foreign Investment Law resolves the main part of the problem, while dealing with IP protection, transparency of approval process, and equal treatment of domestic and foreign companies[[128]](#footnote-128).

Nevertheless, the lifting of zero-Covid restrictions could change the plans of foreign companies regarding foreign direct investment. Besides, due to changes in the percentage of ownership, many companies have already begun to increase the amount of foreign direct investment. For instance, the decision of BMW to build new factory in the US do not mean the full transition of production there. In 2022, BMW Group decided to move the production of MINI electric vehicles from Oxford, England, to China[[129]](#footnote-129). Thus, BMW invested about 2.2 billion US$ for opening electric vehicle plant in Shenyang[[130]](#footnote-130). Perhaps this decision was influenced by the confrontation between the US and China in the trading arena, so the company made a choice to open two new plants. In addition, the opening of electric vehicle factory is now strongly supported in China, and it will be discussed later in the paper.

The best-selling cars in China also include Japanese manufacturers Nissan and Toyota, which have the production plants directly in the country. Japanese brands are also represented by the following companies – Honda, Mazda, Mitsubishi, and etc. The reason for such a large number of FDI by Japanese companies can be dictated by, first of all, a rather small area of a home country, due to which most of the production is moved out. Secondly, China set the goal of attracting technological innovation, that Japan is rich of. Besides, the increase of labor cost led to an enlargement of foreign investment in robotics[[131]](#footnote-131).

Japanese manufacturers have a trend of stable growth in foreign direct investment. Japan has been one of the leading investors since the beginning of reform and opening up policy. It was attracted by China’s rapid economic growth, the growing purchasing power of the population, and, last but not least, low production costs[[132]](#footnote-132). Japanese foreign direct investment brought advanced technology to China, resulting in a structural improvement in the Chinese manufacturing industry. However, the relationship between China and Japan highly depends on political disagreements due to rich historical past and territorial disputes. Nevertheless, due to the proximity of host and home countries and convenient location, a large number of necessary resources, and fairy inexpensive production, Japanese automotive brands tend to choose China as a FDI recipient. Therefore, Japanese companies not only improve their already existing plants through investment, but they also quite often increase the number of affiliates, which requires more FDI.

However, since 2013, the amount of Japanese FDI in China has been declining. Some economists note that Japanese manufacturers are moving their factories to Southeast Asian countries. It is believed that the reason for this phenomenon is the same as the reason for relocating of European brands – the increase in labor prices[[133]](#footnote-133). Furthermore, there are various questions which influence the inflow of Japanese FDI – territorial disputes over the ownership of the Senkaku islands[[134]](#footnote-134), the US-China trade war and Covid-19 pandemic also negatively affect the inflow of Japanese investment to China. Nevertheless, Japanese automotive companies are still among the largest foreign investors, additionally there is a huge wave of investment into green energy technologies at the moment.

As well as European manufacturers, Japanese automotive companies are currently more focused on investing in production of electric vehicles. In particular, Honda intends to invest 40 billion US$ into the production of electric vehicles (abbr. EV) during the next 10 years, namely into research and development of electrification and software technologies[[135]](#footnote-135). It is known that Honda plans to open new EV plants in Wuhan and Guangzhou, as well as in North America. However, the biggest recipient of FDI is China, as the company is going to deepen its ties with local enterprises. Namely, Honda is partnered with CATL (Contemporary Amperex Technology Co., Limited), which is the supplier of batteries. Companies announced that they signed a new agreement on cooperation, according to it, CATL will supply Honda with the recycling and reusable batteries for new pure EVs[[136]](#footnote-136).

Thus, it can be concluded that China’s plans about pollution control lead to investment in renewable energy technologies. Therefore, there are more opportunities for companies that produce green energy equipment. One of such companies is an electric carmaker Tesla, which is the most unique case among automotive companies. Tesla Inc. singed up the deal with the Shanghai government on July 10, 2018, and in January 2019 the company started to construct its factory. By the end of 2019, Tesla had already started to manufacture its first automobiles outside the US.

Many researchers agree that Tesla’s entrance into the Chinese market is sequence of favorable opportunities for the creation of affiliate. Firstly, the establishment of Negative Lists in 2018 was highly advantageous to Tesla. The first Negative List, which was announced on June 28 of that year, allowed automotive firms, that produce new energy vehicles, to set up wholly foreign-owned enterprises. This change let Tesla avoid the necessity of creating a joint venture, which definitely benefitted the company.

The construction of Giga Shanghai, which is the name of Tesla’s factory in China, was highly supported by the Chinese authorities and banks. Four big Chinese banks loaned Tesla about US$ 1,4 billion with a low interest rate. Besides, originally the plant was not located within the SEZ, but it was changed after the Tesla’s entrance. On July 27, 2019, the State Council expanded the Shanghai FTZ, including Lingang area, where the Giga Shanghai factory was building.

According to the plan of CO2 reduction, China Association of Automobile Manufacturers (abbr. CAAM) promotes the transition to electrification of cars. The PRC government intends the full transition to non-fossil energy consumption, therefore, in 2021 about 60% of public transport was already purely electronic vehicles[[137]](#footnote-137). So, foreign investment into “green” automotive production is highly supported. The PRC government introduced various policies for attracting FDI into manufacturing new energy vehicles (abbr. NEV): tax reduction, subsidies, and financial support for reducing R&D and production costs.[[138]](#footnote-138)

One of the main problems, which have been proposed by economists, regarding the role of FDI in the Chinese automotive sector, is that foreign direct investment in automotive industry do not reduce the amount of import. China is ranked 3rd, when it comes to import of automobiles[[139]](#footnote-139). Even though the number of imported cars is reducing since 2013, the Chinese market is still in need of foreign vehicles. The huge market, fast growth of urbanization, and growth of middle-class lead to increase in demand. As the Chinese manufacturers are not able to provide the domestic market, and foreign factories aim not only at providing local buyers, but also at importing, car imports will be kept at quite a high level.

Figure 3.3. Number of cars imported into China

Data Source: Statista

URL: <https://www.statista.com/statistics/244368/number-of-cars-imported-into-china/>

Imports of automotive products are expected to increase during next years, as Covid-19 pandemic has largely reduced demand of many products, including automotive ones. In addition, as it was mentioned above, many automotive enterprises are relocating or seeking new markets for relocating their production, and this, consequently, reduces FDI inflows and increases the necessity of import. Despite the fact that domestic automotive production is currently growing, many Chinese companies are focused on exporting their products, so it is not certain that local production will be able to replace foreign manufacturers.

Analyzing sales of foreign automotive manufacturers, it can become clear which companies should think about relocating their plants to other areas, as there is no necessity to focus on the Chinese market. Firstly, Japanese car brands hold quite a big percentage of market share in China, therefore, it is still very profitable for such companies as Honda and Toyota, which have the percentage of market share 8.33% and 7.87% respectfully[[140]](#footnote-140), to invest more. However, Mazda and Mitsubishi keep showing worse indicators over the years, therefore, it could be a better idea for them to focus on other markets, as it is difficult to compete with huge amount of local and foreign brands.

Figure 3.4. Sales of Japanese automotive companies in China

Data Source: Carsalesbase

URL: <https://carsalesbase.com/car-sales-china-home-main/car-sales-by-brand-china/>

Secondly, European brands also have quite diverse indicators of sales. For instance, BMW has an average growth rate in sales of 18,2% since 2013[[141]](#footnote-141). However, Volkswagen’s indicators have been fluctuating since 2013, and sales significantly diminished in the period of Covid-19 pandemic – the growth rate in 2021 was -17,03%. Nevertheless, Volkswagen is still one of the main automotive companies in China, and its market share is 10,28%, which is the biggest indicator among foreign automotive brands[[142]](#footnote-142).

Figure 3.5. Sales of European automotive companies in China

Data Source: Carsalesbase

URL: <https://carsalesbase.com/car-sales-china-home-main/car-sales-by-brand-china/>

Thus, it can be concluded that in some cases relocating factories to India can be quite a good opportunity for some automotive brands, but companies need to analyze all advantages and disadvantages of this process. Besides, the end of Covid-19 pandemic and cancellation of Covid-zero policy in China can influence the further development of the automotive sector.

As it was already said, at present lots of automotive companies plan to inject a large amount of foreign direct investment into the production of electric vehicles. It is believed that the reason for investing is the fact that China is rich with natural resources, which are critical for production. EV production needs such materials as nickel, lithium and cobalt, etc. For instance, China is the 4th when it comes to lithium reserves, with the indicator of 2 mln MT[[143]](#footnote-143). However, the authorities diminish lithium mining, they have even shuttered some hubs recently, as China is focusing on the more careful usage of domestic resources[[144]](#footnote-144). Nevertheless, the most of domestic lithium is consumed by the producers of batteries for EVs. Additionally, China has an advanced manufacturing sector and infrastructure, therefore, it is easier for companies to build their plants there, rather than in less-developed states.

Nevertheless, some scientists highlight that the high consumption of critical materials by EVs producers and the carbon neutrality plan can lead to the scarcity of natural resources in China. Over and above, it will lead to price increase, as prices are already fluctuating a lot[[145]](#footnote-145). Even so, there is a possibility to import necessary materials from other countries of Asia-Pacific regions. It is more convenient to import some materials, rather than relocate the whole production to other countries, especially EV market. As a rule, automotive companies choose economically advanced states with the developed manufacturing sector, such as China, US, and European countries.

Even though that these days China tries to attract more investors into services, foreign manufacturers are still highly attracted to the Chinese market. Due to the various reasons, which have been highlighted in this paper, automotive sector is going to keep its attractiveness for foreign direct investment. Besides, the introduction of full ownership and the lift of pandemic restrictions will definitely change foreign direct investment inflows into automotive sector. Despite the fact that India is rising as a possible host country for foreign capital, scientists believe that China will not lose a huge amount of FDI.

In the example of the automotive sector, we can see a shift from a quantity to quality of foreign direct investment. The attraction of foreign investors in the production of EVs confirms the “greening” of investment in recent times. While it has been noted before that this shift to “green” investment may lead to a reduction in FDI inflow, in the case of the automotive industry, this shift, on the contrary, may increase foreign direct investment.

3.2. China’s FDI in banking sector

Nevertheless, recently China is experiencing a transition of foreign direct investment from manufacturing to services. It should be noted that many economists suspect that the increase in attractiveness of services became possible because of the astonishing growth of the manufacturing sector[[146]](#footnote-146). While examining the FDI inflow into services, quite an interesting industry is banking, as it is one of the most secured services in most of countries globally. Therefore, banking is one of the most difficult sectors for foreign companies to invest in. Furthermore, it is a very considerable decision for any host country to open this sector for foreign investment. Therefore, China’s restrictions for foreign investment in banking sector is quite strict. The limitations are – China let only 20 percent share for a single foreign investor, and banks are treated as fully foreign if more than 25 percent of investment are foreign[[147]](#footnote-147).

The first foreign banking operation started right after the implementation of reform and opening up policy. Export-Import Bank of Japan, established in 1979, was the pioneer among foreign banks to enter the Chinese market. At first, foreign banks were not capable of engaging in every banking operation. However, the sector has gradually been liberalizing for foreign investors. One of the important steps is the China’s accession to the WTO, which let foreign banks access the vast local currency market[[148]](#footnote-148). In agreement with China’s affirmation to the WTO, foreign banks could open their affiliates since 2006[[149]](#footnote-149). According to the information from CBIRC, the number of representative offices increased rapidly after the accession.

The WTO accession let foreign banks service the Chinese companies and individuals in the local currency, that was permitted before. Additionally, any geographic restrictions on financial organizations were fully lifted. Thus, foreign invested banks and financial organizations were able to essentially operate on the equal terms with the local Chinese banks[[150]](#footnote-150).

Figure 3.6. Number of foreign-invested banks in China

Data Source: Statista

URL: <https://www.statista.com/statistics/277993/number-of-foreign-banks-in-china/#:~:text=In%202016%2C%20there%20were%201031%20foreign%20banking%20institutions%20in%20China>.

On December 22, 2014, the State Council announced the changes in Regulations of the People’s Republic of China on the Administration of Foreign-funded Banks. Since January 1, 2015, when the changes came into force, the Chinese banking market is further liberalizing for foreign investors. In 2018, all regulations of foreign ownership caps in financial sector were removed[[151]](#footnote-151).

According Regulations of the PRC on the Administration of Foreign-funded Banks, there are five types of foreign-funded financial institutions[[152]](#footnote-152):

1. Solely-foreign-funded bank (a foreign-capital bank with its headquarters incorporated within Chinese territory);
2. Foreign bank branch (a branch incorporated within Chinese territory by a foreign bank);
3. Joint-equity bank (a bank with joint capital operated within Chinese territory by a foreign financial institution jointly with any Chinese company or enterprise);
4. Solely-foreign-funded finance company (a finance company with foreign capital which head office is domiciled within Chinese territory);
5. Joint-equity finance company (a finance company with joint capital operated within Chinese territory by a foreign financial institution jointly with any Chinese company or enterprise).

Regulations give the accurate scope of business that is allowed for foreign-funded banks, approved by the People’s Bank of China (abbr. PBOC). Furthermore, there is the Law of the People’s Republic of China on Banking Regulation and Supervision, which standardize regulation of the banking industry in China. According to it, there are two institutions that regulate and supervise banks and financial organizations – China Banking and Insurance Regulatory Commission (abbr. CBIRC) and PBOC[[153]](#footnote-153). As for the registration of a foreign bank, firstly, it is necessary to obtain the approval of CBIRC. Besides, foreign banks must receive a separate permit from PBOC for settlements and sale of foreign currency[[154]](#footnote-154).

Banking operations are still highly regulated in China, almost every change in a company is controlled by supervising institutions. The latest changes in regulations were implemented in 2019. Even though many economists mark that there are not many changes from the previous version of Regulations, there are still quite remarkable modifications. The main one is the fact that the Chinese shareholder of a banking joint venture can be not a financial institution. Therefore, foreign banks can partner with various enterprises for opening its affiliate. Furthermore, foreign-funded banks started to have more flexibility, because there is no need to keep 30 percent of an operational capital as interest-generating assets[[155]](#footnote-155). All these changes made the introduction of foreign capital even easier than it was before.

Despite the challenges, such as Covid-19 pandemic and trade war with the US, China still kept liberalizing its banking sector by increasing foreign ownership and allowing foreign players to participate in pension fund management and credit rating agencies[[156]](#footnote-156). However, in 2021, there were a number of changes that retarded the liberalization of FDI to banking sector. Firstly, the Chinese government limited the amount of money foreign-funded banks can transfer from overseas. Secondly, there are restrictions for some foreign banks in providing loans[[157]](#footnote-157). Some economists believe that the reason of such actions is the political tenses and unsteadiness of foreign businesses. Supposedly, it is too early to analyze how these changes influence foreign direct investment inflow in the banking sector, but it will probably slow down the process of the attraction of greenfield projects.

The opening of China for foreign banks is quite valuable, as the entering new markets gives a great opportunity according to the market development theory and the customer follower theory. Based on these theories, banks follow their customers, mostly international companies, to new foreign markets, so they do not lose any major customers. Therefore, when multinational enterprises start doing business in China, it is easier for them to seek for a more familiar banks on the Chinese territory, rather than deal with unknown banks. The boost up in FDI and entrance of global companies made foreign banks also invade the Chinese market[[158]](#footnote-158).

Most of foreign banks are located in special economic zones, especially in the Shanghai FTZ, because of the different conveniences. Some economists believe that foreign banks are attracted by the availability to operate within more wealthy population, the governmental policies, and the economic environment[[159]](#footnote-159). However, foreign-funded banks still are less profitable than government banks, even with all the benefits for foreign players. Economists highlight that the main reason for such an outcome is higher funding costs for foreign banks. It leads to reduction of retail networks and higher interest rates of foreign banks[[160]](#footnote-160). Nevertheless, the number of foreign-funded banks in China keeps expanding.

There are lots of major global banking institutions, which have affiliates in China. Morgan Stanley, an American investment bank, benefited from the changes of ownership percentage. In February, 2023, the company was approved to have a full ownership of its joint venture, therefore, it increased its stake in Morgan Stanley Huaxin Funds (note: the name of the branch) from earlier permitted 49 percent of ownership[[161]](#footnote-161). Many foreign-invested banks, following the same example, increase their ownership shares. Union Bank of Switzerland (abbr. UBS) also enhanced the ownership of the affiliate, called UBS (China) Limited. The modification of the ownership share let the company increase its holding to 50 percent[[162]](#footnote-162). However, the company also has another affiliate, UBS Securities, which 67 percent is owned by UBS Group AG. Therefore, it should be highlighted that these changes affected not only the bank’s ownership shares, but the holding of any financial institution. Aside from these companies, economists note that such banks as Goldman Sachs, Deutsche Bank, and Citigroup are also enhancing their direct investment in China[[163]](#footnote-163).

Furthermore, the inclusion of Chinese stocks in international indices MSCI has also played a significant role in the attraction of foreign capital. Although this change mainly affected the pool of foreign portfolio investment, it makes sense to consider its impact on FDI. The issuance of securities in China largely forced foreign banks to expand their branches, which required an increase in investment. This inclusion triggered 80 billion US$ investment flows into the Chinese capital market[[164]](#footnote-164). Nevertheless, some economists consider that China’s financial services sector is currently shifting its focus from direct to portfolio investment[[165]](#footnote-165).

Among Russian banks, VTB Bank (PJSC) is the only Russian bank, which has a financial license to do banking business in the People’s Republic of China has an affiliate there. VTB Bank is the part of VTB Group, that is a banking group with offices in Europe, Asia, Africa, and over 20 subsidiaries, with the headquarter in Moscow, Russia. VTB Bank (PJSC) Shanghai Branch has a financial license and been conducting banking operation since March 2008. Besides, the VTB has a representative office in Beijing. The affiliate opens accounts for corporate clients, who are residents and non-residents of China and Russia. Even though the affiliate works only with corporate clients, it still provides a wide range of services[[166]](#footnote-166):

1. Transaction management. The bank provides fast and secure payments within VTB Group, allows to open accounts in Russian branches, supports transaction between Russia and China, while consulting questions of the legislation of both countries;
2. Documentary operations. The bank deals with issuance of all types of guarantees and letters of credit, performing a range of transactions as transfers, advising, etc.;
3. Short-term trade and export finance. The bank gives an opportunity to conduct transactions with the CIS, European, Asian, African and the Middle Eastern banks under URDG, UCP, against Russian and Chinese legislation;
4. Lending and credit. The bank lends to Russian importers for purchasing goods in China, gives working loans to Chinese firms, and finances Chinese buyers under cover of SINOSURE, Russian and European export credit agencies;
5. Foreign exchange. The bank allows foreign exchange in various currencies for Chinese and Russian firms;
6. Derivative transactions. The bank provides currency forwards, currency and interest swaps, and other derivative transactions;
7. Commodity trading. The bank has a wide product range and leverages the global VTB network;
8. Global banking. The bank assists Chinese and other Asian enterprises in investment in regions with VTB Group presence, supporting by a full range of services, such as M&A advisory, etc.

It is believed that the development of investment cooperation between Russia and China lags significantly behind their trade cooperation. Russian investment is very modest – China accounts only for 0,08% in the total amount of FDI[[167]](#footnote-167). Therefore, the decision of the company to open an affiliate in China is rather unusual decision. The reason is the chosen strategy “Go East”, which was announced in 2018. This solution is currently undergoing expansion, as China is the main opportunity for the financial cooperation for Russia.

The sanctions, introduced to banks of the Russian Federation, somehow concerns the Shanghai branch, therefore, it started conducting all transactions in RMB for Chinese residents in 2023. However, it was not the recent idea as the idea of moving to transactions in RMB was introduced back in 2018 as a part of de-dollarization plan, when about 70% of operations were conducted in US dollars. The VTB Group planned to reinforce ties between China and Russia’s financial cooperation, and currently it has a good opportunity to develop even stronger connection.

The issue of de-dollarization is quite relevant these days, as the Chinese government seeks for reduction of its vulnerability to US dollar as a global currency. The key strategy is using the Chinese RMB (yuan) as a tool of international trade, therefore, it would be possible to diminish a dependency from a foreign currency. Firstly, the plan of de-dollarization interfered with the Chinese trade, however, China is already investing its outward FDI in RMB – Brazil has started to accept investment in the yuan[[168]](#footnote-168). Supposedly, China will also fully swift to the yuan in the case of inward foreign direct investment. At the moment it is quite difficult to predict how this policy will affect foreign investment in the banking sector, however, it can be specified that the Chinese state banks have been selling dollars, whereas foreign banks of neighbor countries have been buying the yuan[[169]](#footnote-169).

To sum up everything that has been stated so far, the banking sector still is one of the most protective industries for foreign direct investment, which highly depends on economic and political situation in the country and internationally. Therefore, it is quite difficult to predict what changes will happen in the future. Nevertheless, China keeps actively attempting to liberalize this sector.

Conclusion

China has become the host country, which attracted the largest amount of foreign direct investment. Since the beginning of reform and opening up policy, foreign direct investment has continuously been a necessary condition for the development of the Chinese economy. As FDI plays a large role in micro and macro levels, the Chinese government is actively pursuing a policy to create and maintain a favorable investment climate. During Xi Jinping’s era, China has been elaborating its economic reforms and various policies for attracting foreign direct investment, which has enhanced the liberalization process of the investment structure and legal aspects.

The main goal for this study is to analyze China’s foreign direct investment during Xi Jinping’s era, its changes and impact on the economy of the country. The current president of the People’s Republic of China, Xi Jinping, continues to increase the volumes of FDI as a part of reform and opening up policy, as foreign investment keeps being important in the era of globalization.

Under the leadership of Xi Jinping, China has shown a mixed approach towards FDI, combining efforts to attract foreign investment with measures to safeguard national interests and maintain control over strategically important sectors. Furthermore, China has been continuing to create a positive investment image in front of foreign investors. The rapid growth of the economy has led to a change in the country's investment policy – there is the transition from quantity to quality, where the attention has shifted to science-intensive projects with a high degree of environmental safety and resource conservation, which require improved technologies.

Since the formation, special economic zones keep playing a significant role in attracting foreign investment. These zones are designed to develop trade and investment, as well as to attract new technologies and improve the skills of workforce. The creation of FTZs in 2013 expanded its liberalization efforts to include broader geographical areas and a wider range of sectors. Primarily, FDI inflows to these areas have been driven by cheap labor, good infrastructure, combined with various favorable policies for foreign investors, such as preferential taxation.

Improving of legal issues was also an important factor in attracting foreign direct investment, as it created favorable conditions for foreign investors. Thus, one of the important steps was the adoption of the Foreign Investment Law, which came into force in 2020, which replaced three previous laws governing foreign investment. This law is aimed at create a stable and competitive business environment and to provide reliable legal guarantees for foreign investors. Therefore, it provides a more transparent and predictable field for investors by introducing measures to protect the rights and interests, enhance intellectual property rights protection, and improve the investment approval process. According to the legal act, foreign-invested companies have various benefits in the field of finance, taxation, and natural resources. In general, the Chinese government has established the principle of equality between domestic and foreign enterprises.

Nevertheless, China keeps protecting some sensitive areas from foreign investors, therefore it has introduced negative lists for FDI, which restrict and prohibit some sectors from investment. China’s Ministry of Commerce releases these negative lists every year. Some previously restricted industries, such as finance and automotive manufacturing, have witnessed liberalization measures, allowing for higher levels of foreign ownership and participation. For example, foreign banks can now own majority stakes in joint-venture banks, and foreign automakers have been permitted to establish wholly-owned subsidiaries in China.

Since huge amount of FDI has usually been attracted to industries that contribute to environment pollution, China has introduced a greater control on attracted FDI. It helps to “green” foreign investment, that is one of the main goals of the Chinese government as a part of “decarbonization” policy. The ban on polluting FDI helps attracting investors with advanced green technologies that are characterized by low energy consumption and little polluting waste. The Catalogue of Industries for Encouraging Foreign Investment also reflects China’s efforts to reduce investment in highly polluting industries. Therefore, Recently, we have been observing the transition to a "quality" investment policy, namely the improvement of the legal regime and focus on the "greening" of investments. It is also worth noting that China has made a significant progress in liberalizing the FDI regime by reducing the negative lists, which is a prerequisite for attracting a significant inflow of foreign investment.

Since 2013 there has been a tendency of shifting FDI from a manufacturing to service sector. Nevertheless, the importance of high-tech manufacturing industries remains quite high, as it creates various spillover effects, such as technology transfer, which let China develop domestic industries. When it comes to the automotive sector, which was examined in this study, it has faced various changes these years. First and foremost, as it has already been mentioned, the establishment of the FIL allowed foreign investors to own its enterprises in China, therefore, there is no need any longer to create joint ventures. Over and above that, there is a current tendency of attracting NEV manufacturing brands, as China plans to encourage more high-tech and “green” foreign investment.

The service sector has been also liberalizing during Xi Jinping’s rule, and currently it occupies more than the half of all inward foreign direct investment. In this study we analyzed the performance of a banking service, which is one of the most complicated cases in terms of foreign investment. Traditionally, it is one of the most protected and regulated sectors, as there are concerns over stability and safety of financial stability of the country. Therefore, the liberalization process of this industry is quite moderate and uneasy, because it goes back and forth. Nonetheless, the number of foreign banks has increased substantially since 2013. Hence, China increased the number of areas, which foreigners can invest in, and also increased the percentage of ownership. This change assuredly enlarged foreign presence in the Chinese banking system. Besides, the inclusion of the Chinese stocks in international indices MSCI was an important step not only for portfolio investment, but for FDI as well, because it impacted foreign banks to enlarge their business in China. However, we should notice that recently with regards to banking sector there is a trend of China focusing more on portfolio investment, rather than direct.

In conclusion, China’s FDI policy under Xi Jinping’s rule aims to create a favorable business environment for foreign investors, while ensuring that national priorities are upheld. Thus, Xi Jinping increases China’s participation in global processes by involving in FDI flows, and the Chinese government continues refining its approach to foreign direct investment. However, it is important to note that China’s national security concerns influence FDI policy, so the government maintains tight monitoring of FDI regulations. Therefore, it is crucial to understand that regulations tend to evolve because of economic and political changes.

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Appendix 1

China’s Labor Force

Data Source: Statista

URL: <https://www.statista.com/statistics/282134/china-labor-force/>

Appendix 2

China’s political stability index

Data Source: The World Bank

URL: <https://www.theglobaleconomy.com/china/wb_political_stability/>

Appendix 3

China’s utilized FDI by regions

Data Source: National Bureau of Statistics of China

URL: <http://www.stats.gov.cn/tjsj/ndsj/2019/indexeh.htm>

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