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An interpretative model of foreign direct investment in China: An economic policy approach

José Miguel GINER*, Graciela GINER¹

*Department of Applied Economics and Economic Policy, University of Alicante,
P.O. Box 99, E-03080 Alicante, Spain*

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Abstract

The objective of this paper is to elaborate an interpretative model of foreign direct investment (FDI) in China based on an integrated view of economic policy. Along with the analysis of purely economic factors, other variables will be incorporated such as those relating to sociopolitical instability, the business operating context, and the existence of an export-oriented policy. The methodology that we have chosen recognises the importance of economic elements as well as that of sociopolitical elements, especially with regard to countries in the process of development, transition, and reform, such as China.

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1. Introduction

There exists a broad consensus that foreign direct investment (FDI) occurs when three determining factors exist: the presence of specific competitive advantages, which are the property of a multinational company; the existence of specific advantages of locating in the country receiving the investment; and the presence of greater commercial advantages at the intracompany level.

While the first and third conditions are specific business factors affecting FDI, the second is specific to location and exerts a crucial influence on the flow of direct

* Corresponding author. Tel.: +34-965903958; fax: +34-965903603.

E-mail addresses: giner@ua.es (J.M. Giner), graciela.giner@ua.es (G. Giner).

¹ Tel.: +34-965903400x3171; fax: +34-965903603.

investment towards the receiving country. If only the first condition exists, companies tend to focus on exportation, licensing, or the sale of patents to attend to the foreign market. If the third condition also exists, FDI begins to be the preferred model, but only when specific advantages of location are also present. When all three conditions exist, the factors of location are the only ones that can be directly influenced by governments of those countries receiving direct investment from abroad.

In order to explain the differences in the flows of investment between different countries and to formulate policies designed to attract FDI, we must not only understand how and why multinational companies elect certain countries or zones for such investment but also the manner in which these multinationals act.

The analytic approach that we have chosen to use in this paper is similar to that employed in macroeconomic studies. Although many such studies have discovered the importance of economic determinants, there exists no consensus about those. Along with purely economic elements, many authors, among them [Singh and Jun \(1995\)](#), have emphasised the importance of political and institutional questions as determining factors in FDI. Although each theoretical and analytical approach provides a partial vision of the complexity of the flows of FDI, there does not yet exist an integrated theory that combines these elements in an analytical manner. We have attempted to overcome this significant limitation by proposing an integrated analytical approach that explains the FDI directed towards China and by pointing out not only economic factors but also the important role of variables associated with political stability and with the environment within which companies must function. The empirical research that we have utilised is centred, therefore, on producing models of macroeconomic and sociopolitical factors that affect the flow of FDI to China. In Section 2, we review the recent literature dealing with theoretical and empirical aspects of FDI. In the Section 3, we propose an interpretative model derived from an integrated focus on economic policy of the FDI in China. Together with the analysis of purely economic factors, we incorporate variables associated with sociopolitical instability, with the conditions in which companies must do business and with an export-oriented stance. Finally, we present our conclusions.

2. Theoretical and empirical perspectives: a review of recent literature

2.1. Empirical approaches

The literature describing the factors that determine the flow of FDI, using different and varied methodologies, is voluminous and controversial. Empirical studies that evaluate these determining factors are generally based on one of three approaches. These are microeconomic studies, studies using data analysis, and aggregate econometric studies.

2.1.1. Microeconomic studies

These studies have been carried out at the firm and industrial level, particularly in those industries considered “footloose,”² such as those we find in the electronics sector. When

² Industries that face no restrictions on where they chose to locate.

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