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Letter from the Editor-in-Chief

Myanmar and Korea have many similarities and are complementary relationship. Therefore, we believe that research exchange will expand mutual understanding between Myanmar and Korea, and will be the cornerstone for mutual development.

KOMYRA and YUE have co-published The Myanmar Journal since August 2014. So far, many scholars have published numerous papers through the journal, and We are sure that this journal has helped many people understand Myanmar and Korea more clearly and closely.

The Myanmar Journal covers various issues in Myanmar and Korea. It covers various topics that can promote bilateral development and mutual understanding, not limited to specific topics such as economy, industry, society, education, welfare, culture, energy, engineering, healthcare, and agriculture.

We hope that this journal will continue to promote understanding of the current status and potential capabilities of Myanmar and South Korea and promote in-depth international exchange and cooperation.

We would like to express our deepest gratitude to the editorial board and YUE and KOMYRA for their valuable support in The Myanmar Journal publication.

February 28, 2022

Youngjun Choi *yj choi*

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This journal aims to promote the mutual cooperation and development of Myanmar and Korea through intensive researches in the entire field of society, economy, culture, and industry.

It will cover all general academic and industrial issues, and share ideas, problems and solution for development of Myanmar.

Articles for publication will be on-line released twice a year at the end of February and August every year on the Myanmar Journal webpage (http://www.komyra.com/bbs/board.php?bo_table=articles).

THE EFFECT OF FOREIGN DIRECT INVESTMENT ON CHINA'S ECONOMY

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ABSTRACT : This paper aims to study the contribution of FDI inflows on China's economy by using panel data covering 31 provinces of China for the period of 2000-2019. The role of FDI in China's economy are measured with sectoral distribution of FDI, and the share of foreign-invested firms in total exports and total employment of China. The study found that although the secondary sector has been an important sector in attracting FDI to China, annual FDI inflows to tertiary sector surpassed those of secondary sector since 2011. The export of foreign invested firms took large share in China exports till 2011, however, after that the share of the exports of domestic firms has exceeded those of foreign invested firms in total exports. At the same time, FDI helped to increase the employment opportunities in China. In addition, the results of the regression analysis showed that China's economy has been positively affected by FDI inflows, exports, initial size of economy, human capital, and technology transfer.

Key words : *Foreign Direct Investment (FDI), economic growth, exports, employment, human capital, technology transfer*

I. Introduction

With the consecutive market reforms in China since late 1970s, China became an attractive destination of Foreign Direct Investment (FDI) in Asia. Since the adoption of Open-Door Economic Policies in 1978, China has gradually liberalized economic sectors by improving the political and legal environment and maintaining an open

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and fair market environment to encourage foreign investment. Consequently, China has become the second largest FDI destination in the world since 1993 to reach the cumulative FDI inflows of US\$2170 billion in 2019.

In 2001, China becomes the member of World Trade organization (WTO). Being a member of WTO, China has made substantial improvement trade and investment regime including privatization of State-Owned Enterprises (SOEs), protection for private property rights, the elimination of various barriers on FDI, the removal of geographic and other restrictions on key sectors; increased foreign ownership limits in some restricted sectors, and non-discriminating treatment to foreign banks. Accordingly, since 2003, China realized the double-digit GDP growth rate which led to reach the rank of the second largest economy in the world in 2010.

Research Objectives

The impressive growth of China economy led many scholars to study the determinants and impacts of FDI inflows to China. Several studies focused on productivity and spillover effects of FDI on different industrial sectors while others investigate the effect of GDI on economic growth in different regions of China. However, most of the studies have been conducted for the period of late 1980s to early 2000s. Against this background, this study intends to focus on the period starting from 2000 to recent years. As its accession to WTO lead to significant increases of export-oriented FDI to different regions of the country, this study aims to investigate the contribution of FDI in China economy and to examine the effects of FDI on economic growth together with other determining factors for the period of 2000-2019.

II. Literature Reviews

Foreign Direct Investment (FDI) can be distinguished as export-oriented FDI and domestic market-oriented FDI. Domestic market-oriented FDI is mainly triggered by multinational firms to access the market of host country for resource efficiency and economies of scale while export-oriented FDI is motivated by differences in factor prices and supply security. Domestic market -oriented FDI are mainly attracted by growing market size and improving infrastructures and human capital. Considering other things as constant, the country of large market size in terms of GDP with higher growth rate can attract more foreign investment. In export-oriented FDI, MNEs diversify their value-chain activities and capabilities to different regions with forward

and backward integration. In the age of globalization with integrated international operations of multinational firms, export-oriented FDI is becoming more prominent to serve the regional and international markets efficiently.

According to neoclassical theories, FDI have positive effects on host economy through enhancing capital formation, employment creation, promoting exports, transferring management and technical know-how, and bringing access to international production networks (Zhang, 2001). Moreover, contemporary studies highlight the spillover effects of FDI in efficiency and technology transfer. The skills, technology and productivity of domestic firms can be improved through participating in backward and forward linkages of MNEs and their technical assistance to local partners (Rodriguez-Clare,1996). Moreover, the productivity enhancement of local firms come from competitive pressure exerted by the foreign counterparts through improving efficiency, introducing new technology, and innovations (Blomstrom et al., 1992). On the other hand, the evidences of the studies also highlighted the negative effects of FDI on host economy such as uneven distribution of returns, higher transfer prices, high profit repatriation, suppressing domestic firms in competition through their technological advantage, influences on government policies for favouring and excessive protection for their investment.

Moreover, the role of FDI in host economies seems to be country-specific. Empirical evidence suggested that impact of FDI on growth of the economy depends on economic policy, trade strategy, orientation of FDI, human capital, absorptive capacity, and initial size of economy. Blomstoerm, et al., (1994) examined the role of FDI in economic growth of developing countries for the period 1960-1985. The results highlighted that FDI inflows were determinant of economic growth in higher income developing countries, but not for the lower income developing countries. According to the study of Borenstein et al., (1998), the role of FDI in economic growth is only significant for those economies with sufficient absorptive capability. The results suggested that the less developed countries may be lag behind in technological levels, limited human capital and less absorptive capacity to realize the spillover efficiency of MNEs.

Several empirical studies revealed the role of FDI in host economy. The study of Zhang (2006) found that FDI has been main contributor of economic growth of China through adding capital formation, growing industrial output, increasing exports, creating employment, and raising tax revenue in the period of 1992-2004.

The study on FDI and economic growth of Southern Asia countries (1977-2009) revealed that FDI, human capital, economic infrastructure and capital formation have positive effect on GDP whereas population, technology gap and inflation have negative effect on the economic growth (Behname, 2012).

Adhikary (2011) assessed the relationship between FDI, trade openness, capital

formation and GDP of Bangladesh for period of 1986-2008. He concluded that volume of FDI and level of capital formation have significant positive impact on Bangladesh's economic growth while significant negative effect of trade openness reflects diminishing effect on economy.

According to the study of Sokang (2018) on economic growth of Cambodia during the period of 2006-2016, FDI have significant impact on growth of Cambodia's economy through technology transfer and developing human capital. The study of Nguyen (2020) demonstrated that that FDI and export are major determinants of economic growth of Vietnam during the period of 2000-2018.

III. THE ROLE OF FDI IN CHINA'S ECONOMY

China has experienced high FDI inflows for last three decades since it opened the door to foreign investors especially after the early 1990s. Attracting FDI is an important part of the opening up and economic reform process which has been included into the basic state policies since 1978. In the last 40 years, annual FDI inflows in China have expanded from almost nil in the late 1970s to US\$138.13 billion in 2019. Most of the FDI inflows occurred after 1992 which account for about 95% of the total FDI volume between 1979 and 2019. Accordingly, China has become the second largest recipient of FDI in the world since 1993 and the largest FDI recipient among developing countries since late 1990s.

With its accession to WTO, China opened up its economy to the world through several liberalization measures mainly improvement and deregulations of legal framework, elimination of various barriers and restrictions on FDI, enforcement on protection of private property right, and privatization of state-owned enterprises. As a result, during first decade of 2000s, it can be seen tremendous growth of China economy reflected by the double-digit growth rates of GDP.

Table 1 reflects the important relationship between FDI, exports and economic growth of an economy. The high growth rate of GDP in first decade brought China to the rank of second largest economy in the world in 2010. It was largely attributed by high growth rate of exports and steadily increase FDI with average annual growth rate of 8.7 per cent. Starting from 2010, even though the economy continued to expand with increasing flows of inward FDI, the growth rates of indicators has been gradually slow down mainly affected by the stagnant of world economy starting from global financial crisis of 2008. However, China has still to be recognized as the most prosperous economy among developing countries and in East Asia region.

Table 2 presents the cumulative FDI inflows, sectoral distribution of FDI inflows,

export share of foreign-invested firms in total exports and employment share of foreign invested firms in total employment. During the study period, the cumulative FDI inflows has increased by more than five times to reach almost US\$2170 billion in 2019.

The sectoral distribution of FDI reflects the orientation of inflow FDI in China economy. Till early 2000s, the majority of FDI inflows concentrated on the secondary sector which accounted for more than 50 per cent of annual FDI inflows. Since then, its share has dramatically declined to about 31 percent in 2019 even though it is still an important sector in attracting FDI. On the other hand, it is witnessed the rapid development of tertiary sector in recent decades. In tertiary industry, FDI is mainly concentrated in the sectors of real estate, social services and wholesale & retail trade and hotel & catering services.

The share of foreign-invested firms in total exports has steadily increased from about 48 per cent in year 2000 to almost 58 per cent in in 2004 and after that its share has gradually decreased to less than 40 per cent in 2019. FDI also helped to increase employment opportunities in China. Employment creation impact of FDI has reach the highest point by providing almost 30 million direct jobs in 2013 and 2014 which represents more than 3.8 per cent of total employment and then gradually declined to around 3 per cent in 2019.

These findings highlight the role and importance of FDI in China economy. Till the end of the first decade of twenty-first century, FDI have played very significant role in development of China economy and largely contributed to industry development, international market access and growth of the economy. It can be concluded that with the direct effects and spillover impacts of FDI, local firms have built their capacity to improve productivity and competitiveness in international market.

IV. EMPIRICAL ANALYSIS

1. Methodology and Data

To empirically examine the relationship between FDI on economic growth of China, this study conducts the analysis by using a panel data of 31 provinces in China over the period of 2000-2019. This study applies the conceptual framework used by Wei (1993). In fact, in addition to FDI, there can be many factors impacted on the growth of an economy. Thus, this study incorporates all most possible factors to find out the influential one on economic growth of China. The variables include

gross domestic products (GDP), foreign direct investment (FDI), exports, initial size of economy, human capital, technology transfer and population growth on provincial level.

The GDP and initial size of economy are measured in billions of China Yuan whereas FDI, and exports are described in billions of U.S. dollar. Practically, the initial size of the economy, human capital, and technology transfer are rather difficult to define. A possible way to assess the initial size of the economy is to take the gross capital formation of each province in initial year. Similarly, the level of human capital can be approximately measured by the number of students enrolled in secondary high school since the externalities of education affect the quality of human capital (Stohldreier, 2009). Likewise, technology transfer can be proxy with the number of domestic patents granted since new or enhanced technologies are made available through the transfer of technology and know-how. All the data are collected from the China Statistical Yearbooks of various years published by National Bureau of Statistics of China.

For the empirical analysis, the conceptual model is built in which provincial GDP is analyzed with six explanatory variables: FDI, exports, initial size of economy, human capital, technology transfer and population growth of respective provinces.

The model is expressed as follow:

$$GDP_{i,t} = \beta_1 + \beta_2 FDI_{i,t} + \beta_3 Exp_{i,t} + \beta_4 ISE_{i,t} + \beta_5 HC_{i,t} + \beta_6 TT_{i,t} + \beta_7 Pop-Gri_{i,t} + e_{i,t}$$

where:

β_1 : Regression constant.

$\beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7$: Coefficients to be estimated to measure the effects of FDI, exports (Exp), Initial Size of Capital (ISE), Human Capital (HC), Technology Transfer (TT), and Population Growth (Pop-Gr) on GDP.

e : Stochastic error term.

2. Expectations

Based theoretical assumptions and literature reviews, foreign direct invest, export volume, initial size of economy, human capital and technology transfer are supposed to be contributors of economic growth. Thus, these explanatory variables are expected to have positive impact on GDP. Normally, the absolute value of GDP is directly related to the population of a country. However, with the largest population in the world, the economic growth of China can be adversely affected by a higher growth rate of population. Thus, population growth is anticipated to have negative impact on GDP.

3. Empirical Results

Based on the sample data of 31 provinces of China for 20-year period from 2000-2019 for seven overserved variables, the analysis is conducted using IBM SPSS Statistics 24.0. The regression result is presented in Table 3. As can be seen in the table, the power of the models to explain the variables supposed to affect provincial GDP of China are considered strong as both value of the R2 and adjusted R2 are more than 85 per cent. The value of F-test, the overall significance of the models, came out highly significant at 1% level.

As expected, all explanatory variables apart from population growth rate have significantly positive effect on provincial GDP of China. FDI shows the expected positive sign in coefficient with highly significant at 1% level. This finding implies that increases in FDI inflows will lead to further growth of China economy. Increase of one billion in FDI inflows to China will add the value of provincial GDP by almost ¥1.28 billion.

Export variable has the expected positive sign and significant coefficient at 5 per cent level. It suggests that promoting exports by US\$1 billion will also raise provincial GDP by ¥1.15 billion. The coefficient of initial size of economy also has the expected positive sign and significant 1% level. This finding highlights the fact that initial size of economy is an important determinant of economic growth. It suggests that the province with high initial gross capital formation could have the results of high economic growth in the long term. One billion ¥ of gross capital formation will raise the value of provincial GDP by almost ¥1.32 billion.

Human capital also has the significant positive impact on provincial GDP. It is evidence that investment in human capital could be large contribution to growth of the economy. The coefficient of technology transfer has the expected positive sign and significant at 1 per cent level. It implies that technology transfer and spillover effect of foreign investment can also have the large impact on economic growth. Although population growth rate is expected to have negative impact on provincial GDP, the coefficient of population growth has positive effect, but not significant.

As indicated by the values of standardized coefficient (β), among all explanatory variables, technology transfer is the largest contributor to the provincial GDP, followed by human capital, foreign direct investment, initial size of capital, and exports. It implies that, assuming other factors are constant, the absorptive capacity for new technology and innovation and developing human capital are the most important determinants for the growth of an economy.

V. CONCLUSION

The study is conducted with the aims to investigate the contribution of FDI in China's economy and to examine the effects of FDI on economic growth together with other determining factors in China economy.

The contribution of FDI in China's economy have analyzed in terms of sectoral distribution of inflow FDI, the share of foreign-invested firm in total exports, the share of foreign-invested firm in total employment. The results showed that although secondary sector was the largest FDI recipient in early period, the sectoral choice of foreign-invested firms have obviously shifted to tertiary sector in recent decade. Although the export of foreign-invested firms took large share of China exports till 2011, after that its share was surpassed by the share of the exports of domestic firms. It is witnessed that Chinese firms promote their role of exports in global market. By expanding export, FDI helps China to integrate further into regional and global markets, contributes to have favorable balance of payment, brings a big source of foreign currency, and this, in turn, attracts more foreign investment. Although employment creation impact of FDI is frequently cited in literature and evidenced in empirical studies, the impact is considerably low in China's economy in comparison with its contribution to exports and other economic sectors.

To examine the effect of FDI on economy of China together with other influencing variables. provincial GDP is regressed with FDI, exports, initial size of economy, human capital, technology transfer and population growth of 31provinces for 20 years period from 2000 to 2019. The results proved that the China's economy has been positively affected by FDI inflows, exports, initial size of economy, human capital, and technology transfer. Based on these findings, it can be concluded that through both direct effects and spillover benefits, FDI inflows has largely contributed to the growth of China's economy.

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Table 1. Overview of China Economy

	2000-2004	2005-2009	2010-2014	2015-2019
Average Annual Growth Rate of GDP (%)	9.20	11.48	8.66	6.70
Average Annual Growth Rate of Export (%)	25.39	16.55	14.68	3.71
Average Annual Growth Rate of FDI (%)	8.68	8.72	6.08	2.95
Average Annual Inflows of FDI (US\$ billions)	50.90	76.11	114.12	131.28

Source: China Statistical Yearbooks (Various Years), National Bureau of Statistics of China

Table 2. Contribution of FDI in China's Economy

	2000	2004	2009	2014	2019
Cumulative FDI inflows (US\$ billions)	348.36	562.12	942.67	1513.24	2169.65
Sectoral Distribution of FDI Inflows (%)					
Primary	1.77	1.84	1.59	1.27	0.41
Secondary	77.46	74.98	55.62	36.75	30.62
Tertiary	20.77	23.18	42.79	61.97	68.97
Share of Foreign-invested Firms in Total export (%)	47.93	57.07	55.93	45.88	38.85
Share of Foreign-invested Firms in total employment	0.89	1.39	2.24	3.83	3.05

Source: China Statistical Yearbooks (Various Years), National Bureau of Statistics of China

Table 3. The Determinants of China's Economy

	B	SE	β
(Constant)	23.774	50.892	
FDI	1.275**	.291	.156
Exp	1.147*	.570	.069
ISE	1.315**	.396	.087
HC	.935**	.074	.286
TT	.019**	.001	.648
Pop-Gr	5.333	17.740	.005
R2	.861		
Adj. R2	.859		
F-Statistics	631.725***		
Observation	620		

Source: China Statistical Yearbooks (Various Years), National Bureau of Statistics of China

Note: ** Significant at 1% level, * Significant at 5% level

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