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# Government Incentives and Actual FDI Performances of China, South Korea, and Singapore

## Topic and Research Question

Foreign direct investments provide the recipient countries' businesses with the newest technologies, "best practices" in management, accounting, or legal guidance from the investors. MNCs can incorporate the latest technology, operational practices, and financing tools in the host countries. Governments use special incentives to soften the difference in entry into the market between domestic and international companies in order to attract foreign enterprises. The connection between government incentives and actual performances is highly relevant for both state authorities and investors, as the former strive to determine the most effective incentives to attract foreign investors and the latter try to understand which policies deserve attention in location choice.

As for East Asia, China, South Korea, and Singapore have been dependent on foreign investments in their economic and technological development; thus, these states were selected for further analysis in the present work. Bearing in mind the above-mentioned factors, the research question is as follows:

*"Can differences in actual FDI performances be fully or partially explained by differences in government incentives?"*

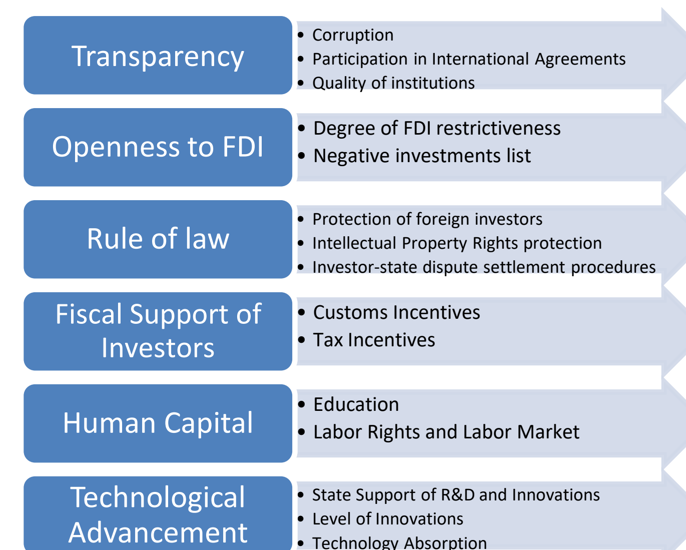
## State of the Art

Despite the fact that there is no comprehensive theory of FDI that would explain how the companies direct their investments, many scholars focus on the macroeconomic level, defining FDI attraction through location factors, production costs, technological advantages, etc. (Nayak and Choudhury 2014, 4-12; Denisia 2010, 55-58). According to Erdal and Gocer (2015, 757) in the case of South Korea, Singapore, and China, FDI played a major role in the technological and innovative sectors' development, bringing in all the necessary technologies and promoting their expansion on the domestic level (Coclanis 2000, 61; Nicolas, Thomsen and Bang 2013, 33-34; Chen 2018, 611). To attract more FDI into R&D sectors, it was found necessary to increase the innovative capacity of a state by escalating government efficiency to trigger domestic investments, innovations, and R&D activities, as noted by Chang Yang, Jin Zeng and Zhiding Zhou (2021, 2). Technological development along with the transparency of the government (mainly, control of corruption), and rule of law are named the key factors in FDI attraction (P.N. Kayalvizhi and M. Thenmozhi 2018). The UNCTAD (2009) research demonstrates the necessity of implementing fiscal incentives and human capital development, which are as important for the location choice of investors as the above-mentioned factors.

## Methodology and Approach

The thesis is based on a comparative approach, which implies identification of differences and similarities of the established FDI regulations in the specified countries. Given the complexity of the FDI regulations, the absence of a common framework for measuring their successful attraction in the administrative context, and the subsequent problems of choosing an appropriate set of variables for comparison, the analytical framework for current research is based on the UNCTAD (2009) approach to evaluating the host country's determinants of FDI mixed with several Ease of Doing Business indicators, scientific papers of P.N. Kayalvizhi and M. Thenmozhi (2018) and Yang, Zeng, and Zhou (2021). Moreover, the variables used in Cotula (2016) and Contractor et al. (2020) findings, namely rule of law, openness to FDI, and human capital, played an important role in formulating the analytical framework.

Such an eclectic approach enabled pursuing a comparison of China, South Korea, and Singapore using the analytical framework presented below:




## Main Facts

The analysis has facilitated the discovery of the following facts:

- Despite attracting the most investments (net inflows), the PRC has demonstrated quite low results in the majority of criteria selected for analysis. The government's approach to slow but systematic improvement of the investment climate has earned the confidence of foreign investors. However, hardening of the political line of China increases political risks for foreign companies and undermines the impact of government incentives.
- Such events as numerous corruption scandals over the last decade, preferential position of chaebols, and lacking improvement in the labor rights field, causing multiple labor strikes all over the country, have undermined trust of the investors and decreased FDI inflows in South Korea.
- Government incentives in the fiscal and technological spheres have facilitated high inflows of foreign investments into R&D-related sectors in all three countries.
- The Singaporean government, motivated by the lack of natural resources, has managed to successfully implement government incentives in all of the sectors mentioned in the framework, which has enabled the country to enjoy quite sustainable FDI inflows.
- Government incentives enhancing the rule of law, labor rights, and transparency in South Korea and China are quite ineffective and lag behind the expectations of foreign investors. However, China maintains a high level of investments, and South Korea faces a slowdown in them.
- Openness to FDI and human capital development remain weak points for China, despite the existing state policies, which may pose a threat to the high-tech development due to the lack of qualified cadres.

## Results

The research question was answered through the application of analytical framework criteria to each of the selected states. Government incentives were discovered to have only a partial impact on actual FDI performances in the chosen countries. Such incentives have been the most influential in such dimensions as openness to FDI, fiscal support of investors, and technological advancement. R&D-related sectors received the biggest tax cuts, administrative support, and positive investment climate-building efforts of the authorities of all three states and demonstrated the highest performance in terms of FDI inflows. Specifically, in the case of the ROK, easing FDI restrictions, provision of a preferential tax regime for tech companies, and various incentives aimed at the attracting FDI into technological sectors largely facilitated the restoration of foreign investment inflows in R&D-related industries. However, the overall level of FDI has been steadily decreasing since.

Along with government incentives, other factors, such as market size, trade routes, political risks, exchange rates, etc., have a significant impact on FDI inflows. In the case of China, the investment climate remains weak due to the gradual nature of state incentives, so the size of its market has a greater influence on the location choice of investors. Proximity to the Malacca Strait, an important trade route in Asia, along with the state's efforts in human capital development, facilitated high FDI inflows in Singapore. Manufacturing accounts for 90% of the ROK's exports and 30% of country's GDP, so the increase in FDI in this sector would have happened anyway, and state incentives' impact was quite modest. Thus, government incentives only partially affect FDI inflows, and their impact may be undermined or, on the contrary, significantly increased by external factors (market size, geographic location), and internal events (corruption scandals, political stability).

## References

All references can be found in the full version of the MA thesis available at http://othes.univie.ac.at/

## About the Author

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