

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of Economics**



**Master's Thesis**

**The impact of monetary and fiscal policy on international  
capital movements case study of China**

**Mohamad Bilal**

**© 2021/2022 CZU Prague**

# Diploma thesis Assignment

## CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

### DIPLOMA THESIS ASSIGNMENT

Mohamad Bilal

Economics and Management

Economics and Management

Thesis title

**The impact of monetary and fiscal policy on international capital movements – Case study of China**

---

#### Objectives of thesis

The research aims to provide a practical study on the impact of fiscal and monetary policies as attracting and motivating factors for international capital investment by examining the factors that determine these policies and their instruments to achieve a perfect business environment for investment in the local market.

#### Methodology

The practical part of the research uses the statistical analysis method to extract the relationship between the variables and to know the effect of the independent variables which are the exchange rate, the interest rate, and the volume of public expenditure on the dependent variable which is foreign direct investment using China as a case of study. This study will be conducted between 2005 and 2019.

**The proposed extent of the thesis**

40 – 60 Pages

**Keywords**

monetary policy, fiscal policy, interest rate, exchange rate, public expenditure, foreign direct investment

---

**Recommended information sources**

Bénassy-Quéré, A., Jacquet, P. and Pisani-Ferry, J., 2010. Economic policy: Theory and practice. Oxford University Press, USA. ISBN-10: 0195322738

Dullien, S., Goodwin, N., Harris, J.M., Nelson, J.A., Roach, B. and Torras, M., 2017. Macroeconomics in context: a European perspective. Routledge. ISBN-10: 1138185175

Simpson, T.D., 2014. Financial markets, banking, and monetary policy. John Wiley & Sons. ISBN-10: 9781118872239

---

**Expected date of thesis defence**

2021/22 WS – FEM

**The Diploma Thesis Supervisor**

prof. Ing. Mansoor Maitah, Ph.D. et Ph.D.

**Supervising department**

Department of Economics

Electronic approval: 22. 11. 2021

**prof. Ing. Miroslav Svatoš, CSc.**

Head of department

Electronic approval: 23. 11. 2021

**Ing. Martin Pelikán, Ph.D.**

Dean

Prague on 27. 11. 2021

---

## **Declaration**

I declare that I have worked on my master's thesis titled " The impact of monetary and fiscal policy on international capital movements case study of China " by myself and I have used only the sources mentioned at the end of the thesis. As the author of the master's thesis, I declare that the thesis does not break any copyrights.

In Prague on 30/11/2021

---

## **Acknowledgement**

I would like to thank my thesis supervisor, Prof. Ing. Mansoor Maitah Ph.D. et Ph.D., for his steadfast support, advice, and insight throughout the process. I would also want to thank my family and all my close friends for their unending encouragement and support.

# **The impact of monetary and fiscal policy on international capital movements case study of China.**

## **Abstract**

This research will focus on examining how monetary and fiscal policy play a significant role to attract and motivate the movement of international capitals.

The main aim of economic policy is to establish economic stability at full employment without an increase in the general level of prices, and this goal will not be accomplished without the use of effective policies, which can be fiscal policy, monetary policy, or a combination of both.

Fiscal policy has a substantial influence on the goods and services markets, with government spending and taxation serving as its primary instruments. In terms of monetary policy, its main tools are the discount rate, reserve requirement, and open market operations; the interest rate connects the two markets. Both policies, through their tools, perform a significant role in the transfer of international capital, which has become the focus of their work in various countries around the world.

This research is divided into two parts, theoretical and practical. The theoretical part discussed the concept of monetary policy and its importance, by presenting the objectives and instruments of monetary policy and The concept of fiscal policy in terms of its objectives and instruments.

The second section focused on the movement of direct foreign capital by explaining the concept and significance of the movement of direct foreign capital, determinants of the movement of direct foreign capital, and the most important types of direct foreign investment.

The last section discussed the impact of each policy on the transfer of international capital has been explained, by studying the impact of monetary policy instruments represented by the exchange rate and deposit interest rate also studying the impact of fiscal policy instruments represented by the general government final consumption expenditure on the movement of international capital represented by foreign direct investment. In the last phase, statistical analyses were tested using regression analysis in the case of study China.

**Keywords:** monetary policy, fiscal policy, interest rate, exchange rate, public expenditure, foreign direct investment.

## Table of content

<b>Diploma thesis Assignment .....</b>	<b>II</b>
<b>Declaration .....</b>	<b>IV</b>
<b>Acknowledgement .....</b>	<b>V</b>
<b>Abstract.....</b>	<b>VI</b>
<b>Table of content.....</b>	<b>VII</b>
<b>1. Introduction.....</b>	<b>1</b>
<b>2. Objectives and Methodology .....</b>	<b>2</b>
Objectives.....	2
Methodology .....	2
<b>3. Literature Review.....</b>	<b>3</b>
3.1 Monetary Policy: .....	3
3.1.1 Monetary policy objectives: .....	3
3.1.2 Instruments of Monetary Policy: .....	7
3.2 Fiscal Policy .....	10
3.2.1 Fiscal Policy Objectives: .....	11
3.2.2 Instruments of fiscal policy: .....	14
3.3 International capital movements .....	17
3.3.1 Classification of international capital movement: .....	19
3.3.2 Determinants of international capital flows: .....	22
<b>4. Practical Part.....</b>	<b>24</b>
4.1 Overview of the Chinese economy after the global crises 2007: .....	24
4.2 The role of international capital in the Chinese economy: .....	26
4.3 Monetary policy as a key role to attract foreign direct investment:.....	27
4.3.1 The Exchange rate: .....	28
4.3.2 The interest rate: .....	30
4.4 Fiscal policy as a key role to attract foreign direct investment.....	31
4.5 Development of Linear Regression Analysis Model: .....	34
<b>5. Results and Discussion: .....</b>	<b>43</b>
<b>6. conclusion: .....</b>	<b>45</b>
<b>References.....</b>	<b>46</b>
<b>List of figures and tables: .....</b>	<b>49</b>





# 1. Introduction

Financial crises and fluctuating economic situations affect countries all over the world. As a result of the interconnection between the economies of most countries around the world on the one hand, and the dependence of developing countries' economies on the economies of more developed countries on the other, these effects reflect in the economies of all countries in varying proportions. Considering these successive crises and rapid volatility, the importance of states in interfering in local and global markets becomes clear. Through the economic policies, particularly the fiscal and monetary policies pursued by countries to influence the price levels, inflation rates, employment rates, and the optimal exploitation of the economic resources available to the national economy with the aim of restoring balance and economic stability, which leads to the achievement of high employment rates and stable levels of prices, maintaining the value of money and protecting the economy from deflation, recession, and inflation.

Thus, countries can achieve economic equilibrium when aggregate supply equals aggregate demand without the presence of economic crises such as inflation and recession within the economy, furthermore, economies of countries are considered as the most significant attractor of international capital which is always seeking for energy supplies, raw materials, low-cost labour, and local and regional exchange markets via economic stability and balance, as well as the laws and regulations that support in achieving the optimal return on the capital used in investment projects.

Countries that provide an appropriate environment for these investments gain many benefits, represented in providing financing for development and transition to advanced technology in management, in addition to creating job opportunities and developing exports, thus increasing the volume of national income and its reflection on economic and social development programs.

## **2. Objectives and Methodology**

### **Objectives**

The purpose of the study stems from the fact that the movement of international capital is one of the most important factors that support the growth of countries' economies, through their transfer of management and technology to their host countries, resulting in financial surpluses that help to improve individual income levels and meet their growing demands.

The research reviews government intervention in the local market to achieve this goal through fiscal and monetary policies, as well as the mechanisms of integration between them in the presence of other economic factors, in an effort by countries to attract international capital.

The research aims to provide a practical study on the impact of fiscal and monetary policies as attracting and motivating factors for international capital investment by examining some of these factors that determine these policies and their instruments to achieve a perfect business environment for investment in the domestic market.

The goal is to analyse how monetary and fiscal policy through their instruments impact the movement of foreign investment in Chinese economy.

### **Methodology**

The theoretical part of this research has been based on a descriptive approach which enables the identification of the instruments of monetary and fiscal policies as factors that attract and encourage the movement of international capital. The practical part of the research uses the statistical analysis method (regression analysis) to extract the relationship between the variables and to know the effect of the independent variables which are the exchange rate, the deposit interest rate, and general government final consumption expenditure on the dependent variable which is foreign direct investment using China as a case of study. This study will be conducted between 2005 and 2019. for regression analysis, the Microsoft Excel software built-in regression tool has been used to analyse and display the results.

## **3. Literature Review**

### **3.1 Monetary Policy:**

Monetary policy regulates money and credit in the economy; this policy is determined by the government through monetary authority which utilizes this policy to influence the economy in the short and medium term.

Monetary policy definitions varied widely, as economic thought's perspective of this policy differed according to different trends and affiliations to schools and theories that dealt with the issue of money, also the solutions and instructions related to it that were presented to monetary authorities in order to implement their monetary policy.

Some definitions referred to monetary policy through its role to control the quantity of money in order to influence macroeconomics indicators such as inflation and economic growth, the process of overseeing a nation's money supply to complete specific objectives such as restraining inflation, or achieving full employment (Warin, 2005).

Others expanded on explanation of the concept of monetary policy to include monetary authorities' objective of achieving balance in various economic indicators with the aim of achieving price stability; to prevent liquidity crises, situations of money market disorders, and financial crises; and ensuring the smooth functioning of the payments system (Barbara Casu, et al., 2006, p. 110).

The central bank controls the supply of money through open market operations, money issuance, or changing interest rates to maintain economic and price stability and avoid disastrous economic situations. For example, after the 1973 oil crisis, the unemployment rate skyrocketed, and central banks in most developed countries pumped money into the economy to stimulate the economy, which was quite effective in the short term.

To summarize, monetary policy can be defined as a set of decisions and techniques that allow regulating the supply of money in a specific economy as well as adjusting interest rates and exchange rates to achieve economic policy objectives.

#### **3.1.1 Monetary policy objectives:**

The objectives of monetary policy have been numerous and have evolved alongside the evolution of the stages of monetary policy through and the evolution of its roles. The Central

Banks through the monetary policy aims to achieve the following objectives (Stephen G. Cecchetti, 2015):

**A. Price stability:**

Economic policymakers have become clearly aware of the economic and social costs of inflation, and therefore they have become more interested in achieving price stability as a goal of economic policy, and because of its importance in confronting inflation.

Price level fluctuations widen the gap between consumers and investors on the one hand and the monetary and fiscal authorities on the other hand, while inflation negatively affects the economic growth rate the central bank works to control the general level of prices and inflation through monetary policy (Agnès Bénassy-Quéré, 2010).

Controlling inflation through the monetary policy of the Central Bank by targeting a certain level of inflation in the economy plays a significant role by maintaining a certain price level, many central banks have established an inflation goal of around 2%. this proportion varies from one country to another based on economic situations and aims to be accomplished, for instance, China has set its consumer inflation target at around 3 percent for the year 2021, according to this year's government work report (Xinhua, 2021). Targeting inflation has become very important, especially after the 2008 financial crisis, which was marked by the collapse of house prices, as central banks use these tools to prevent deflation, achieve price stability and lower the unemployment rate.

**B. Reduce Unemployment:**

High unemployment rate have negative social and economic effects:

The social aspect: High unemployment causes a lot of human misery, as families suffer from poverty, people lose their self-esteem, and the level of crime increases, unemployment affects people and their families, and there is a study in Australia that says that most of the unemployed people in the community are from lower-income earners in the community (Alison McClelland, 1998).

Economic aspect: When unemployment is high, the economy will not only suffer from the presence of unemployed people but there will also be idle resources (closed factories and unused equipment) and this causes a loss in real growth of the economy. From a different perspective, when the unemployment rate rises, customers' purchasing power and demand fall, and as a result, company revenues fall, and corporations cut their budgets and reduce their employees' numbers. In this instance, the monetary authorities must intervene to put a halt to the situation and keep unemployment rates low.

In any case, this does not necessarily mean that zero unemployment is the goal of monetary policy since others argue that there is a specific level of unemployment required for the effective operation of a dynamic economy, the main goal is to maintain low unemployment. Even in the case of almost full employment in the economy, employees who switch jobs remain temporarily unemployed. This is known as frictional unemployment. In addition, unemployment may be the result of a mismatch between work skills and job opportunities, and this is known as structural unemployment. As a result, the purpose of monetary policy is to reduce unemployment in proportion to the supply of labor and demand for it in order to achieve an economically acceptable rate of unemployment, economists differ in determining it (Mishkin, 2011).

### **C. increase economic growth:**

The pursuit of economic growth as a monetary policy goal dates back to the twentieth century, following the Second World War. Economic growth is an indicator that expresses a country's economic health and is the process by which a country's wealth increases over time (Cornwall, 2018).

Since economic growth is necessary in order to raise the standard of living, it is closely linked with the goal of reducing unemployment, that is when unemployment is low, the possibility of business investment in capital equipment is greater, and this leads to higher productivity and economic growth, and vice versa, i.e. when Unemployment is high, the business sector is less likely to invest in capital equipment, and this leads to lower productivity and economic growth. The rate of economic growth should be at least comparable to the rates experienced by similar nations (Barbara Casu, et al., 2006).

### **D. Stable interest rates:**

An interest rate is a percentage charged on the total amount is borrowed or paid on the amount was saved (England, 2021). Interest rates are the most important factors affecting currency price trends at all, and interest rates affect the movement of currencies, as high-interest rates in a particular country encourage investment in that country, and thus the demand for currency and its value increase, and vice versa (Mishkin, 2011).

The view of money and its role in economic activity has changed, the monetary theory has been developed and updated, and the rate of interest is seen as a monetary phenomenon because it is determined based on money supply and demand.

The monetary authorities employ the interest rate in two major ways (increasing the interest rate, reducing the interest rate) to generate effects according to the demands of the current

economic condition. As a result, the monetary policy focuses on utilizing interest rates to achieve the goals that all countries strive towards., such as encouragement of investment and savings, preservation of domestic capital, and attraction of foreign capital, as changes in interest rate have a negative or positive impact on production, investment, and consumption decisions.

#### **E. Stable financial markets:**

Monetary policy works to stabilize financial markets by possessing sufficient capital and sufficient liquidity to manage financial operations and fluctuations.

The fluctuations that the financial markets are exposed to, on the other hand, demonstrate the monetary authorities' ability at this stage to restore balance to these markets through methods and regulations that limit these fluctuations, as large fluctuations in the financial markets contribute to a lack of investor confidence in these markets, Financial markets dislike uncertainty and risk, and the prices of financial assets fall when uncertainty and risk rise. Another way to view this is that investors must be compensated to take on risks. The more risk, the larger must be the compensation—meaning that the price of the financial asset must be cheaper to attract buyers (SIMPSON, 2014, p. 11).

Financial market stability is an important goal for monetary authorities because financial market crises have significant negative effects on the economy, such as the global financial crisis in 2007, which resulted in losses exceeding tens of trillions of dollars; such crises are rare, but they shed light on the consequences of financial market crises.

#### **F. stable exchange rate:**

An exchange rate is the amount of currency you can acquire from another country's currency in exchange for one unit of domestic currency.

The exchange rate is now recognized as a critical connection between a country's domestic economy and the international economy. Given the low degree of flexibility in internal pricing, the nominal exchange rate is critical in determining the actual exchange rate in the short and medium term. Real exchange rates, in turn, are critical in determining macroeconomic stability and the incentive to engage in trade (Williamson, 2009).

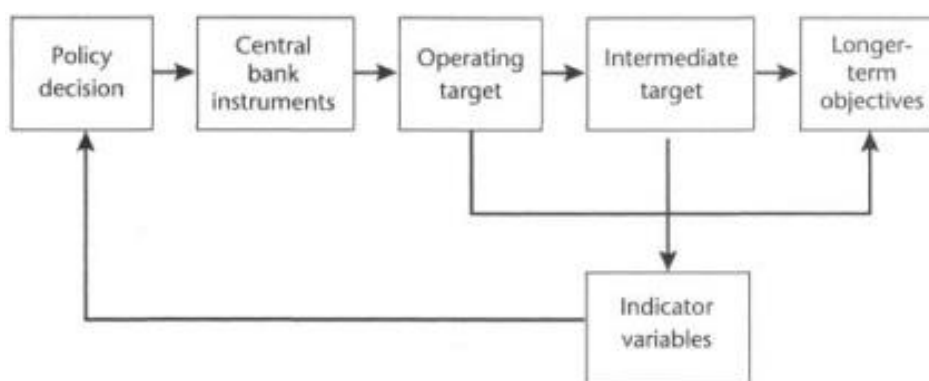
To achieve stability in the foreign exchange rate, the amount of money circulating in the national economy must be controlled, and this differs between the fixed exchange rate system and the floating exchange rate system. The fixed exchange rate is characterized by stability, and the central bank intervenes to maintain the stability of the exchange rate through currency buying and selling operations, fixed exchange rate promotes international

trade and investment which can be an important source of growth in the long run. The floating exchange rate, it is affected by market prices, supply, and demand, floating exchange rates leaves the monetary and fiscal authorities free to pursue internal goals such as full employment, stable growth, and price stability. Countries choose one of the two methods of exchange rate, but most countries currently rely on a strategy of a mixture of these two policies in proportion to their economic objectives (Labonte, 2004).

### 3.1.2 Instruments of Monetary Policy:

A variety of techniques, instruments, and technical approaches are employed in the regulation of money and credit in the implementation of monetary policy and figure (1) illustrate this process, Central Bank through its instruments is responsible for implementing this policy to achieve the various monetary policy objectives, which vary depending on the crises and circumstances surrounding the economy and the country's monetary system. Monetary policy instruments are generally classified as either direct or indirect (Alexander, et al., 1995):

*Figure 1: Process of Monetary Policy Implementation*



Source: IMF e-library, (Chorng-Huey Wong, et al., 2002)

#### A. Direct instruments:

The term “direct” refers to the one-to-one correspondence between the instrument (such as a credit ceiling) and the policy objective (such as a specific amount of domestic credit outstanding) (Alexander, et al., 1995). The Central Bank uses some procedures and tools to influence the volume of credit, either to reduce it or expand it, for example, to support some sectors in the economy by granting them facilities in the borrowing process to cover their

financing needs. Direct instruments function according to regulations that directly affect either interest rates or the volume of credit; the most common types of direct instruments are administratively set interest rate ceilings, individual bank credit ceilings, and directed lending (Chorng-Huey Wong, et al., 2002, p. 143). Indirect instruments are more effective than direct instruments in today's increasingly open economic environment (Alexander, et al., 1995).

### **B. Indirect instruments:**

Indirect instruments covers the tools and techniques utilized for indirect credit effect, such as the discount rate policy, open market operations, and the reserve requirement.

Direct instruments operate by setting or limiting either prices (interest rates) or quantities (amounts of credit outstanding) through regulations, while indirect instruments act through the market by, in the first instance, adjusting the underlying demand for, and supply of, bank reserves (Alexander, et al., 1995).

### **I. Reserve Requirement:**

Reserve requirement occurs when the monetary authority requires depository institutions to hold a minimum level of non-interest-earning reserves in proportion to their depository liabilities (HEIN & STEWART, 2002).

Three main motivations for traditional reserve requirements have been mentioned: reserve requirements were first used for micro-prudential regulation purposes to make sure the banks held the proper portion of liquid assets, reserve requirements can also be used for monetary control purposes and adjusted, similarly to monetary policy, along the business cycle, and reserve requirements are also used for liquidity regulation purposes, whereby the central bank attempts to affect banking system liquidity to reduce pressure on inflation, exchange rates, and interest rates (Lepers, 2018).

The importance of the reserve requirement tool varies from one country to another. In developed countries, there are developed and efficient financial markets that help to use open market operations efficiently, as it ranks first as a monetary policy tool, and the percentage of the required reserve is not used except in special cases.

In developing countries, the use of the required reserve ratio is more important and effective than other tools, given the lack of developed financial markets and the state of uncertainty in banks in the borrowing process.



## **II. Open Market Operations:**

Open market operations are the main monetary policy instrument, through which the central bank buys or sells securities with financial institutions in the open markets, thereby influencing the amount of money in circulation and/or interest rates (Korea, n.d.).

For instance, in the USA when the Federal Reserve tightens monetary policy by draining bank reserves through open market sales of government securities, the federal funds rate and other short-term interest rates rise almost immediately, reflecting the market's lower supply of bank reserves. Short-term interest rate hikes that are sustained result in decreased deposit and money growth as well as higher long-term interest rates. Higher interest rates enhance the cost of capital, which has a negative impact on business investment demand over time (AKHTAR, 1997).

Open market operations are widely used, for their flexibility, and efficiency but this open market strategy requires the presence of highly efficient monetary and financial markets of regulation and advancement, and it is well recognized that developing economies lack such development in their markets, which objectively weakens the monetary authorities' effective impact.

## **III. Discount Rate and interest rate:**

Discount rate is the interest rate charged by the Central Bank to commercial banks on loans they receive from the Central Bank.

The discount rate is used to influence economic activity by changing it, thus affecting prevailing interest rates. The central bank can control the discount rate through two directions: raising or lowering the discount rate; using the discount rate to influence economic activity and then influence interest rates for example when the economy is in recession, the central bank lowers the discount rate, which reduces the cost of obtaining liquid funds and credit by commercial banks by borrowing from the central bank, and this, in turn, leads to lower interest rates on commercial bank loans, which encourages investors to invest, which is reflected positively on the volume of total spending and thus boosts the economy; In the case of inflation, the central bank raises the rate of discounting to absorb cash liquidity in the economy, causing the price level to fall and encouraging individuals to deposit their savings in commercial banks, thus reducing inflation.

And interest rate is the cost of borrowing or the price paid for the rental of funds, the interest rate affects both individuals and businesses alike, as it is an indicator of the health of the economy, this rate is an indicator of the interest rates of commercial banks, which should

not be less than the central bank rate. The interest rate also helps the central bank to control the money supply up and down in the medium term, and raising interest means reducing the borrowing process and thus reducing the liquidity ratio in the market, which leads to lower inflation (high prices) (Mishkin, 2011, p. 3).

Interest rates are determined based on the forces of supply and demand. If the demand rates for the money supplied rise, this will lead to an increase in interest rates. At the same time, it will reduce lending rates in the economic circle, and interest rates will be affected by the size of their rise and fall within the various financial markets, as the financial markets are interconnected as a result of the movement of money within these markets. The financial market which is characterized by high interest rates attracts capital in search of higher profitability which increases the money supply, in turn, leads to a reduction in interest rates in response to the forces of supply and demand at the same time. At the same time, the owners of capital transfer their money from markets with low interest to markets with a greater return, which results in a decrease in the supply of them and this is a factor in the increase in the interest rate, as well as the consequences of the prosperity of the economic situation will lead to rising in interest rates, as interest rates tend to rise in periods when economic institutions need financing in response to increased production, which occurs in a state of economic recovery, and the demand for capital increases which works to raise the rate (Mishkin, 2011). The Central Bank raises, lowers, or fixes the interest rate as required by economic conditions.

### **3.2 Fiscal Policy**

The concept of fiscal policy has developed significantly, Until it became different in the modern era from what it was in the early nineteenth century until the emergence of the thoughts of the Keynesian school, and it was limited to some procedures that determine the sources of the nation's public revenues and their spending, and full commitment to the principle of balancing the public budget annually, which means that public revenues are equal to public expenditures, and the emphasis on the state's neutrality This concept persisted in economic life until the appearance of the Great Depression and the end of fiscal neutrality, as the severity of economic crises compelled the state to participate in fiscal policy and increase its impact on economic life. The International Monetary Fund defined fiscal policy as the use of government spending and taxation to influence the economy and boost stable and sustainable growth (Horton & El-Ganainy, 2020).

Some economists define fiscal policy as the government's use of taxation and public spending policies to achieve economic goals such as increasing economic growth, as well as social goals such as eliminating poverty and improving the lives of the poorest people (Weeks & Patel, 2007).

Some studies also confirmed the use of fiscal policy to achieve political goals as well the results reveal that expectation of getting voted out of office lead governments to increase expenditures and reduce revenues in electoral years, there is evidence that strategic manipulation of fiscal variables generates votes for the incumbent (Mourão & Veiga, 2010).

Through the previous definitions, we can say that fiscal policy is the government's tool to achieve the economic, social, and political goals that it seeks to achieve through the fiscal policy tools which are public expenditures, public revenues, and the public budget, to achieve economic stability, economic development, and social justice, which are the factors that attract international capital, the main purpose of the fiscal policy is to generate the revenue stream in the form of taxes and those taxes are utilized to carry out the government expenditures (Ahmed, et al., 2018).

The importance of fiscal policy comes from the fact that it is the ideal method for redistributing income and investments to various economic uses. Thus, fiscal policy has become an effective tool to encourage investments to move towards vital areas as well as attract international capital.

### **3.2.1 Fiscal Policy Objectives:**

The objectives of the fiscal policy were to achieve balance in the state's general budget at the lowest possible level, but after the great recession, the governments started intervention in economic life influenced by the ideas of the economist Keynes. fiscal policy employs instruments such as public revenues, public expenditures, and a general budget to contribute to the resolution of economic problems varying from unemployment and recession to inflation, to achieve the following goals:

#### **A. Economic stability:**

One of the most important aims of fiscal policy is to maintain economic stability and thus avoid price fluctuations, as well as to achieve full employment of available resources in a

manner that provides price stability and sustainable growth, thereby creating an ideal environment for business and attracting international capital.

Fiscal policy impacts aggregate demand through its tools such as taxation and public expenditure to ensure stability in the general level of prices and full employment of the available economic resources. Fiscal policy is implemented through an anti-depression tax policy which increases the disposable income of the individual, promotes consumption and investment through cut taxes in this case. This will ultimately result in an increase in spending activities which in turn, increase the effective demand of the people (Frakulli, 2017).

In the case of inflation, where the aggregate supply is less than the aggregate demand, the government increases taxes and reduces public expenditures to reduce the amount of financial supply and reduce the level of aggregate demand in contrast to the case of depression, and the spending policy works to rationalize consumer demand by reducing public spending items, and thus The fiscal policy used to reduce inflation consists of two aspects, the first is an increase in taxes and fees, and the second is a reduction in public expenditures (Johnson, 1975).

#### **B. Allocate resources:**

One of the most important concerns of fiscal policy is the issue of resource allocation, because these resources are limited, and these resources are intended to achieve the highest possible benefit to the economy by allocating them, fiscal policy is important for allocating resources to maintain a balance between the three key assets of the society: human capital, physical capital, and natural capital. The accumulation or depletion of these assets depends on the incentives created by tax policies and resources allocated through expenditure policies (López, et al., 2010).

In a competitive economy, market forces are the main driver of economic efficiency through resource allocation the policy instrument that brings about an efficient allocation is relative prices determined by supply and demand (Daly, 1992).

When market forces fail to achieve economic efficiency in the allocation of resources, the government (according to Keynesian theory) plays an important role through fiscal policy and its tools to restore economic efficiency by allocating resources. fiscal policy is powerful enough to influence macroeconomic expansion and contraction and to affect intergenerational transfers through debt, social security, taxation on extractable resources

and pollution, and subsidies and expenditures on mitigation and adaptation (López, et al., 2010).

For example, the government may resort to providing some subsidies and tax exemptions for certain sectors, as it imposes taxes on some luxury goods to achieve a fair allocation of resources.

### **C. Equitable distribution of income and wealth:**

The government's financial activity has a significant influence on modifying the income distribution pattern through influencing the types and percentages of government spending that different income classes benefit from, as well as the taxes collected from different classes of businesses and individuals.

Taxation an instrument of fiscal policy has been one of the government's ways of influencing the distribution of income and wealth in a society. To implement this policy fairly, the government applies high taxes on the rich, and this increases the government's revenues while subsidizing income and consumption for the poor, because of the potential disincentive effects on dependent workers taxes lost some of their potential effects on income distribution, Because of the ineffectiveness of this policy of equitable distribution of income, Governments have resorted to replacing it with universal entitlement programs, especially with education and health, because it benefits all citizens, not just the poor. Governments have used government spending to support these programs, which achieve a kind of equitable distribution of wealth and provide their services equally to the entire population. In addition, government spending plays a significant direct role by supporting the income of the poor, increasing consumer power by supporting them with cash or direct support for spending, as well as indirectly by supporting sectors that benefit the population, such as transportation and healthcare, which help those with lower income to obtain benefits similar to those of the rich (Afonso, et al., 2008).

### **D. Accelerate economic growth:**

This is one of the objectives that the government seeks to achieve because of its direct reflection on the long-term prosperity of the economy for businesses and individuals. Economic development requires the provision of the necessary financial resources. The importance of fiscal policy in providing these resources is due to the adoption by the government of programs and plans to achieve and finance economic development based on two main sources: domestic resources (Savings, taxes, cash issuance) and external sources (loans, foreign donations, foreign investment, etc.)

The government uses taxes and public spending to influence the factors that determine economic growth and increase economic output to ensure the development and sustainable growth of the economy. The government has not only to mobilize more resources for investment but also to direct the resources to those channels where the yield is higher, and the goods produced are socially acceptable (Ionela & Diana, 2010).

After identifying some of the objectives of the fiscal policy, it is obvious that all these goals work together to produce economic well-being, which is why they are complimentary. However, there might be a conflict between them. In this instance, fiscal policy must prioritize one aim above another to achieve the greatest potential economic well-being.

### **3.2.2 Instruments of fiscal policy:**

The importance of the financial instruments used by the government in its endeavour to meet citizens' demands and achieve economic development is growing, as the government finances its expenditures with revenues obtained from taxes, fees, and loans. Taxation, and public expenditure, they will be discussed as one of the most significant fiscal policy instruments applied by the government to achieve its objectives.

#### **A. Taxes:**

Taxes play an important role in financing government spending and through them, the government can achieve its economic goals, taxes have a key role to play in making growth sustainable and equitable, and The OECD working definition of a tax is compulsory unrequited payment to the government.

Tax policy can affect the overall economy in three main ways (Page, 2017):

- by altering demand for goods and services.
- by changing incentives to work, save and invest.
- by raising or lowering budget deficits.

Taxes affect economic activity, government spending, and consumption, as the government has a wide range of types of taxes that it imposes on individuals and businesses, such as income tax and property tax on buildings. The total of these taxes generates revenue for the government and therefore comes the government's responsibility in employing this instrument to achieve its economic aims. For example, the government may raise taxes on

one segment of society while lowering taxes on another, which is one of the strategies used to assist redistribute income.

The taxes levied by the government vary, but the main goal of these levies is to ensure permanent revenue for the government that assists it in achieving its economic objectives. One of the most critical issues confronting policymakers is drafting an efficient tax system that supports economic goals. These tax laws must be transparent and provide an adequate revenue for the government, while also maintaining justice in tax collection.

In using tax instruments to attract foreign investors, many governments in developing countries rely on a targeted approach which is a popular tax incentive is a reduction in the corporate income tax rate for specific investments to attract more capital for their economies, for the same reason few countries have chosen a non-targeted approach which is lowering the effective corporate tax rate for all firms while providing limited or no incentives, and this approach is followed by some small economies to attract international investors who look favourably on a country offering a low statutory tax rate, especially one well below the international norm of 35–40 percent. (Morisset, 2003).

Tax incentives are one of the most significant tools used by financial policy to attract foreign capital, since countries aim to attract international capital through a variety of methods, including taxes, and depending on this strategy resulted in the formation of so-called tax incentives which are several measures taken by fiscal policy to build a tax structure that fosters the attraction of international capital, an example of tax incentives is the tax exemption which is the portion of revenue that is not taxable. The tax exemption boosts the project's earnings by the amount of the exemption, encouraging continuous investment and the entry of additional capital, as the rate of profit in exempt businesses rises.

The direction of international capital to a particular country depends on the factors that attract this investment and the incentives provided to attract it to these countries. Tax incentives are one of the most important methods used by the host country to attract international capital, which led to the emergence of the so-called tax competition between countries. Countries that offer distinct tax incentives and tax exemptions attracting more international capital.

Taxes are considered an influential factor in the volume of profits, and therefore the low taxes in a particular country attract foreign capital and vice versa also it may even lead to the outflow of the national capital from the economy. As a result, many capital-receiving countries in their initial stages of development offer tax incentives to foreign capital that participates in the country's development.

## **B. Government expenditure:**

Government expenditure is considered as a tool on which the government depends to achieve the economic and social growth that it seeks. As a result, the spending strategy primarily reflects the government's aims, which attempt to enhance the national economy to progress development and create economic stability through its functional expenditures represented in spending on human capital through its formation and training, and its transformational expenditures such as subsidies granted by the state to producers of a certain type or in a particular region, as well as its capital expenditures which are the expenditures made by the government through its investment in infrastructure and projects that are related to investment, which is directed to serving the public utility more than aiming at making a profit these expenditures would facilitate the foreign investors to create ideal environment to start their investments. Public expenditure is the amount spends by the government in order to achieve its economic and social goals this includes spending on vital sectors in the country such as healthcare, education and transportation, while all countries spend a significant share of their outlays on social protection and health, the amount they spend on these activities still differs (Dullien, et al., 2018).

The government uses these expenditures to achieve development purposes and maintain stability in the economy, for instance, if the economy enters a recession, taxes will fall as government's revenue and employment fall. At the same time, government spending will increase as people are given unemployment compensation and other transfers such as welfare payments, public spending by the government plays an important role in keeping consumption at higher levels than it should be in this case, and this helps in increasing aggregate demand, which alleviates the recession (Edgmand, et al., 1996).

Government expenditures are divided into three main sections (Acemoglu, et al., 2016) :

- a) Government consumption: The World Bank defines the final consumption expenditure of the general government includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditures on national defense and security but excludes government military expenditures that are part of government capital formation (World Bank national accounts data, 2021).
- b) Transfer payments: payments provided by the government without providing any service in return and these payments are part of the personal income, there are many



types of these transfers such as retirement and disability insurance benefits, medical benefits (BEA, 2021).

c) Interest payments: government payments paid to holders of government bonds.

Government expenditure cannot be discussed without including government investment spending, since it is one of the government's instruments for achieving social growth and prosperity through investing in infrastructure development and research, particularly in developed countries, government investment expenditure refers to spending on fixed assets such as machinery, equipment, and public utilities (such as developing the public transport system) for the benefit of society and to accomplish sustainable development.

**Summary:**

The role of monetary policy has become clear to achieve the objectives of economic policy through achieving price stability, increasing the rate of economic growth, and stability in the financial market.

As for the fiscal policy, it has contributed, through its tools, to achieve the objectives of the economic policy by achieving economic stability, justice in the distribution of income, and economic development.

There is a relationship and reciprocal effects between fiscal and monetary policy and macroeconomic variables, monetary policy through the central bank affects the price stability, and fiscal policy is more effective in economic stagnation cases, unlike monetary policy that is more effective in inflationary pressures, however, coordination and integration between the two policies is necessary, because each of them has common effects on economic activities and aim to achieve economic stability.

### **3.3 International capital movements**

Foreign trade grew along with the growth and development of civilizations, and the world market was formed as a result of the industrial revolution in the middle of the nineteenth century, and the growth of production also led to the development of industrial and commercial institutions, banks, and transportation. With the industrial development in transport and communications, as well as the movement of capital and people, the relationship between economies has become a coherent ring in the body of the global economy, and the issues of transferring foreign capital have become an essential element in the process of international economic relations, so foreign capital between countries means the transfer of rights and debts between these countries, and foreign capital means any

transfer of the resources outside the borders, from the country that owns those resources to the destination country.

The majority of the world's countries are interested in strengthening international relations in order to create and provide appropriate conditions for the establishment of investments, recognizing that encouraging and mutual protection of investments will be a catalyst for revitalizing economic initiatives in this field, working on free movement of people and capital between countries, and removing all obstacles that stand in the way, as a result, one of the most fundamental foundations of international economic relations is the study of the process of capital transfer between countries.

The international monetary system plays a significant role in increasing the transfer of investments, as capital moves from countries with a relative surplus to countries in need, which also contains a suitable business environment, where the transfer process takes place for specific reasons and goals, and the transfer of these capitals is a transfer of the rights derived from the capitals from an individual or group of natural or legal individuals in one country to the same in another country.

The movement of direct foreign capital has played an important role in the emergence of globalization on a broader and more comprehensive scale, and the most notable feature of this is the intense competition between countries to attract the greatest possible amount of this capital by providing the components and factors for attracting international capital, as well as by creating economic and political stability, creating investment opportunities, and adhering to sound economic policies.

The International Monetary Fund has clarified the importance of capital movements across countries through various types of research, as it provides a significant benefit to countries through the ability of this capital to finance projects and investment, as well as the transfer of technology and management applications that accompany the direct transfer of this capital, also it provides indirect benefits through enhanced international trade, efficiency in resource allocation, financial sector development, and macroeconomic policy discipline (IMF, 2018).

To summarize the preceding elements, international capital movement is the transfer of capital between nations under certain criteria agreed upon by the parties involved, in order to establish an adequate environment for development and growth or for other purposes.

#### The importance of international capital movement:

The availability and growth of capital is a crucial prerequisite for a country's economic development. As a result, the movement of international capital is critical, particularly in the early stages of development. The most significant challenge confronting development programs is the issue of finance, particularly in light of the absence of domestic resources, which are in certain cases insufficient to set up investment projects, requiring the need of foreign sources of financing to ensure cash flows.

The importance of capital transfers between countries varies according to various points of view between countries that lend capital and countries that borrow it on the one hand, and according to the type of capital transferred on the other, and the importance of these transfers is as follows:

The importance of international capital transfers for borrowing countries (recipients of capital):

The capital recipient countries gain several economic and social advantages in order to increase their development or economic initiatives, or even to sustain and improve the sustainability of their projects and economy. Among their goals are the following (L'Hotellerie-Fallois, et al., 2016):

- Financing investments to promote economic and social development initiatives and strategies.
- Improving the population's standard of living through increasing consumer welfare and enabling households to better smooth consumption.

External financial transfers of developing countries in their various forms, as well as related economic reform policies, have constituted an effective transfer element of financial resources, which has contributed to providing financial resources related to transferred profits and loan services to investing countries and support their economies.

### **3.3.1 Classification of international capital movement:**

Many economists were interested in the factors that influence the decision of the foreign investor. Some of these factors are due to the host countries, such as the investment, political, and social environment, while others are due to the foreign investors themselves, such as the availability of resources, and there are factors that are due to the home country and the nature

of their market. The degree to which these elements impact a firm's choice to invest abroad differs by country and by company.

There are many types and forms of international capital transfer based on several considerations, including the type of capital, which may be cash, labor transfer, technology, and management methods, the methods of capital flow formation differ for considerations related to the structure of the economy and the goals to be achieved. Therefore, the capital flow consists of two main types:

#### 1. Foreign Direct Investment Flows (FDI):

Foreign finance for economic initiatives is one of the most critical issues in light of capitalism tendencies. The policies of openness to foreign capital, rising indebtedness, and International Monetary Fund recommendations are increasing international capital transfers in investment-receiving countries, and the majority of these countries are working to attract foreign investment in order to bridge the gap between investment and saving and reduce reliance on external indebtedness.

Direct investment is the investment by foreign residents having control or a significant degree of influence on domestic enterprises (Sui, 2019), in addition the Organisation for Economic Co-operation and Development (OECD) defines Foreign direct investment (FDI) as a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy (OECD, 2021).

Foreign direct investment is becoming increasingly important since it has a favorable impact on the economy and its numerous sectors. Because of the severe competition among countries for these investments, countries have issued laws regulating these investments and giving precedence to investment in certain areas that the state needs to grow but due to a lack of finances, they are unable to carry out these initiatives, therefore they must seek funding from other sources, thus it must rely on foreign finance for projects. The desires of investors to attain long-term profit for the production activities have spurred foreign direct investment (Mallampally & Sauvart, 1999), and one of the most important advantages of foreign direct investment is that can potentially expand access to financing channels and

reduce the cost of borrowing, and further increase a country's rate of saving and investment (Yi, 2021).

Direct investments for host countries do not involve financial obligations to service debts in the case of borrowing, and the transfer of revenues or any portion of them outside the host country's boundaries remains subject to the realization of profits on such investments. It is an advantage that makes direct investments preferable to debts and the resulting constraints on the host nations' balance of payments, especially if the purpose of direct investments is to boost exports or local production in order to minimize imports.

## 2. Foreign Portfolio Investment Flows (FPI):

It is one method of investing across borders by purchasing stocks, assets, or government bonds (issued by another nation) , In other terms, it also implies to the investment involving debt or equity securities by nonresidents other than those included in direct investment, aiming at speculative purposes (Sui, 2019). In an open economic system, this type of investment is one of the sources of money obtained by the government or businesses. It is also a chance for investors to diversify their investment portfolios and lessen the risks that may occur in the local market; this sort of capital transfer draws a bigger percentage of FPI in developed nations than in developing economies. This is because the high production costs in developed economies make the projects there less profitable, and thus make it less beneficial to incur the fixed costs associated with FDI. Moreover, the high transparency in developed economies makes FPI there more efficient (Goldstein & Razin, 2005).

Since foreign portfolio investment is the entry of foreign funds into the economy to invest, which is often in financial assets, it strengthens the financial position of the companies when buying shares in foreign currencies and also creates a surplus of foreign currencies for the country hosting the capital when investing in government bonds, which often attract investors, especially if the country has a strong and stable economy, to conclude, foreign portfolio investment increases the liquidity of domestic capital markets, brings discipline and know-how into the domestic capital markets, and facilitates the use of new products and instruments for risk mitigation (Albulescu, 2015).

When foreign investors seek a long-term investment, they turn to foreign direct investment, which involves the acquisition of tangible assets or the establishment of businesses, as compared to foreign portfolio investment, which involves investors seeking profits from

short-term investments by concentrating their investments in financial assets that can be easily converted into liquidity cash, such as stocks and bonds. We will focus on foreign direct investments in this study since governments want them for their stability and the long-term advantages they bring to the economy.

### **3.3.2 Determinants of international capital flows:**

The decision to invest abroad, and the form it takes, is influenced by factors unique to each institution, and in this regard, one place may be more appealing to some activities than others. On the other hand, the form and location of the investment are determined by a set of advantages that the investing company possesses, as well as the region that attracts these investments; some of these factors may be economic factors or factors related to infrastructure, and others related to monetary policy and some development indicators:

- Economic factors: It is reflected in the volume of the local market, the rate of growth, economic development, access to global markets, transparency, natural resource availability, and other production aspects.
- Monetary policy factors: The monetary policy aims at ensuring the stability of the national economy, also the foreign investor needs price stability in the economies targeted by the investment process. If this does not happen, inflation will distort the investment pattern, therefore the monetary authorities use the monetary instruments to ensure balance in the market and prevent fluctuations in prices and prevent inflation and these encourage foreign investment.
- Other factors: Reduced production costs and solid infrastructure provide an ideal investment environment for investors, as do regulations that facilitate the process of foreign investment and the smooth transfer of capital in the economy, and good education indicators that indicate the presence of a qualified workforce. All of these factors encourage capital flows and attract international capital and make the national economy suitable for such investment.

For China, the changes in foreign direct investment were as shown in the following table:

*Table 1: Changes in foreign direct investment, net inflows in China (BoP, current USD) numbers in Billion.*

<b>Date</b>	<b>Foreign direct investement</b>	<b>Percentage change</b>
2005	104.11	---
2006	124.08	19%
2007	156.25	26%
2008	171.53	10%
2009	131.06	-24%
2010	243.70	86%
2011	280.07	15%
2012	241.21	-14%
2013	290.93	21%
2014	268.10	-8%
2015	242.49	-10%
2016	174.75	-28%
2017	166.08	-5%
2018	235.37	42%
2019	187.17	-20%
Average	201.13	---

Source: World Bank Open Data, published on the Bank's website for the above years.

According to Table No. 1, foreign direct investment rose at different rates until 2009, when it experienced a negative decline in the value of foreign direct investments, but it began to rise between 2010 and 2011, to return to a negative 14 percent decline in 2012, then rise and return to a negative decline for four consecutive years until 2018, when it experienced a noticeable rise, only to decline in 2019.

The decline in 2009 can be traced back to the impact of the global financial crisis and the beginning of its reversal, and that one of the most important reasons for the increase at the beginning of the study period from 2005 to 2008 is the amendment of laws that began in 2001 that allowed foreigners to fully own projects and allow foreign banks to enter The Chinese market. In addition to the issuance of the industries guide for the investment of

foreign businessmen and the granting of special privileges to investors. and the most important reasons for the decline in the recent periods of the study are due to the economic sanctions applied to companies that limit foreign investment in Chinese companies.

## **4. Practical Part**

### **4.1 Overview of the Chinese economy after the global crises 2007:**

The World bank describes the pace of growth of the Chinese economy as the fastest sustained expansion by a major economy in history. The Chinese economy was subjected to a strong shock as a result of the global crisis in 2007 that affected its performance, which led to a clear slowdown in the growth of the gross domestic product, reaching in 2007 to 6.6% after it was 14.2% according to the data of the International Monetary Fund. In the late 2008, China had to bring about a vast stimulus package. Among all the regions, China has emerged first from the World Global crisis on an economic scale. In the same year, the economy of China has back on recovery and showed a trend that depicts growth. China adopted some fiscal stimulus measures that affected its decisions and follow-ups of implementation strategies (Wang & French, 2014). The stimulus package that has bolstered China's economic standing demonstrates how strong its public sector is. The meter used to measure economic growth is unmistakable, and when a broader one is used, the impacts of the crisis are mitigated. The country's GDP increased in 2009, as evidenced by the speed with which investment projects were undertaken in the region. In terms of the projects that were completed, the region has a strong absorptive capacity. The stimulus initiative raised worries among policymakers about the region's growth pace and the accompanying by-products. The expansion of credit availability has also contributed significantly to the rising cost of housing and land purchase. In the year 2009, several of the country's most prominent areas sold their houses, often known as housing projects, for more than double the price they paid when they first bought them. Because of these factors, the government issued a call for all investment firms to halt activities. The local administration was taken aback by fears that rising prices would raise indebtedness. The investment corporations' freeze has slowed the progress of several projects. The main challenge that the administration has is regulating the region's inflation rate.



China's transition to a market economy has resulted in an exceptionally protracted era of growth. As a worldwide economic area, the country has also grown economically in recent years. With China's exports increasing in 2009, it overtook Germany. In 2010, China surpassed Japan to become the world's second-largest economic region. These breakthroughs may have occurred sooner as a result of the global financial crisis that began in 2007. This economic slowdown was felt in a number of countries (Griffith-Jones & Ocampo, 2009). China's recovery was accelerated, allowing it to move past the crisis and achieve economic success. The scenario that plagued many countries throughout the world had an impact on the export markets. This was mostly due to the considerable decline in the global market. The growth curve of China's export market fell sharply beginning in 2008 and continuing through 2009. As a result, industries were compelled to shut down, and many workers were laid off as a result. Following a decline in the export market in the middle of 2009. The export market, which had previously served China well in terms of GDP, saw a significant fall. This significantly slowed the nation's growth curve.

China's government began to establish measures that would result in a steady fall in inflation. In 2008, the country's central bank, the country's major financial institution, developed strategies to control monetary expansion. The quarterly GDP represented these growth rates as the financial reversal of the country's economic assets. Policymakers saw this effect, which mitigated the impact of the global crisis on China's economy (BRESLIN, 2011). The 2008 regime seen China use regulatory money strategies that raised growth rates in order to stabilize the country's inflation rate. In the middle of 2008, the worldwide economic consequences that had endangered the nation's financial status and other sectors altered. The loan rates were also adjusted by the Chinese central bank. They were scaled back to accommodate and alleviate what was going on throughout the world. The alternative financial plan is to reduce the interest rate by a factor of five. This enabled the country's economic sectors to be revitalized. These reforms were proposed at the time by China's State Council. New policies for small and medium-sized businesses were implemented, including the development of improved lending facilities. Another area that improved the region's financial situation was improved methods of handling corporate bonds.

Special funding were also given for the real estate sector. The council issued a proclamation at the end of 2008 that authorized the allocation of loans to banks. This allowed Chinese commercial banks to raise the amount of money they could lend to customers. The entire abolition of credit quotas was another change that benefitted the economy. Later on, there

was a problem persuading the banks to boost the lending ratio even further. All of these initiatives laid the ground for a response that was good to China's economy.

The Chinese government has accepted slower economic growth as the "new normal," recognizing the need for China to adopt a new development model that depends less on fixed investment and exports and more on private consumption, services, and innovation to drive economic growth. Such reforms are required for China to avoid falling into the "middle-income trap," which occurs when countries reach a given economic level but begin to face dramatically declining economic growth rates due to an inability to adopt new sources of economic development, such as innovation (Morrison, 2019).

#### **4.2 The role of international capital in the Chinese economy:**

Global economic integration is common concept right now. In ancient times, there have been some aspects of trade that enabled communities to bond. The use of technology and sound communication systems have been at the forefront of boosting global economic integration. However, with the rising trends of the worldwide capacity for trade, there have been some shortcomings. Despite the increase in these shortcomings, there has been an improvement in how people conduct transactions in the international domain. The cost of conveying goods and services from one part of the world to another has been made easy and cheaper by modern transportation channels. Additionally, people are noted to have evolved tastes that make them leverage on opportunities that get from declining costs of transportation and communication channels. Public policies have also played an essential role in increasing economic integration. The dimensions of the global financial interrogation have been positively influenced in terms of pace with these factors. These dimensions that affect global economic integration are human migration, the trade-in of goods and services, and capital movements. Usually, the effect of technology use and public policy affect the pace of economic integration. The changes in technology and communication, which contribute to economic integration, do not occur rapidly (Mussa, 2000).

China's economic growth and stability are affected mainly by foreign capital. Through direct foreign investment, China has a lot of reserves from the foreign market that it benefits from. China also experiences disequilibrium from the foreign assets that have led to reforming its resources. For stability, facing the financial crisis experienced in the mid-1900s, China has

benefited from foreign investments. The eastern coast regions have been the primary beneficiaries, having received huge investments. The ongoing use of foreign capital is likely to bring about disproportions within various areas. There is more sensitivity attributed to the use of foreign assets as a means of direct investment that does not necessarily react to a country's policy. Due to China's large foreign assets reserves, the management of the said assets has been challenging. This has brought some inefficiencies into handling these foreign reserves (LIANG & TENG, 2006).

International commerce and investment are major contributions to international capital flow in many countries. Because China relies heavily on foreign assets for economic growth, they have implemented active policies that allow them to manage and employ its reserves. The country's officials have actively backed the standards for managing foreign funds. In the twenty-first century, China's tax income has been expanding. Currently, the intermediate business that drives China's finances is underdeveloped in comparison to other countries. Legislative concepts are critical for economic progress. With no regard to China's poor infrastructure in its institutional framework, China will still be enjoying higher growth. In addition, the review of the state's intercession plan in the local business has enabled people to achieve their goals through fiscal and monetary policies.

### **4.3 Monetary policy as a key role to attract foreign direct investment:**

Monetary policy is one of the most important policies pursued by China in attracting international capital, as it recognizes that monetary policy tools play an important and fundamental role in creating an appropriate environment for international investments, due to their impact on many economic decisions and actions. The exchange rate and interest rate are the main drivers in many economic decisions and measures, as well as in attracting international capital, and because they may affect directing it outside the country in the event of wrong exploitation, in addition to the presence of many other influences that may push it abroad, it cannot be relied on Monetary policy tools alone without the rest of the economic policies followed, but this requires high coordination with the other economic policies followed; the impact of these tools may differ from one economy to another due to the varying nature of prevailing economic structures and the degree of development of monetary and financial markets from one country to another, and thus the varying degree of economic progress, in addition to the various economic situations.

China uses two monetary instruments to attract the foreign investment:

#### **4.3.1 The Exchange rate:**

The exchange rate is one of the most important economic variables which can explain why the investors choose such a country to invest. The exchange rate represents a real criterion for the government's success in managing the macro economy. Therefore, the intervention of the Central Bank in exchange rates reduces the sharp movements of the economy and reduces its volatility.

The depreciation of the exchange rate did not gain its status as a scientific method based on economic theory until the early 1930s, when the issue of currency depreciation became one of the most important issues at the level of countries, due to this concept which has effects on various economic and fundamental variables, perhaps the most prominent of which is the movement of international capital.

The flow of capital to and from the state is affected by the policy of devaluation of the currency, and the process of influence is through what individuals expect of a change in the real prices of their in-kind assets (estimated in foreign currency) after the devaluation occurs. Knowing that the reduction process does not take place suddenly, but often occurs during a period of time in which there is a general feeling in the commercial and financial circles that the reduction is an inevitable accident. This prompts investors and project owners to liquidate their projects and transfer their assets abroad (considering the stability of the exchange rate) until they avoid the reduction that will occur on their real assets as a result of currency devaluation.

As the economy was directed and foreign currency reserves were limited, China's exchange rate regime passed through many periods of rigorous control over the exchange rate. This stage saw effective control over financial transfers of foreign currencies that had to go via government channels; then there was a gradual transition to the stage of exchange rate liberalization, which began with China's transition to a market economy, which was accompanied by easing restrictions on the movement of international capital, including individuals and corporations, and double exchange rates were adopted: the official rate and the internal settlement rate, until 1994 the floating exchange rate was adopted. The controlled float of 8.70 yuan per US dollar was determined by market supply and demand (LI, 2006); Despite the foregoing, it remained difficult for individuals and businesses operating in China to obtain foreign currencies and conduct exchanges or obtain the yuan

outside of China due to government restrictions, but in 2009 some amendments were made that facilitated capital transfer and the Chinese Central Bank remained involved through operations of buying and selling to maintain the exchange rate's stability.

Since 2008, China's central bank has set fluctuation bands for the yuan, allowing it to move within certain ranges. In practice, this float of the currency rate ends up acting as a central bank-managed exchange rate. When a longer timeline is considered, claims of currency manipulation for the aim of depreciation are not well established. Since the end of the fixed exchange rate system in 2005, the yuan has gradually gained value until 2014. However, there has been a depreciation from 2014 to 2019.

*Table 2: Changes in exchange rate in China (1 Yuan per USD\$, period average)*

<b>Year</b>	<b>exchange rate</b>	<b>Percentage changes</b>
2005	8.19	---
2006	7.97	-3%
2007	7.61	-5%
2008	6.95	-9%
2009	6.83	-2%
2010	6.77	-1%
2011	6.46	-5%
2012	6.31	-2%
2013	6.20	-2%
2014	6.14	-1%
2015	6.23	1%
2016	6.64	7%
2017	6.76	2%
2018	6.62	-2%
2019	6.91	4%
<b>Average</b>	<b>6.84</b>	<b>---</b>

Source: World Bank Open Data, published on the Bank's website for the above years.

Table No. 2 illustrates that in 2005, the year in which China ended dealing with fixed exchange rate, the exchange rate was at its greatest value. As a result, the yuan was at its lowest level against the dollar during the study period, and then the exchange rate began to gradually decline, implying that the value of the currency increased against the dollar until the year 2014 and during this period the yuan had a highest value 6.05 Yuan to USD in study period and the highest since 1995, so that the exchange rate experienced a gradual rise between the years 2015 and 2017, before beginning to decline in 2018, to rise again the exchange rate for 2019 also during this period Yuan had the lowest value since 2008, 7.04 Yuan to USD .

The central bank depreciated the currency gradually because it worried capital flight outside the country if it decreased the exchange rate rapidly, and the exchange rate reduction was intended to boost Chinese exports overseas and help domestic industry.

#### **4.3.2 The interest rate:**

The interest rate is one of the monetary policies taken by the Central Bank to activate the performance of the economy and push it to growth. In addition, it is one of the most important tools used to attract international capital. The rise in interest rates is an incentive for foreign investors to lend larger amounts of capital, meaning that changes in the interest rate would stimulate the movement of international lending between the different countries of the world. The monetary authorities raise the interest rate with the aim of attracting more money and thus increasing the net foreign capital entering their economy, and this varies according to the economic policy followed. China is gradually moving towards using the market interest rate as a major tool in its monetary policy, and interest rate liberalization is an essential part of price reforms in China, where the start of this step dates to the end of the nineties of the last century, but it remained under strict control of the government. It has a positive impact on the Chinese economy, as well as in attracting foreign capital.

According to the previous table No. 3, the interest rate rose between the years 2005 and 2006, reaching 4.14 percent in 2007, the highest value during the study years, before falling again to return and rise until 2013, then declining in 2014 and continuing to fall in 2015 at 1.5 percent, remaining constant until the year 2019.

The Chinese Central Bank has lowered interest rates in line with central banks around the world (European Central Bank, Bank of England) in order to reduce financing costs for companies and encourage them to seek credit, in addition to transferring funds from deposits

to the financial market and investments in an attempt to save the economy from a state of slowing infrastructure investments, weak demand, and an industrial surplus.

*Table 3: Deposit interest rate in China (%)*

<b>Date</b>	<b>Deposit interest rate</b>	<b>Percentage changes</b>
2005	2.25	---
2006	2.52	12%
2007	4.14	64%
2008	2.25	-46%
2009	2.25	0%
2010	2.75	22%
2011	3.5	27%
2012	3	-14%
2013	3	0%
2014	2.75	-8%
2015	1.5	-45%
2016	1.5	0%
2017	1.5	0%
2018	1.5	0%
2019	1.5	0%
<b>Average</b>	<b>2.39</b>	<b>---</b>

Source: World Bank Open Data, published on the Bank's website for the above years.

#### **4.4 Fiscal policy as a key role to attract foreign direct investment**

The fiscal policy plays an important role in creating a suitable environment for investment in order to attract and raise international capital, both through one of its components, tax policy, where tax exemptions and privileges (exemption, reduction,

postponement) play an important role in attracting international capital, and through the other component, spending policy, which also works to create an appropriate environment for investment, represented by government expenditure on infrastructure, education, and other sectors of the economy to provide pioneering models of economic achievement and to encourage investors to trust the economy. Therefore, fiscal policy, in addition to monetary policy, must be used to affect the attraction of international capital, as it is an effective tool of economic policy in steering the economic route toward drawing international capital.

Taxation is one of China's most important sources of revenue, contributing for 8.32 trillion yuan in 2018, or roughly 9% of GDP. In 1991, the state established the Income Tax Law on Firms with Foreign Investment and Foreign Companies, which was followed by some tax amendments in 1994, and China now imposes 14 distinct types of taxes on foreign companies and individuals. China has concluded tax treaties with many countries through which it offers some tax preferences on the capital that comes from those countries.

China uses taxes as a tool of fiscal policy through regional tax incentives that target the development of specific regions of China. These incentives contribute to attracting foreign investment due to incentives that reduce the tax burden on companies, as well as contribute to the development of the targeted regions and facilitate the transfer of capital, technology, and management to those regions, As well as tax incentives for exports, as China encourages its exports through tax exemptions and incentives that encourage producing companies to export, and this contributes to an inflow of foreign currencies into the Chinese market.

Several studies have shown the clear and positive impact of tax incentives on attracting investments, as foreign direct investment has increased significantly after the introduction of the concessionary tax rates (Tung & Cho, 2000).

Small firms in the country enjoyed the business environment simply because the government of China reduced the tax they were supposed to pay. Concerning the export market, the value-added tax was increased, and the limit for the tax levy by the government on income was increased by almost a half. The government proceeded to have a straightforward rollout of the investment type of the value-added tax to the consumption type value-added tax. These changes were done in early 2009. With the government's changes on the citizens, firms could now grant a deduction on sales for specified investments. The value-added tax collected by the government was significantly reduced following the changes.



This confirms the prominent role that tax policy plays in the economy, as the ideal use of this tool is positively reflected in two directions, as it increases state revenues as well as reduces the burden on taxpayers.

The other tool of fiscal policy is government spending, where the Chinese government has given this tool great attention, which appeared in the increasing spending, both transformational and capitalist expenditures, to support growth and development and achieve economic goals, Chinese's government has increased spending on certain sectors such as the services sector, infrastructure development, transportation, and the education sector ( which was 3.5% of Gross Domestic Product (GDP) in 2018) to ensure the creation of an attractive environment for investment. Government spending has also increased in granting subsidies to exporting companies to maintain the competitiveness of Chinese products abroad.

*Table 4: General government final consumption expenditure (billion USD)*

<b>Date</b>	<b>General government final consumption expenditure</b>	<b>Percentage changes</b>
2005	338.27	---
2006	407.88	21%
2007	519.3	27%
2008	665.51	28%
2009	752.65	13%
2010	887.94	18%
2011	1150.76	30%
2012	1344.34	17%
2013	1520.16	13%
2014	1656.94	9%
2015	1793.95	8%
2016	1838.19	2%
2017	2009.66	9%
2018	2297.62	14%
2019	2394.82	4%
<b>Average</b>	<b>1305.20</b>	<b>---</b>

Source: World Bank Open Data, published on the Bank's website for the above years

The previous table No. 4 shows an increasing and gradual rise in general government final consumption expenditure over the entire study period, with the lowest general government final consumption expenditure recorded at 338.27 billion US dollars in 2005 and continuing to rise until it reached the highest value in 2019 at 2394.82 billion US dollars. One of the most important reasons for the increase in general government final consumption expenditure in China is the rapid and growing because of the increased demand for goods and services increase in spending on national defense and security, in addition to increasing government expenditure on education and working to raise the proportion of highly educated people, another reasons can explain the gradual and continuous rise in government expenditures in China due to the increase in the population, which requires a corresponding increase in public expenditures in order to make more investments and provide more services, in an attempt to raise the population's needs and demands.

#### **4.5 Development of Linear Regression Analysis Model:**

The aim of this research is to analysis the relationship between monetary policy tools represented by the exchange rate and interest rate, and financial policy tools represented by general government final consumption expenditure, on foreign direct Foreign direct investment in the Chinese economy, and what are their role in attracting the foreign investment. The built-in regression function in Microsoft Excel program was utilized to get the findings of the regression analysis.

The independent variables are:

- General government final consumption expenditure (Billion USD): **X1**
- Deposit interest rate (%): **X2**
- Exchange rate (Yuan to USD): **X3**

The dependent variable is:

- Foreign direct investment (Billion USD): **Y**

The equation of multiple linear regression is as follows:

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3$$

$b_0$  : Intercept indicates the value of Foreign direct investment in case of all independent variables have no impact (when the coefficients of these variables equal to zero).

$b_1, b_2, b_3$  the coefficients , when the independent variables change by (1) unit the dependent variable increase or decrease by coefficient value positively or negatively.

Table no. 5 shows the values of independent and dependent variables, then the Microsoft Excel software built-in regression tool has been used to analyze and display the results.

*Table 5: Dynamics of Multiple Regression Variables in 2005-2019*

Date	Foreign direct investment (Billion USD)	General government final consumption expenditure (Billion USD)	Deposit interest rate	exchange rate
2005	104.1086939	338.27	2.25	8.194316667
2006	124.0820356	407.88	2.52	7.973438333
2007	156.2493352	519.3	4.14	7.6075325
2008	171.5346503	665.51	2.25	6.948655
2009	131.0570529	752.65	2.25	6.831416052
2010	243.7034346	887.94	2.75	6.770269029
2011	280.0722191	1150.76	3.5	6.461461327
2012	241.2138682	1344.34	3	6.312332827
2013	290.9284315	1520.16	3	6.195758346
2014	268.0971811	1656.94	2.75	6.143434094
2015	242.4893316	1793.95	1.5	6.227488673
2016	174.7495846	1838.19	1.5	6.644477829
2017	166.0837557	2009.66	1.5	6.758755086
2018	235.36505	2297.62	1.5	6.615957177
2019	187.1698224	2394.82	1.5	6.90838501

Source: World Bank Open Data, published on the Bank's website for the above years

The results of regression analysis are shown in table No. 6.

*Table 6: Summary Output for Multiple Regression Using the Developed Model*

Regression Statistics						
Multiple R	0.90304					
R Square	0.81548					
Adjusted R Square	0.76516					
Standard Error	29.06					
Observations	15					
ANOVA						
	DF	SS	MS	F	Significance F	
Regression	3	41060.65	13686.88	16.20554	0.000238	
Residual	11	9290.386	844.5806			
Total	14	50351.03				
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	551.5324	161.4883	3.415308	0.005771	196.099	906.9657
General government final consumption expenditure	0.024098	0.020182	1.193994	0.257593	-0.02032	0.068519
Deposit interest rate	33.29623	13.0451	2.552394	0.02688	4.584162	62.0083
exchange rate	-67.485	18.02218	-3.74455	0.00324	-107.152	-27.8184

Source: Own Calculations

### Summary Output for Multiple Regression

$$Y = 551.53 + 0.02X_1 + 33.29X_2 - 67.48X_3$$

From regression analysis tool we notice the following results:

The intercept equals to 551.53 indicates the value of foreign direct investment when the rest variables equal to zero.

We have high adjusted R square which indicates high impact of independent variables on dependent variable. According to R square value, 81.5% of foreign direct investment

(dependent variable) can be explained by our independent variables and more precisely 76.5%.

From multiple regression analysis we can see that the impact of general government final consumption expenditure on foreign direct investment is very small **0.02**, also the significant level (p-value) is **0.25 > 0.05** which mean this variable is statically insignificant and can't be useful and we can drop it from the model.

The other two independent variables have clear impact on the foreign direct investment as following:

The foreign direct investment will increase by 33.29 when the interest rate increases by 1 unit assuming rest variables unchanged or don't have any impact, with significance level  $0.026 < 0.05$ . This means deposit interest rate variable is statistically significant and can help us understand the foreign direct investment.

The foreign direct investment will decrease by 67.48 when the exchange rate increases by 1 unit assuming the rest variables unchanged with significance level  $0.0032 \ll 0.05$  and the variable is statistically significant.

Also, the F distribution (Fisher) is relatively high with value of 16.2 and significance level  $0.000238 \lll 0.05$ , i.e., that the independent variables together contributed to explaining the changes in the dependent variable

### **The multiple linear regression of both variables:**

The independent variables are:

- Deposit interest rate:  $X_2$
- exchange rate:  $X_3$

The dependent variable is:

- Foreign direct investment (Billion USD) :  $Y$

$$Y = b_0 + b_2X_2 + b_3X_3$$

$b_0$  : Intercept indicates the value of foreign direct investment in case of all independent variables have no impact (when the coefficients of these variables equal to zero).

$b_2, b_3$  the coefficients , when the independent variables change by (1) unit the dependent variable increase or decrease by coefficient value positively or negatively.

The results of regression analysis are shown in table No. 7.

Table 7: Summary Output for Multiple Regression Using the variables above

Regression Statistics						
Multiple R	0.88970					
R Square	0.79157					
Adjusted R Square	0.75683					
Standard Error	29.572					
Observations	15					
ANOVA						
	DF	SS	MS	F	Significance F	
Regression	2	39856.59	19928.3	22.78726	8.2E-05	
Residual	12	10494.44	874.5366			
Total	14	50351.03				
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	714.757169	87.47794	8.170714	3.03E-06	524.1591	905.3552
Deposit interest rate	22.7150744	9.741162	2.331865	0.037942	1.490907	43.93924
exchange rate	-83.0475286	12.66524	-6.55712	2.7E-05	-110.643	-55.4524

Source: Own Calculations

$$Y = 714.75 + 22.71X_2 - 83.047X_3$$

Y is foreign direct investment,  $X_2$  is deposit interest rate and  $X_3$  is exchange rate.

From regression analysis results we notice the following results:

R squared = 0.79, this means around 80 % of foreign direct investment is explained by this model and more precisely 75.6 % of foreign direct investment is explained.

The intercept 714.75 represent the value of foreign direct investment when there is no impact of any variable or when the independent variables equal to zero.

The foreign direct investment will increase by 22.71 when the deposit interest rate increase by 1 unit assuming no change in exchange rate, with significance level at  $0.037 < 0.05$  and the variable is statistically significant

The foreign direct investment will decrease by 83.04 when the exchange rate increase by 1 unit assuming no change in interest rate, with significance level  $\lll 0.05$  and the variable is statistically significant.

Also, the F distribution (Fisher) is relatively high with value of 22.78 and significance level  $\lll 0.05$  i.e., that the independent variables together contributed to explaining the changes in the dependent variable.

*Table 8: Summary Output for simple Regression Using the variables above*

Regression Statistics							
Multiple R	0.21163						
R Square	0.04478						
Adjusted R Square	-0.02868						
Standard Error	60.8250						
Observations	15						
ANOVA							
	DF	SS	MS	F	Significance F		
Regression	1	2255.116	2255.116	0.609543	0.448944		
Residual	13	48095.92	3699.686				
Total	14	50351.03					
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	
Intercept	163.9156	50.18293	3.266362	0.006132	55.50197	272.3292	
Deposit interest rate	15.5436	19.909	0.780732	0.448944	-27.4672	58.55438	

Source: Own Calculations

### Simple linear regression

Consider simple linear regression models. This is the equations of simple linear regressions:

The independent variables are:

- Deposit Interest rate:  $X_2$

The dependent variable is:

- Foreign direct investment (Billion USD) :  $Y$

$$Y = b_0 + b_2X_2$$

$b_0$  : Value of Foreign direct investment when there is no impact of interest rate or when the coefficient is equal to zero

$b_1$  : Slope of regression or the coefficient of interest rate indicates the change of Foreign direct investment when the interest rate change by 1 unit.

$$Y = 163.91 + 15.54X_2$$

From table No. 8 an independent variable and absence of exchange rate we can figure out that R squared is not significant at all with very small value **0.044** that's mean less than **5%** of our dependent variable data could be explained by deposit interest rate also p-value is  $0.44 \gg 0.05$  also the F distribution is very small which means this variable is statistically insignificant and we can't use it to understand or describe the foreign direct investment.

### Second simple regression:

The independent variables are:

- Exchange rate:  $X_3$

The dependent variable is:

- Foreign direct investment (Billion USD) :  $Y$

$$Y = b_0 + b_3X_3$$



*Table 9: Summary Output for simple Regression Using the variables above*

Regression Statistics						
Multiple R	0.83494					
R Square	0.69713					
Adjusted R Square	0.67383					
Standard Error	34.2500					
Observations	15					
ANOVA						
	DF	SS	MS	F	Significance F	
Regression	1	35101.22	35101.22	29.92271	0.000107	
Residual	13	15249.82	1173.063			
Total	14	50351.03				
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	746.4577	100.0833	7.458366	4.78E-06	55.50197	272.3292
exchange rate	-79.7316	14.57573	-5.47017	0.000107	-27.4672	58.55438

Source: Own Calculations

$$Y = 746.45 - 79.73X_3$$

This means that when the exchange rate increases by one unit the foreign direct investment will be decreased by 79.73 billion.

In case of exchange rate, we can see that R square is 0.697 that's mean around **70%** of our data could be explained by this variable at significant level **0.0001**<<< **0.05**, the F distribution with high value which equal to 29.92271 with significance level 0.000107<< 0.05 and this variable is statically significant, and we can use it in explaining foreign direct investment policy.

The intercept equals to 746.45 indicates the value of foreign direct investment when the exchange rate close to zero and 79.73 is the coefficient of exchange indicates that Foreign direct investment decreases by 79.73 when exchange rate increase by 1 unit.

## **5. Results and Discussion:**

To describe the results after analysing the correlation between the independent variables (exchange rate, deposit interest rate, general government final consumption expenditure) on the one hand and their significance on the dependent variable (foreign direct investment) on the other. Monetary policy, as represented by its instruments, the exchange rate and deposit interest rate, has a higher influence on attracting international capital, as represented by foreign direct investment, than fiscal policy, as represented by general government final consumption expenditure. The exchange rate showed great effectiveness in influencing foreign direct investments, and the effectiveness was clear when the exchange rate and the deposit interest rate were independent variables (Table No. 2) and this shows a direct correlation between the exchange rate, the interest rate, and foreign direct investments. The deposit interest rate did not show the same level of correlation when it was used in the simple linear regression equation with foreign direct investment for China, as the effect no longer exists and there is no statistically significant effect of the deposit interest rate on the foreign direct investment.

The results of the multiple linear regression equation confirmed that fiscal policy as represented by general government final consumption expenditure had no effect on foreign direct investment, as there is no statistically significant effect of fiscal policy as represented by general government final consumption expenditure in the movement of international capital for China in attracting foreign investment.

The model in which the exchange rate and interest rate were used as independent variables and foreign direct investment is the most effective model, as the correlation between the independent variables and the dependent variable is a strong correlation and shows the extent to which the dependent variable is affected by the independent variables, the exchange rate and the interest rate combined contributed explaining 75.6% of the changes in foreign direct investment.

The exchange rate is the most influential in attracting international capital, so the Chinese monetary authorities, represented by the Central Bank, gave this monetary instrument a priority to make the Chinese market competitive. After 2005, China implemented comprehensive monetary reforms, particularly regarding currency stability, which reflected positively on growth and provided international investors' confidence to invest in the Chinese market, as seen by the increase in foreign direct investment.

It was not clear that China is trying to devalue the yuan to obtain greater competitive advantages, as the exchange rate index showed a gradual stability in the value of the Chinese yuan to the US dollar, especially after it was recognized by the International Monetary Fund in 2016 as a reserve currency.

The interest rate showed a clear impact in attracting foreign investment when used with other monetary tools such as the exchange rate. After 2010, the Chinese Central Bank was able to maintain moderate interest rates, and a monetary policy was adopted to facilitate the process of borrowing and reverse repurchase operations. The government adopted a market-based approach. As a result, this facilitated borrowing, especially for foreign companies operating in the Chinese market which will reinvest their profits in the domestic market.

The fiscal policy represented by general government final consumption expenditure did not have an impact on the movement of capital entering the Chinese market during research years, despite the large stimulus packages by the government, which had a significant impact on the development and growth of the Chinese economy. Government spending and taxation may have a role in the long run or indirect effects in attracting foreign investors, government spending for Chinese government helps in developing economy's sectors while taxes help allocate the resources to create a suitable environment for foreign investment.

To answer the research question, monetary policy directly influences the international capital, in the Chinese economy, the monetary authorities, represented by the Chinese Central Bank, have been effective in using monetary instruments such as the exchange rate and interest rate to make the Chinese market increasingly attractive to foreign investors, whereas financial policy has had a less direct impact on attracting international capital. The financial authorities represented by the Chinese Ministry of Finance has implemented many reforms in the bond market and tax policy, which have led to more market development and a more tendency to open the market to foreign investments, as well as the expansion of government spending has led to more growth and development, especially in the education and technology sectors, these tools may not have a direct impact on directing foreign direct investment towards the Chinese market, but they certainly have an indirect effect.

## **6. conclusion:**

The integration of fiscal and monetary policy creates an appropriate business environment in which the primary objectives of these policies are stability and economic growth, and the ideal implementation of these policies gives the domestic market a competitive advantage in attracting international capital.

The Chinese economy is a socialist market economy which including private companies, a private sector, state-owned enterprises, and a government public sector. Chinese economic policies that tend to liberalize the economy and implement open market operations to ensure financial stability and economic growth have proven their effectiveness in attracting foreign investment. In addition to several other factors, including qualified labor and a large consumer market.

The success of the Chinese economic experience has been a reflection of the state's economic policies since 1978, which marked the beginning of the transition to a market economy with a margin of economic freedom that encouraged investors to direct their investments to the Chinese market, leading to further growth benefiting from the foreign capital brought by those investments, as economic reforms and opening policies have continued to attract international capital to the Chinese market.

Based on the foregoing, the suggestions can be drawn:

Because China has demonstrated its great potential to attract international capital, it is better to depend on monetary policy instruments such as the exchange rate and interest rate to affect the flow of foreign capital through integrated monetary policy.

Fiscal policy may not have a direct impact on attracting international capital through government consumption expenditure to the Chinese economy; however, the effect of fiscal policy tools can be seen as indirect or long-term effects, as government expenditure policy in the long term has led to raising the standard of living of citizens, as well as tax policy that has been able to effectively direct growth to vital sectors.

Creating an investment environment in terms of legislation, laws, economic structure, and political climate that facilitates and encourages an increase in the transfer of international capital, as well as granting more freedom to local and foreign investors, which facilitates capital transfer in a more smooth and effective manner.

## References

- Acemoglu, D., Laibson, D. & List, J. A., 2016. *ECONOMICS*. 1st ed. Harlow: Pearson Education Limited.
- Afonso, A., Schuknecht, L. & Tanzi, V., 2008. *INCOME DISTRIBUTION DETERMINANTS AND PUBLIC SPENDING EFFICIENCY*, Frankfurt: European Central Bank.
- Agnès Bénassy-Quéré, B. C. P. J. J. P.-F., 2010. *Economic Policy Theory and Practice*. s.l.:Oxford University Press, Inc..
- Ahmed, F., Talreja, S., Aman, Y. & Lohana, G., 2018. *Fiscal Policy and Economic Stability: A Case of Pakistan*, s.l.: Faculty of Education and Teacher Training, Jambi University.
- AKHTAR, M. A., 1997. *understandinfg open market operations*. s.l.:Federal reserve bank of New York.
- Albulescu, C. T., 2015. *Do Foreign Direct and Portfolio Investments Affect Long-Term Economic Growth in Central and Eastern Europe?*, Prague: Elsevier B.V.
- Alexander, W. E., Enoch, C. & Baliño, T. J. T., 1995. *Adopting Indirect Instruments of Monetary Policy*. Washington DC: International Monetary Fund.
- Alexander, W. E., Enoch, C. & Baliño, T. J. T., 1995. *Adoption of Indirect Instruments of Monetary Policy*. Washington: International Monetary Fund.
- Alison McClelland, F. M., 1998. *The social consequences of unemployment*, s.l.: the Business Council of Australia.
- Anon., 2021. *The world bank*. [Online]  
Available at: <https://www.worldbank.org/en/topic/taxes-and-government-revenue#1>  
[Accessed 16 November 2021].
- BANK, W., 2001. *WORLD DEVELOPMENT REPORT*, s.l.: Oxford University Press, Inc.
- Barbara Casu, Girardone, C. & Molyneux, P., 2006. *INTRODUCTION TO BANKING*. Harlow: Pearson Education Limited.
- BEA, B. o. E. A., 2021. *Bureau of Economic Analysis*. [Online]  
Available at:  
[http://www.hoosierdata.in.gov/dpage.asp?id=59&page\\_path=&path\\_id=&panel\\_number=3&view\\_number=1](http://www.hoosierdata.in.gov/dpage.asp?id=59&page_path=&path_id=&panel_number=3&view_number=1)  
[Accessed 23 November 2021].
- BRESLIN, S., 2011. *The 'China model' and the global crisis: from Friedrich List to a Chinese mode of governance?*. s.l.:International Affairs.
- Chorng-Huey Wong, Mohsin S. Khan & Nsouli, S. M., 2002. *Macroeconomic Management Programs and Policies*. s.l.:International Monetary Fund.
- Cornwall, J. L., 2018. *Britannica Group, Inc.* [Online]  
Available at: <https://www.britannica.com/topic/economic-growth>  
[Accessed 8 November 2021].
- Daly, H. E., 1992. Allocation, distribution, and scale: towards an economics that is efficient, just, and sustainable. In: *Ecological Economics*. Amsterdam: Elsevier science Publishers B.V, p. 186.
- Dullien, S. et al., 2018. Public Budgets in Europe. In: *Macroeconomics in Context A European Perspective*. New York: Routledge, p. 575.

- Edgmand, M. R., Moomaw, R. L. & Olson, K. W., 1996. problems. In: *Economics and contemporary issues*. 3rd ed. s.l.:Fort Worth:Dryden Press, p. 301.
- England, B. o., 2021. *Bank of England*. [Online]  
Available at: <https://www.bankofengland.co.uk/knowledgebank/what-are-interest-rates>  
[Accessed 6 November 2021].
- Frakulli, A., 2017. *Fiscal Policy as a tool of Economic Stabilization - the case of Albania*, s.l.: University of Business and Technology in Kosovo.
- Goldstein, I. & Razin, A., 2005. *An Information-Based Trade Off between Foreign Direct Investment and Foreign Portfolio Investment*, Cambridge: NATIONAL BUREAU OF ECONOMIC RESEARCH.
- Griffith-Jones, S. & Ocampo, J. A., 2009. *The Financial Crisis and Its Impact on Developing Countries*, s.l.: UNDP - International Policy Centre for Inclusive Growth.
- HEIN, S. E. & STEWART, J. D., 2002. *Reserve Requirements: A Modern Perspective*, s.l.: Federal Reserve Bank of Atlanta.
- Horton, M. & El-Ganainy, A., 2020. *Fiscal Policy: Taking and Giving Away*. [Online]  
Available at: <https://www.imf.org/external/pubs/ft/fandd/basics/fiscpol.htm>  
[Accessed 11 November 2021].
- IMF, S. o., 2018. *The IMF's Institutional View on Capital Flows in Practice*, s.l.: International Monetary Fund.
- Ionela, P. & Diana, C., 2010. *Fiscal Policy and its role in ensuring economic stability*, s.l.: Munich Personal RePEc Archive.
- Johnson, H. G., 1975. Economics and Society. In: Chicago: University of Chicago press, p. 241.
- Korea, B. o., n.d. *Bank of Korea*. [Online]  
Available at: <https://www.bok.or.kr/eng/main/contents.do?menuNo=400027>  
[Accessed 10 November 2021].
- L'Hotellerie-Fallois, P. et al., 2016. *Dealing with large and volatile capital flows and the role of the IMF*, Frankfurt: European Central Bank.
- Labonte, M., 2004. *Fixed Exchange Rates, Floating Exchange Rates, and Currency Boards: What Have We Learned?*, Washington D.C: Library of Congress. Congressional Research Service..
- Lepers, E., 2018. *Reserve Requirements: Current Use, Motivations and Practical Considerations*, s.l.: s.n.
- LIANG, Q. & TENG, J.-Z., 2006. *Financial development and economic growth: Evidence from China*, s.l.: s.n.
- LI, H., 2006. *Exchange Rate and Determinants in China*, Sejong: KDI School of Public Policy and Management.
- López, R. E., Thomas, V. & Wang, Y., 2010. *The Effect of Fiscal Policies on the Quality of Growth*, Washington, DC: The World Bank.
- Mallampally, P. & Sauvant, K. P., 1999. Foreign Direct Investment. *finance and development A quarterly magazine of the IMF*, March.
- Mercado, R. & Park, C.-Y., 2011. *What Drives Different Types of Capital Flows and Their Volatilities in Developing Asia?*, s.l.: Asian Development Bank.
- Mishkin, F. S., 2011. *The economics of money, banking and financial markets*. 4th Canadian ed ed. New Jersey: s.n.
- Morisset, J., 2003. *TAX INCENTIVES USING TAX INCENTIVES TO ATTRACT FOREIGN DIRECT INVESTMENT*, Washington, DC: THE WORLD BANK GROUP PRIVATE SECTOR AND INFRASTRUCTURE NETWORK.

Morrison, W. M., 2019. *China's Economic Rise: History, Trends, Challenges, Implications for the United States*, s.l.: Congressional Research Service.

Mourão, P. R. & Veiga, L. G., 2010. *Elections, Fiscal Policy and Fiscal Illusion*, s.l.: Universidade do Minho.

Mussa, M., 2000. Factors driving global economic integration. In: *Global economic integration: Opportunities and challenges*. s.l.:s.n., pp. 9-55.

OECD, 2021. *OECD ilibrary*. [Online]  
Available at: <https://doi.org/10.1787/9a523b18-en>  
[Accessed 21 November 2021].

Page, B. R., 2017. *The Macroeconomic Effects of Taxes*, s.l.: TAX POLICY CENTER | URBAN INSTITUTE & BROOKINGS INSTITUTION.

SIMPSON, T. D., 2014. *Financial markets, Banking, and Monetary Policy*. New Jersey: John Wiley & Sons, Inc..

Stephen G. Cecchetti, K. L. S., 2015. *MONEY, BANKING, AND FINANCIAL MARKETS, FOURTH EDITION*. 4th ed. New York: McGraw-Hill.

Sui, Q.-y., 2019. *China's Economic Growth and International Capital Flows*, s.l.: Policy Research Institute, Ministry of Finance, japan.

Tung, S. & Cho, S., 2000. The Impact of Tax Incentives on Foreign Direct Investment in China. *Journal of International Accounting, Auditing and Taxation*, 9(2), pp. 105-135.

Wang, H. & French, E., 2014. *China in Global Economic Governance*, s.l.: Asian Economic Policy Review.

Warin, T., 2005. *Monetary Policy: From Theory to Practices*, VERMONT: DEPARTMENT OF ECONOMICS MIDDLEBURY COLLEGE.

Weeks, J. & Patel, S., 2007. Economic Policies, MDGs and Poverty. *International Poverty Centre*, Issue 1, pp. 2,17.

Williamson, J., 2009. *Exchange Rate Economics*, s.l.: Peterson Institute for International Economics Working Paper No. 08-3.

World Bank national accounts data, 2021. *the world bank*. [Online]  
Available at: <https://databank.worldbank.org/metadataglossary/world-development-indicators/series/NE.CON.GOV.T.ZS>  
[Accessed 24 November 2021].

Xinhua, 2021. *xinhuanet*. [Online]  
Available at: [http://www.xinhuanet.com/english/2021-07/15/c\\_1310063138.htm](http://www.xinhuanet.com/english/2021-07/15/c_1310063138.htm)  
[Accessed 11 November 2021].

Yi, Y., 2021. *An Overview of International Capital Flows and Its Impact on Chinese Financial Market*, Melbourne: The University of Melbourne Faculty of Business and Economics Australia.



## List of figures and tables:

Figure 1: Process of Monetary Policy Implementation .....	7
Table 1: Changes in foreign direct investment, net inflows in China (BoP, current USD) numbers in Billion. ....	23
Table 2: Changes in exchange rate in China (1 Yuan per USD\$, period average).....	29
Table 3: Deposit interest rate in China (%) .....	31
Table 4: General government final consumption expenditure (billion USD) .....	33
Table 5: Dynamics of Multiple Regression Variables in 2005-2019 .....	35
Table 6: Summary Output for Multiple Regression Using the Developed Model .....	36
Table 7: Summary Output for Multiple Regression Using the variables above .....	38
Table 8: Summary Output for simple Regression Using the variables above .....	39
Table 9: Summary Output for simple Regression Using the variables above .....	41