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# **Inward FDI in developing countries**

An ethical approach

International business,  
Bachelor's thesis

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## **Bachelor's thesis**

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### **Abstract**

Foreign direct investment (FDI) has increased drastically in the past decades. Nowadays, about 50% of FDI is done in developing countries. FDI has many benefits for these countries and can lift a country out of poverty, but ethical problems may arise. The aim of this thesis is to look at FDI and the benefits and ethical problems it has on developing countries through existing literature and overall consequences of FDI will be considered. These ethical problems and consequences will be analyzed in practice with a case example that researches FDI's impact on the economic growth and ethical problems of China.

The ethical problems of FDI can be categorized in a few areas. Labor right violations include sweatshop labor, forced and bonded labor and child labor. All of these violations are harmful for working people but sometimes arise out of desperation. Sweatshop labor and child labor exploit people's bad economic situation. Sweatshop labor is working long days in bad or hazardous conditions with inadequate pay. It is voluntary, so people can quit anytime, but are replaced easily. Child labor doesn't have a clear definition but refers to school age children going to work. Child labor is harmful for a child's development and schooling. Forced and bonded labor are more severe violations, where people are forced to work out of fear of a penalty and can't leave voluntarily.

Other consequences are related to the environment and business environment. Countries can attract FDI by establishing pollution havens, where companies can pollute the environment without repercussion. FDI can also impact the business environment when domestic firms face competition and are forced to adapt or go out of business. If the business environment is controlled by foreign companies, then a country becomes dependent on them. FDI can also cause spillovers where knowledge is transferred to local people, and they can use it to create businesses and help domestic firms.

The case example of China examines all the effects of FDI in practice. China used FDI to boost economic growth and its vast supply of workers made it possible to construct the biggest sweatshop in the world. Cases of workers being exploited, poor product quality and environmental violations are often associated with China. The MNCs didn't always know about the conditions of the workers in Chinese factories. China managed to become the 2<sup>nd</sup> biggest economy in the world, where sweatshop labor wasn't needed anymore and the working conditions improved. However, the environmental consequences of China's economic policy are still impacting the environment today. China has tried to fix the problems by investing on sustainability and renewable energy.

**Keywords:** FDI, Developing economies, ethical issue, labour right violations, environmental violations, China

## Kandidaatintutkielma

**Oppiaine:** Kansainvälinen liiketoiminta

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### Tiivistelmä

Yritysten ulkomaille tehtyjen suorien sijoitusten (FDI) määrä on lisääntynyt huomattavasti viimeisten vuosikymmenten aikana. Nykyään noin 50 % FDI:stä kohdistuu kehittyviin maihin. FDI:llä on mahdollisuus nostaa nämä maat köyhyydestä, mutta niiden mukana saattaa tulla eettisiä ongelmia. Tämän tutkielman tarkoituksena on tarkastella FDI:n hyötyjä ja eettisiä ongelmia kehitysmailla hyödyntäen olemassa olevaa kirjallisuutta ja tarkastella FDI:n vaikutuksia ylipäättänsä. Näitä ongelmia ja seuraamuksia analysoidaan käytännön tapauksen avulla, mikä tutkii FDI:n vaikutusta Kiinan talouskasvuun ja Kiinan eettisiin ongelmiin.

FDI:hin liittyviä eettisiä ongelmia voidaan luokitella tiettyihin alueisiin. Työoikeudellisiin rikkomuksiin liittyy sweatshop tyylinen työ, lapsityövoiman käyttö, pakkotyö ja sidottu (bonded labor) työ. Kaikki näistä rikkomuksista ovat haitallisia ihmisille, mutta jotkut niistä aiheutuvat ihmisten epätoivoisesta tilanteesta. Juuri lapsityö ja sweatshop tyylinen työ hyväksikäyttävät ihmisten huonoa taloudellista tilannetta. Sweatshop tyylinen työ tarkoittaa työskentelyä huonoissa ja mahdollisesti vaarallisissa olosuhteissa alipalkattuina. Saatetaan tehdä myös ylityötä ja työajat ovat yleensä pitkiä. Lapsityövoimalla ei ole selkeää määritelmää, mutta tarkoittaa kouluikäisten lasten työskentelyä. Työskentely on haitallista lasten kehitykselle ja koulunkäynnille. Pakkotyö ja sidottu työ ovat vakavampia rikkomuksia, missä ihmiset työskentelevät rangaistuksen uhalla, eivätkä voi vapaaehtoisesti lopettaa työsuhdetta.

FDI:llä on myös ympäristöllisiä ja taloudellisia seuraamuksia. Valtiot voivat houkuttaa sijoittajia tarjoamalla mahdollisuuden saastutusparatiiseihin. Yrityksen voivat näissä tilanteissa saastuttaa ympäristöä ilman seuraamuksia. FDI voi vaikuttaa myös yritysten kilpailuun. Paikallisten yritysten on pakko muovautua kilpailun mukaan tai mahdollisesti lopettaa liiketoiminta. Tämä voi myös johtaa tilanteeseen, jossa ulkomaiset yrityksen hallitsevat liiketoimintaympäristöä ja valtio tulee riippuvaisiksi niistä. Ulkomaiset yritykset voivat myös olla tiedonlähteenä paikallisille ja tietoa voi liikkua niistä paikallisiin yrityksiin.

Tutkielman käytännön esimerkitapaus tutkii FDI:n vaikutuksia Kiinan talouskasvuun ja siihen liittyviin ongelmiin. Kiina on tullut tunnetuksi työntekijöiden oikeuksien loukkaamisesta, huonolaatuisista tuotteista ja ympäristörikkomuksista. Yritykset, joilla oli tuotantoa Kiinassa eivät myöskään olleet täysin perillä rikkomuksista. Kiinasta kuitenkin tuli maailman toiseksi suurin talous, jolloin työntekijöiden olot paranivat. Kuitenkin ympäristörikkomusten vaikutukset näkyvät Kiinassa vielä tänäkin päivänä. Kiina on yrittänyt korjata tilannetta sijoittamalla kestävyteen ja uusiutuvaan energiaan.

**Avainsanat:** FDI, suorat ulkomaille tehdyt sijoitukset kehittyvät maat, eettiset ongelmat, työoikeuksien loukkaaminen, ympäristörikkomukset, Kiina

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## 1 Introduction, aim of thesis and key concepts

Foreign direct investment (FDI) has increased rapidly over the last 50 years. It is defined as investment done in a foreign country. In 1975 the FDI inflows amounted to 25 billion US dollars whereas in 2025 it was over 1,6 trillion. (World bank.) FDI is done in both developed and developing countries for different reasons. According to UNCTAD (2025, 2) the FDI inflows in developing countries are slightly higher than developed economies, but compared to 2024, the difference reduced by over 200 billion. Developing countries have a vague definition and people use different metrics to classify a country as developing or not. (Barros Leal Farias, 2024, 651) Cambridge Dictionary defines a developing country as a country with little economic activity and where people have lower incomes.

There are various reasons for doing FDI in developing countries instead of developed ones. These include availability of cheap low-skilled labor and natural resources. The host country wants to receive FDI for multiple benefits both direct and indirect. Direct benefits for the host country include bringing job opportunities and infrastructure alongside tax revenue. Indirect benefits include spillovers and bringing expertise. (Kinda 2010, 498; Anwar & Sun 2012, 489) These benefits will be further discussed in a later chapter to analyze their prevalence and if the drawbacks outweigh the benefits.

FDI could bring problems to developing countries. These problems concern different things, for example labor rights, environmental sustainability, taxation and favoritism toward foreign firms. Labor right violations can be classified further to sweatshop labor, bonded- and forced labor and child labor. Developing countries have more loose environmental laws and could become pollution havens. The phenomenon is similar to a tax haven, but instead of evading taxes, a company tries to avoid environmental responsibility by moving pollution to a developing country. While FDI isn't done for the reason of tax evasion, it still poses taxation related issues. Developing countries might use taxation as an incentive to attract FDI and compete by lowering corporate taxes. (Feld & Heckemeyer 2011, 234)

FDI is usually done by multinational corporations (MNCs). These are companies that have activity in multiple countries. FDI can be done in multiple ways, and these can be categorized even further. The main methods of entry are greenfield and merger and acquisition (M&A). Greenfield investment means that facilities and operations are built from scratch in the host country. This can

be further categorized as brownfield, which is FDI, where the MNC purchases or leases facilities that already exist. In M&A investment the MNC acquires or merges with an already existing company in the host country. It is different from brownfield, because in brownfield just facilities are acquired, but in M&A an already existing company is acquired. (Beuck et al., 2022, 91.) Also it must be decided if the company wants to do the FDI project alone and establish a wholly owned subsidiary (WOS) or if it needs a partner(s) and establishes a joint venture (JV). According to Nguyen & Binh (2021, 80) in Vietnam 77% of FDI projects were WOSs and 22% were JVs. FDI can be categorized as inward and outward FDI. Outward FDI is focusing on the country doing to FDI, whereas inward FDI is received FDI from another country. In this thesis the focus will be mostly on inward FDI.

Knowledge spillovers are an indirect benefit of FDI. It means that knowledge is transferred from one entity to another and it leads to benefits. Knowledge spillover can be classified in many ways by being active or passive and horizontal or vertical. Passive knowledge spillover is information spilling through public sources without formal agreement, while active spillover involves collaboration between entities. Horizontal spillover involves mimicking competitors and using involuntarily leaked knowledge from them, while vertical spillover is between a firm and its suppliers. (Audretsch & Belitski, 2026, 1.)

#### Aim of thesis

In this thesis, it will be examined how FDI is done in developing countries and the impact it has. The emphasis will be on the negative impacts and ethical issues of FDI. After going through developing economies in general, China will also be analyzed as a case example. China has risen from a developing economy with a GDP lower than most countries to the 2nd biggest economy in the world. FDI had a huge impact on the growth, but it had ethical problems associated, so it will provide a concrete example on top of the theory in this thesis. The main research question is: What is the impact FDI has on developing countries.

The sub questions in this thesis are

- What is specific for FDI and ethics in developing countries
- What benefits FDI has for developing countries
- How ethics impact FDI in developing countries

The case example of China will provide a practical example of FDI's impact on developing countries. China is infamous for its environmental and labor violations along the phenomenon of ultra cheap products. On the other hand, China managed to grow from a developing country to an economic behemoth. The case example will be analyzed with the research question and the sub questions. The replicability of the case example will be analyzed, since the world has many developing countries that could potentially achieve similar growth. Lastly the actual impact of FDI will be analyzed, since it is thought that China achieved the growth with the help of FDI, but reality might be different.

## 2 FDI in developing countries

### 2.1 Characteristics of FDI in developing countries

FDI has differences when we compare developing and developed economies. One of the biggest differences is the availability of infrastructure and companies. The lack of infrastructure is a major thing that will turn away companies. While having good infrastructure increases a country's chance to attract FDI. (Kinda, 2010, 505.) Because there might be no companies on the branch that the MNC operates, it can't do a M&A but must do greenfield.

Developing countries have barriers to entry related to policy. Investment process is longer compared to developed countries. Developing countries have tried to do policy reforms and offer advantages to foreign firms, which domestic competitors can't access. (Tanaka & Arita, 2016, 281.) This phenomenon will be further discussed in the case example, since China also used incentives to attract FDI.

FDI in developing economies possesses risks that developed countries don't have. Political uncertainty will turn away some investors and in resource-based industries this risk is more acute. According to Hajzler (2014, 124) expropriation or seizure of assets is a significant political risk. In this case a company that has access to natural resources through FDI would be driven out of a country and the resources taken by the government.

Developing countries have advantages compared to developed countries. The resource-based view can be used to quantify some advantages. Developing countries and least developed countries can attract FDI by giving access to natural resources. MNCs from developed countries won't sell anything to the local market but are there just to harvest the natural resources that the country offers. (Alvaro Cuervo Carruza, 2008, 971) Less developed countries can also offer cheap labor for these resource seeking companies. (Ramírez-Alesón & Fleta-Asín, 2016, 39)

### 2.2 Ethical problems with FDI

FDI has some ethical problems associated with developing countries. Sweatshop Labor implies that workers are forced to work in unsafe conditions for long hours. It exploits people and their desperate situation, but it can be mutually beneficial for the employee and employer. (Mikols 2019, 59–61.) Sweatshop labor is not the same as forced labor, but it has similar ways of exploitation. ILO

defines forced labor as all work that is extracted from a person under a penalty, and the person hasn't agreed to work voluntarily. The main difference is that sweatshop labor is voluntary and workers can quit any time. (ILO; Mikols 2019, 61.) When looking at the ethical problems of FDI, sweatshop labor is a lot more prevalent than forced labor. Forced labor is usually associated with human trafficking, while sweatshop labor is usually done in developing countries. The more prevalent problem among sweatshop labor is child labor. Child labor is defined as labor done by children which is harmful for them and interferes with a child's normal development. This includes not being able to attend school or requiring a child to combine work with school. (ILO.) According to ILO 138 million children are working today. This mostly stems from families being in a bad economic situation.

FDI can cause environmental problems in developing countries. These countries might have less strict laws, which entice MNCs to build heavy pollution industry there. These pollution havens can bring economic growth to the country, but at the cost of the environment. (Singhania 2021, 516; Demena 2020 1–2.) The environmental violations include pollution of air, water supplies and nature, which slowly destroys the environment. Emitting greenhouse gases into the atmosphere.

### **2.3 Reasons behind the exploitation**

MNCs can neglect ethics when doing FDI for various reasons. Mikols (2019, 59–60) mentions that desperation of people is easy to exploit. People in developing countries lack education and are willing to do a job even in exploitative conditions just to earn money and be able to afford necessities. If a worker were to quit his or her job, a replacement would be easily found. Chan (1998, 889) mentions that migrant workers fall victim to exploitation easier than local workers. In certain arrangements migrant workers can have their documents taken away and they are effectively prisoners. If they tried to leave the arrangement, getting out of a country without any official documents can lead to being detained and questioned by the police.

### **2.4 Problems with domestic firms and taxation**

FDI can have negative effects that aren't ethical violations, but still negative for the host country. It can create a business environment where MNCs will pay better wages than domestic firms. (D. T. H. Nguyen et al., 2019, 5312) MNCs have vastly bigger resources than domestic firms in developing countries and can offer better wages, while turning a profit. This scenario isn't completely awful for the nation, since jobs will still exist and the MNCs pay taxes, but it will shift ownership of companies abroad. This will lead to the host nation becoming more dependent on

foreign firms and through this dependency the MNCs can worsen conditions and pay gradually, if competition remains minimal.

### **3 Ethical consequences of FDI for developing countries**

#### **3.1 China as a case example**

China has seen massive economic growth since it has been opened to the western markets. In 1978 its population was around 965 million and it had a GDP of 148 billion USD, whereas in 2014 the population had increased to 1,37 billion and GDP to 10 trillion USD. (Gunby et al. 2017, 242; World bank statistics). This means that the GDP per capita went from 153 USD to 7407 USD. This is an increase of 4840% in just 36 years, which when compared to non-developing countries is very substantial. If we compare FDI flows and GDP in China a correlation between the two variables can be seen. When FDI started flowing in China, GDP started to rise. After reaching a certain point however, FDI flows stagnated, but China's GDP keeps growing. This implies that China isn't fully dependent on FDI anymore but can foster economic growth on its own. China grew from a developing country to an economic powerhouse and is now the 2nd largest economy in the world. (Investopedia 2026) This growth can be attributed to many things, but removing barriers to entry and opening to FDI accelerated the growth significantly. In 2002 China's FDI policy was completely overhauled and it opened to the world even more. (Deng et al., 2024, 3.) In the following years FDI flows increased by over 10% per year until 2012.

#### **3.2 FDI's impact on the environment in China**

In an earlier chapter I talked about the negative impact that FDI can have on the environment. It can be argued that FDI causes incentive to establish pollution havens, because of more loose legislation. In the case of China its co2 emissions were 1,5 gigatons in 1978 and have increased to 13 in 2024 (Worldometer). While the negative effects can be highlighted, the positive effects of FDI don't get as much attention. If the MNC that is doing FDI cares about the environment, it can bring innovations and change to the host country. China has been building solar panels, and it wants to focus on green energy. Its co2 emissions have stagnated recently in stark contrast to the early 2000s, when emissions increased by up to 15% per year. (Myllyvirta 2026) China has achieved the stagnation with the rapid development of wind and solar energy. It stated that carbon peak is achieved in 2030 and carbon neutrality is a target by the year 2060. (Fan et al., 2025, 1.) Before starting to build all the wind turbines and massive amounts of solar panels, China had already started to invest in treating pollution. Its environmental stringency also doubled from the period of 2005-2015. The stricter regulations affect the likelihood of receiving FDI. (Ullah et al., 2022, 1342.) The previous study hasn't accounted for the recent shifts of FDI in China. According to World

Bank, FDI in China was stable at around 240 billion USD and peaked at 344 billion US in 2021. However, in 2022 FDI dropped to 190 billion and in the following years the amount dwindled to 51 billion and in 2024 it was only 18 billion. (World Bank.)

### **3.3 Labor right violations in China**

#### **3.3.1 Sweatshop and forced labor**

China has been notorious for its labor right violations. Chen (2016, 25) states that the labor force has remained unorganized in China, whereas in the west unions are prevalent. Authoritarianism and the Chinese accepting to submit to the system might explain the lack of organization. This has had an impact on the labor rights, since single workers can't effectively point out violations. (Chan, 1998, 887; Chen 2016, 26) State that the workforce in China is very fragmented, not just by being unorganized, but having migrant workers from the countryside who fall victim to the violations easier.

Sweatshop labor has been prevalent in China for a long time. Chan (1998, 888–891) lists many different examples of how labor rights are violated. Debt bondage is a practice where a person must make a deposit to work at a company. This deposit will be held by management until a worker's contract expires and will be returned then. This leads to situations where a worker can't quit if they can't afford to lose the deposit. A similar thing was done with work permits in China. Permits were kept by management and if a worker leaves without a permit, they could be detained and face consequences.

Chan (1998, 893) mentions a case of a footwear factory that produced footwear for major brands including Nike, Adidas and Reebok. Labor violations happened there and the factory was Taiwanese owned. The western companies whose footwear was manufactured might not know about these violations, but the Taiwanese who established the factory had to be aware of the conditions that they built for the workers.

#### **3.3.2 Child labor**

Child labor has been a problem in China for a long time. According to a study, in 2010 7,74% of children aged 10-15 were engaged in labor. Child labor is harmful for a child's development and will hamper education. Working children still go to school but spend less time there and have a higher risk of dropout. (Tang et al., 2018, 150.) This problem is more prevalent with people from rural areas as was the exploitation of migrant workers discussed in the previous chapter. According

to Tang et al. (2018, 151) people from the less developed west were approximately three times more likely to engage in child labor. In the west the working rate was from 15% to 20% whereas in the central and the East the working rate was around 5% on 10–15-year-olds. If we compare the working rates of children living in rural or urban areas, the stark contrast persists. Only 4% of 10-year-olds from urban areas went to work, whereas the number was 13% on rural areas. By age 15 the difference is smaller. 8% of children in urban areas and 14% of children in rural areas work.

### **3.4 Ethical problems and benefits of FDI in developing countries**

While FDI has negative effects on developing countries it also has a positive impact. These benefits can also have other negative consequences. FDI can promote entrepreneurship and bring knowledge spillover effects, but MNCs can simultaneously drive local competitors out of business. If successful local people want to become entrepreneurs and will have more skills to do so learned from foreign companies. (N. M. Nguyen 2023, 63.) This effect can be directly seen in the case example of China, where through knowledge spillover Chinese people begun manufacturing electronics, cars and buses on their own and doing outward FDI.

The environmental problems associated with FDI have severe consequences. Air pollution leads to the loss of millions of lives every year. Global warming and the increase of greenhouse gases in the atmosphere is responsible for destroying the environment, thus leading also to loss of life. (Adeel-Farooq et al., 2021, 1.) However, as people become more aware of the problems, environmental sustainability improves. Halting CO<sub>2</sub> emissions is a global issue, and China is at the forefront, since it emits considerable amounts of CO<sub>2</sub>. (Ullah et al., 2022, 1340–1341.)

FDI can also lead to improving the environment. Garriga and Zhang, (2025, 232) state that market pressure is one driver of improvement in environmental sustainability. Firms with unsustainable practices are boycotted in masses and thus face considerable public backlash. To avoid loss of reputation, these companies are forced to improve sustainability. Garriga and Zhang, (2025, 233) also state the importance of protected areas related to FDI. Protected areas are spaces where nature is preserved and left untouched. Having these areas can improve the reputation of a country and attract FDI. FDI can also bring green innovations to a country. In recent times CO<sub>2</sub> emissions have declined in BRICS countries which comprise around 40% of the global GDP. These countries receive a considerable share of global FDI, so even though FDI amount has remained high, CO<sub>2</sub> emissions are beginning to stagnate. (Uche et al., 2023, 287.)

The consequences of child labor and sweatshop labor are harmful for people. Working as a child will interfere with education and lead to worse school performance. (Tang et al., 2018, 150.) One reason for people working in sweatshops was low education level (Mikols 2019, 59). If children don't get educated, they are forced to work jobs with low education requirements and sweatshops offer such jobs with low requirements. Sweatshop labor can also be life threatening or otherwise hazardous. The Rana Plaza incident where a thousand workers died was an example of hazardous conditions leading to deaths. Getting rid of sweatshops needs to be done at a governmental level. Sweatshops hire people who don't know their rights and rely on ignorance to continue their practices. They don't hire people who know they will be mistreated and if someone becomes aware of mistreatment, they are fired. Thus, a situation is formed where people who don't know better are stuck working in poor conditions with minimal pay. (Firoz & Ammaturo, 2002, 30.)

## 4 Conclusions

The aim of this thesis was to discuss the impact FDI has on developing countries and look at China as a case example. There are multiple studies about child labor, sweatshop labor, different forms of FDI and its effects, but I wanted to discuss everything in this thesis. The case example of China was a concurrent one about how a nation rose from developing status to an economic behemoth. This example proves that every nation could accomplish similar growth in theory. Knowing what problems are associated with FDI is good knowledge for consumers and nations receiving FDI.

Consumers have become more aware about sustainability issues in the last decade. According to Nisen (2013), Nike faced major boycotts due to sweatshop practices. Because of the backlash Nike was forced to change its practices and improve work conditions. In 2013 Rana Plaza, a building in Bangladesh collapsed taking the lives of 1100 people most of whom were garment workers. Following this incident all factories were assessed, and work safety was prioritized in Bangladesh. One of the main reasons for building sweatshops was the lack of legislation and developing countries wanting to attract FDI for any price. After these incidents going back to the same unethical practices is practically impossible and would result in major backlash. However, companies will try to conceal unethical practices, so sweatshop labor still exists.

When looking at the case example of China, it managed to reap all the benefits of FDI while falling victim to many ethical issues. China needed FDI in the beginning to establish infrastructure and gain knowledge. This will come at a cost and China has been infamous for dealing with environmental and labor violations and cheaply made items are often associated with China. In the recent years after environmental sustainability has become more important, China has been forced to solve all the issues on its own. This is the downside of attracting FDI and not caring about sustainability. The companies who did FDI do have responsibility on this matter, but the main responsibility of fixing all the issues created remains on China. This case example shows that not caring about sustainability and ethics will backfire in the future. As mentioned before countries have taken action to combat the issues like Bangladesh did with the Rana Plaza collapse. MNCs aren't legally obligated to improve the situation they caused, and the host country must find solutions for the problems. Prevention of ethical violations and sustainability issues is the best action to avoid any consequences associated.

To conclude, does FDI have a positive impact on developing countries. When looking at the facts and numbers and the case example it absolutely is. In developing countries there is a lot of available

workforce, who are willing to do jobs that western people consider monotonous. FDI will bring these jobs to the nations and the economy will grow. The negative effects of FDI are still a problem but aren't so prevalent these days. Developing countries have been forced to improve work conditions and environmental issues are taken more seriously nowadays. Establishing a sweatshop that pollutes a lot is impossible to do in China. The problems are more prevalent when a country is knowingly exposing itself to exploitation. Offering a pollution haven opportunity could be an opportunity to attract FDI, if the violations would never surface. To prevent such cases, it is important to have strong legislation in the host country and conduct factory audits.

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