



The relationship between inward direct foreign investment and China's provincial export trade

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Abstract

This study evaluates the causal links between inward foreign direct investment (FDI) and exports from the PRC as a whole and also from its provinces. The national study is based on a monthly time series for the years 1986 to 1999 and cointegration/error correction modelling (ECM) techniques are used to conclude that for the PRC as a whole the relationship between FDI and exports is bidirectional. The relationship between inward FDI/exports for the PRC's provinces, cities, and autonomous regions is analysed in three panel data sets: the high FDI recipients (HFDI, $n=144$) concentrated along the Chinese coast, medium FDI recipients (MFDI, $n=192$) in Central China, and the low FDI group (LFDI, $n=128$) in Western China. The panel data studies reveal that in the HFDI and LFDI, bidirectional causality applies, while exports Granger cause FDI in the MFDI. All regional results are confirmed by Sims tests. The policy implications are explained. © 2001 Elsevier Science Inc. All rights reserved.

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1. Introduction

The objective of this analysis is to explain the causal relationship between China's inward foreign direct investment (FDI) and exports for China as a whole and for its provinces and

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cities. This analysis focuses on the precedence and timing of the relationship between inward FDI and Chinese exports.

Stern (1997) summarises the arguments about the complementary nature of inward FDI and the trade of the recipient (host) country. FDI and exports from the host country may be complementary, particularly if the foreign interest is secured through the establishment of foreign invested enterprises (FIEs). Inward FDI brings with it the expertise of the foreign partner in selecting and promoting exports on international market in this way FDI enhances the recipient country's export performance.

The nature of the relationship between inward FDI and exports from the host country is inextricably associated with questions about precedence and timing. The literature about this aspect of the inward FDI/exports relationship is incomplete in the case of the PRC. This study is designed to fill this gap. The following question is addressed here. Does inward FDI precede or lead exports, or vice versa? Although this questions evaluated empirically for the PRC and its provinces, an economic rationale is presented for the possibility that the relationship can occur in either of two single directions; alternatively, that there exists a bidirectional relationship between inward FDI and exports or there is no causal link at all.

The importance of the causal relationship between inward FDI and exports is central to development planning and strategies. If there is a definite unidirectional causality from export expansion to FDI ($EXP \rightarrow FDI$), then some credence is given to an export led growth strategy. Exports not only stimulate economic development and structural change, they also attract FDI into China. If this is so, then development planners can expect those regions of their domestic economies with a pre existing export orientation to act as conduits for FDI. An appropriate policy in these circumstances is trade liberalisation designed to reduce exporters' cost and to encourage exports. The FDI that is encouraged by export expansion will stimulate the overall development of the domestic economy. If the causative process is in the opposite direction ($FDI \rightarrow EXP$), then the implication is that the inflow of FDI is a prerequisite for the expansion of China's exports. Then, the appropriate development strategy is to provide incentives for FDI, which in time leads to export growth. This seems to have been the motivation for the establishment of the first special economic zones (SEZs) by the PRC in 1979. Alternatively, export growth and inward FDI may have a reciprocal causative relationship ($EXP \leftrightarrow FDI$). In other words, FDI and exports interact in the process of development. Finally, if there is no evident direction of causation between export growth and FDI, then alternative strategies to the encouragement of FDI or export promotion are required for structural transformation and growth of the Chinese economy. In summary, a rigorous test of causality between PRC's exports and its inward FDI is necessary as a way of informing the Chinese government and development agencies about the success of past policy and future development strategies for China.

To this point in time, the policy emphasis has been focused on the eastern or seaboard provinces of China or provinces and cities close to the major sources of FDI, such as Hong Kong. The Chinese government has encouraged the growth of exports in the east by establishing SEZs and economic and technological development zones (ETDZs) and providing incentives for investment in them. This experience suggests that inward FDI should lead, precede, or cause export growth in the coastal provinces of China and the

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