Developing inland China: Do heterogeneous coastal foreign direct investments and exports help?

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Abstract: By applying panel estimation models to Chinese provincial level data for 1993-2008, this paper examine the impacts of China's coastal foreign direct investment (FDI) and exports on its inland regions. The results show that coastal FDI has overall positive interregional impacts, while coastal exports do not. Cooperative joint ventures generate positive impacts, but little impact is produced by wholly foreign-funded enterprises. In the case of equity joint ventures, there may even be negative impacts. The interregional impacts do not exhibit any differences across FDI origins or exporters' ownership status. The authors attribute these findings to the protectionist behaviour of state-owned enterprises participating in equity joint ventures as well as to the prevalence of processing exports.

JEL classification: F23, O33, R11, R12.

Keywords: Foreign direct investment, exports, interregional spillovers, China.

Contents

List of tables

1. Introduction

China's coastal regions have formed the country's front line in implementing its open-door policy during the country's reform era. Comprising 40% of the total population and 30% of the total land area, the coastal regions attract 90% of the country's foreign direct investment (FDI) inflows and export trade. Support for this uneven development strategy in favour of the coastal regions has been justified by, among other reasons, the belief that the coastal economic boom would subsequently spread back into the inland regions.

It is well understood that FDI and exports benefit Chinese local area economies. However, there is no consensus that they will necessarily benefit other regions, as their positive spatial spillovers may be offset by the negative impact of their competition with inland regions for talent and resources. On the one hand, China's coastal FDI inflow and exports have sustained very strong performance for almost 20 years. On the other hand, the widening income disparity between the coastal and inland regions has long been of concern among Chinese policymakers who are trying to steer the country towards a harmonious society. In the wake of the recent global financial crisis, rebalancing the economy by reducing its heavy reliance on foreign demand as well as by improving efficiency and upgrading the quality of FDI and exports has become a policy priority. The new Government of China, under Xi Jinping and Li Keqiang, is working on a blueprint for a new round of comprehensive reform. Against this backdrop, this paper attempts to answer the question of whether or not China's coastal FDI inflow and export trade really contribute to inland development through positive spatial spillovers that are large enough to offset the competition effects.

Studies carried out on China's coastal and inland development have mainly focused on relative regional disparity. For example, Zhang and Zhang (2003) found that the role of FDI and export trade play an important role in contributing to the widening regional inequality in China while Su and Chang (2013) explored the issue of convergence in per capita income between the eastern and western provinces. This paper, however, studies how the level of inland economic development has been affected by coastal FDI and exports. The spatial impacts of coastal FDI and exports on inland economies are estimated by focusing on the impacts generated by different modes of FDI and exports, i.e., FDI by type of local partnership and by origin, and exports by ownership of trading companies. This approach is used in this study because different types of FDI and exports interact with the inland economy through different mechanisms, and could generate very different spatial impacts.

Given the co-existence of a positive spillover effect and a negative competition effect on the inland generated by coastal FDI and exports, it is difficult to predict in theory the net impacts. Nevertheless, the stylized features of the Chinese foreign trade and investment regimes can help in speculating on possible outcomes of this empirical investigation of the issue. First, the bulk of Chinese exports constitute processing goods with low domestic value-added. This implies that true Chinese export activities are not as intensive as the export volume suggests, and that domestic spillover of production technology and management know-how could be limited.

Second, China's technology-for-market policy requires high-tech foreign investors who are seeking access to the Chinese market to form equity joint ventures (EJVs) with domestic firms, mostly state-owned enterprises (SOEs). As far as intellectual property rights protection is concerned, wholly foreign-funded enterprises (WFFEs) are the best form of overseas investment. EJVs make possible the maximum transfer of production technology and management know-how from foreign investors to local partners. In-between are the cooperative joint ventures (CJVs). China's high-tech sectors are dominated by monopolistic SOEs. So the Chinese partners in high-tech EJVs are mostly SOEs. They benefit from foreign partners' transfers of technology and know-how, but also have an interest and the ability to protect themselves from leaks to other firms, including firms in other regions, and from competition. Therefore, EJVs may not do better than other forms of foreign investment.

Third, FDI with advanced technology normally comes from advanced countries. For the same reason, FDI originating from advanced countries may not necessarily do better than lower-tier countries in interregional technology spillovers.[2]