

# RESEARCH NOTE

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## **The impact of inward foreign direct investment on the nature and intensity of Chinese manufacturing exports**

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Using data for the period 1983-2002, this study examines the relationship between inward foreign direct investment (FDI) and export performance in China. The results indicate that FDI promotes exports by foreign as well as domestically-owned firms, and that this effect is strongest for labour-intensive industries. This impact, however, does not depend on the country of origin of the investor. This finding contradicts previous results that showed that western transnational corporations (TNCs) were significantly less export-oriented than the affiliates of TNCs from other economies, suggesting that western TNCs in China have become more export-oriented in recent years. The finding that the relationship between FDI and exports is not influenced by the country of origin underscores the timeliness of the elimination of the discriminatory policy of China towards foreign investors.

### **1. Introduction**

The contribution of transnational corporations (TNCs) to exports from developing countries has long been a point of debate. Host countries often complain that TNCs export too little, and the findings in some studies support these arguments. For

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example, Lall and Mohammad (1983) found that TNCs performed rather poorly in generating exports from India. However, other empirical studies have suggested the opposite, showing that inward foreign direct investment (FDI) was export-oriented and raised the level of exports from host economies (O'Sullivan, 1993; Blake and Pain, 1994; Cabral, 1995). Research on the role of inward FDI in improving Chinese export performance has been a more recent addition to the literature. Many studies found evidence of a generally positive and significant role for inward FDI in promoting the expansion of Chinese exports (Buckley, Clegg and Wang, 2002; Sun, 1999, 2001; Zhang and Song, 2000).

What remains unclear, however, is the mechanism through which FDI creates or encourages Chinese exports; the rise in Chinese exports could result either directly from the export activities of foreign affiliates<sup>1</sup> or from the expansion of exports by domestically-owned firms. This study contributes to this stream of research by shedding some light on the ways in which inward FDI has impacted on Chinese export expansion and upgrading.

The question at issue is the nature and structure of the relationship between inward FDI and Chinese exports. Firstly, we examine the extent to which the growth of Chinese exports is attributable to inward FDI. Secondly, we assess whether FDI has contributed to the changing structure of Chinese exports. The expansion of Chinese exports is taking place alongside a shift in the composition of exported goods, namely, an increasing share of capital- and technology-intensive goods (and a relative decline of traditional labour-intensive goods). There has not been much research on this issue. Thirdly, we examine the country-of-origin effects. Depending on the origin of the parent company, foreign affiliates in China are perceived as either "local market-oriented" or "export-oriented". A survey by De Beule *et al.* (2001) showed that the affiliates of "overseas" Chinese firms in Guangdong province sold a substantially larger share of its

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<sup>1</sup> In China, foreign affiliates are often referred to as foreign-invested enterprises or FIEs.

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output abroad than western TNCs. The affiliates of European TNCs exported less than 30% of their sales, while the average in Guangdong province was approximately 50%. This study examines whether (and to what extent) these country-of-origin effects are present in more recent data.

The rest of this article proceeds as follows. Section 2 outlines the theoretical framework. We then present the model specification and the data in section 3. The empirical results and discussion are given in sections 4 and 5. Concluding remarks are offered in the last section.

## **2. Conceptual framework**

One of the challenges currently facing applied research is how to investigate the theoretical predictions regarding the impact which the movement of factors of production (and the export of factor services) via TNCs' operations has on the patterns of the host economy' trade. In this regard, the recent experience of China offers a valuable case for examining how developing countries are able to realize their export potential when factors and services are internationally mobile. The substantial differences in factor endowments between China and developed countries are the principal drivers of the export of technology, management skills and headquarter services in the form of FDI from developed countries to China, which, according to theory, could stimulate exports from the labour-abundant host. Dunning (1998) argued that the relationship between trade and FDI was conditional on the motivation of the FDI in question. Market-seeking FDI can displace exports from the home to the host country, while efficiency-seeking FDI will increase the volume of trade (Gray, 1998; Kojima, 1978; Buckley, 1983). Theory therefore suggests that FDI plays an important role in reallocating global economic resources and stimulating productive capabilities.

Foreign affiliates are usually considered as better placed to serve international markets than their host country counterparts since they are usually better informed about international market conditions and benefit from access to

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international marketing and distribution networks of their parent companies. Moreover, TNCs are often larger than local firms and have managerial, entrepreneurial and financial resources to afford the high fixed costs associated with export activities (Blomström and Kokko, 1998). Hence, inward FDI should positively impact on the volume of exports from China. Thus, our first hypothesis is:

*Hypothesis 1: Inward FDI has raised the volume of exports from China.*

Foreign affiliates may directly enhance the exports of local firms in the host economy through the provision of competitive assets (UNCTAD, 2002), but may also indirectly create external effects that enhance the export prospects of local firms (Rhee and Belot, 1990). Such externalities may arise, for example, through the formation of linkages where local firms are engaged as suppliers and subcontractors to TNCs. These linkages provide channels through which knowledge about technologies and foreign market conditions can be transmitted. In addition, local firms may learn how to succeed in foreign markets by imitating TNCs. In the case of Sino-foreign joint ventures, marketing knowledge and know-how might be transferred back to the Chinese parent company. TNCs may also train local employees in export management and foreign market knowledge, and local firms can acquire this knowledge through hiring these employees of TNCs. These arguments are empirically supported by Aitken *et al.* (1994) for Mexico and by Kokko *et al.* (1997) for Uruguay. This forms the basis of our hypothesis 2:

*Hypothesis 2: Inward FDI has raised the volume of exports by domestically-owned firms.*

The first two hypotheses are concerned with the general impact of FDI on exports. Next, we investigate the specific nature of the impact that arises from China's current stage of development and its comparative advantage. As China is abundant in labour, it is expected that the dominant motive of incoming TNCs is to use it as a production base for labour-intensive goods. Thus, our third hypothesis is:

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***Hypothesis 3:*** *The impact of inward FDI on Chinese exports is stronger for labour-intensive goods than for capital- and technology-intensive goods.*

A notable feature of inward FDI in China is that investing countries can be divided into two distinct groups: “overseas” Chinese, including Hong Kong (China) and Macao (China), and “western” countries (primarily, the European Union, Japan and the United States).<sup>2</sup> TNCs from overseas Chinese and those from developed countries have different types of technological advantages (Yeung, 1994; Shi, 1998; Luo, 1999). Western TNCs’ knowledge assets are typically in proprietary state-of-the-art product and process innovations, generated by extensive investment in R&D (Buckley and Casson, 1976). In contrast, overseas Chinese TNCs are relatively small and less innovation-intensive. Their primary knowledge assets are skills of using standardized technology and experience in organizing labour-intensive production. Much of these have been generated through export-oriented production conducted during the take-off period of the development of their home economies (Shi, 1998).

These differences in ownership advantages are expected to influence the motivations of the two groups of investors. Market-seeking is the prime motivation for FDI by western TNCs in developing countries with large domestic markets (Shi, 1998). TNCs from overseas Chinese typically originate from newly-industrialized economies (NIEs) which are export-oriented. The ownership advantages of overseas Chinese TNCs - in combination with the availability of cheap labour and land in the host economy - allows them to reduce production costs. The main motive for FDI by overseas Chinese TNCs is therefore likely to be efficiency-seeking. These TNCs relocate export-oriented industries out of their home economies to take advantage of cheaper immobile factors abroad in order to pursue

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<sup>2</sup> The use of the term “overseas” Chinese to refer to firms based in Hong Kong and Macao is, in some sense, a misnomer since these two territories are part of China. However, the business communities in these territories are quite distinct from their mainland counterparts and so are the regulations governing them. Therefore, they are treated as “overseas” firms in this study.

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export expansion. This line of argument suggests that overseas Chinese TNCs contribute more to China's exports than their western counterparts. This is the basis for hypothesis 4:

*Hypothesis 4: The contribution of overseas Chinese FDI to Chinese exports is greater than that of western FDI.*

### **3. Data and model specification**

The econometric analysis was conducted using aggregate data obtained from various issues of *the China Statistical Yearbook* and *the China Foreign Economic Statistical Yearbook*. Table 1 presents the figures for annual exports and inward FDI for the period under consideration. It is clear that the rapid increase in the volume of exports from China was accompanied by an increasing share of exports by foreign affiliates. Partly as a result of the priority given to the development of new export industries in China, a substantial share of FDI flows has been in industries that are highly export-intensive. Wei (1995, 1996) concluded that almost all of the growth of Chinese exports since 1992 could be directly or indirectly attributed to foreign affiliates' activity. The growth of exports by domestically-owned firms has been relatively slow but still substantial in absolute terms. Total exports by these firms in 2002 were worth \$156 billion, seven times the value of 1983.

Although many of the world's largest TNCs have established operations in China, a large share of the realized investment has originated from smaller investors within the Asian developing region. Table 1 shows that over the period under consideration, 47% of the accumulated FDI came from Hong Kong (China) and Macao (China).<sup>3</sup> Since 1996, a growing

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<sup>3</sup> The dominance of Hong Kong (China), however, may be overstated for two reasons. First, some of the investments may have been "round-tripping" investments: i.e. domestic Chinese investment re-routed through Chinese affiliates in Hong Kong so that they are able to enjoy the special tax breaks and incentives FDI into China receives. Second, some FDI listed as originating from Hong Kong is in reality from Taiwan Province of China that is placed into China via their affiliates in Hong Kong.

**Table 1. Exports and inward FDI of China, 1983-2002**  
(Millions of dollars)

Years	Export			FDI				
	Total	Domestic firms	Foreign firms (the share in per cent )	Total	Hong Kong and Macau (China)	Japan	United States	EU
1983	22 226	21 896	330 (1.49)	636	378	97	52	41
1984	26 139	26 070	69 (0.26)	1 258	748	225	256	148
1985	27 350	27 053	297 (1.08)	1 661	956	315	357	168
1986	30 942	30 360	582 (1.88)	1 874	1 132	201	315	130
1987	39 437	38 229	1 208 (3.06)	2 314	1 597	219	263	53
1988	47 516	45 060	2 456 (5.17)	3 194	2 095	515	236	157
1989	52 538	47 625	4 913 (9.35)	3 392	2 077	356	284	188
1990	62 091	54 277	7 814 (12.6)	3 487	2 214	503	456	147
1991	71 843	59 796	12 047 (16.8)	4 366	2 487	533	323	246
1992	84 940	67 584	17 356 (20.4)	11 007	7 709	710	510	243
1993	91 763	66 526	25 237 (27.5)	27 515	19 516	1 324	2 060	671
1994	121 006	86 293	34 713 (28.7)	33 767	20 170	2 075	2 490	1 876
1995	148 780	101 904	46 876 (31.5)	37 521	20 500	3 108	3 083	2 239
1996	151 048	89 538	61 510 (40.7)	41 725	21 257	3 679	3 443	3 002
1997	182 792	107 893	74 899 (41.0)	45 257	21 027	4 326	3 239	4 439
1998	183 712	102 750	80 962 (44.1)	45 463	18 930	3 400	3 898	4 309
1999	194 930	106 302	88 628 (45.5)	40 319	16 673	2 973	4 220	4 797
2000	249 210	129 769	119 441 (47.9)	40 720	15 847	2 916	4 383	4 673
2001	266 152	132 932	133 218 (50.1)	46 850	17 038	4 348	4 433	4 182
2002	325 600	155 615	169 985 (52.2)	52 943	18 329	4 190	5 424	3 909
Total				445 070	210 710	36 010	39 780	35 610

*Source:* authors' calculations from *Almanac of China's Economy* and *China Statistical Yearbook*, various issues.

proportion of inward FDI has come from other sources, such as the European Union, Japan and the United States. Nevertheless, in terms of accumulated investment, China's inward FDI is still dominated by Asian developing economies. FDI from developing Asia typically consists of fairly small scale, labour-intensive projects, often concentrated in the processing of imported inputs for re-exports.

The composition of China's exports has also experienced a significant transformation over the period. Table 2 shows that the share of capital- and technology-intensive goods in Chinese

exports has more than doubled, from 19.6% in 1983 to 43.7% in 2002. UNCTAD (2002) reported that all of China's 10 principal exported goods in 2000 (accounting for 42% of the total) were products exhibiting rapid growth in world trade. All of these findings are consistent with the common perception that inward FDI has been important for China, but more research on the precise nature of this relationship is necessary.

Following previous studies (Sun, 2001; Zhang and Song, 2000), we model the level of exports as a function of FDI, domestic investment, the exchange rate and the economic performance of the host country (as proxied by the level or

**Table 2. Export structure of China, 1983-2002**  
(Millions of dollars)

Year	Labour intensive goods	Capital and technology intensive goods (% of total)
1983	8 169	2 472 (19.6)
1984	9 751	2 857 (20.1)
1985	7 979	2 130 (15.8)
1986	10 804	2,827 (14.4)
1987	14 843	3 976 (15.2)
1988	18 757	5 666 (17.1)
1989	21 652	7 075 (18.9)
1990	25 262	9 318 (20.2)
1991	31 076	10 967 (19.7)
1992	50 369	17 567 (25.9)
1993	55 173	19 905 (26.5)
1994	73 155	28 131 (27.8)
1995	86 788	40 501 (31.8)
1996	84 922	44 189 (34.2)
1997	104 836	53 927 (34.0)
1998	102 610	60 550 (37.1)
1999	105 800	69 200 (39.6)
2000	129 050	94 700 (38.0)
2001	131 530	108 270 (40.7)
2002	154 779	142 301 (43.7)(1)

*Source:* Authors' calculations from *China Statistical Yearbook*, *China Foreign Economic Statistical Yearbook* and *China Almanac of Foreign Economy and Trade*, various issues.

In this study, capital or technology intensive goods comprise "chemicals and related products" and "mechanical and transport equipment".

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growth of GDP). The following theoretical arguments underpin the selection of these variables. Domestic investment allows local firms to upgrade their technological capabilities and improve efficiency. As a result, they are better able to compete in international markets. Indeed, studies of the determinants of exports confirm that domestic investment is a significant predictor of export performance (Zhang and Song, 2000). Exports are also affected by exchange rates. A depreciation of the country's currency tends to increase its export earnings.<sup>4</sup> GDP (and its growth) is also an important determinant of export performance as it represents the overall performance of the economy (Zhang and Song, 2000). The model can be written as follows:<sup>5</sup>

$$\text{LogEX}_t = \alpha_0 + \alpha_1 \text{LogFDI}_{t-1} + \alpha_2 \text{LogR}_{t-1}, \quad (1)$$

where *EX* is the value of exports, *FDI* is the “utilized FDI”<sup>6</sup>, *R* is the exchange rate, expressed as the Renminbi (RMB) yuan price of foreign exchange.<sup>7</sup> We estimate the model by OLS.

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<sup>4</sup> During the period under study (1983-2002), the Chinese currency depreciated significantly from \$1=RMB1.98 yuan in 1983 to \$1=RMB8.27 yuan in 2002. The REER of Chinese currency fell from 285.16 in 1983 to 121.37 in 2002. The Chinese authorities have stated that in managing the RMB exchange rate, priority must be given to encouraging export.

<sup>5</sup> Following Zhang and Song (2000) and Sun (2001), we sought to avoid the problem of omitted variables by including lagged domestic investment and GDP growth. In almost all preliminary regressions, GDP growth had no effect on exports, while domestic investment was usually insignificant and often wrongly signed. In view of this, and suspected collinearity with the FDI variable, these two variables were removed from the equation. Possible reasons for the poor performance of the domestic investment variable include the extreme variability in the data: the average growth rate from 1983-2002 was 13.7%, with a low of 6.5% in 1989 climbing to 25.0% in 1991, 35.1% in 1992 and 47.8% in 1993. Another possible explanation is that the bulk of domestic investment went to the infrastructure sector, which may be only weakly linked to export activities.

<sup>6</sup> Utilized FDI is the official term given to investment actually made. This is to be distinguished from the value of investment for which permission has been granted by the Chinese authorities.

<sup>7</sup> A rise in this variable represents a depreciation in the foreign exchange value of the Chinese currency, and therefore a fall in the foreign currency price of Chinese exports.

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The value of exports ( $EX$ ) is deflated by a retail price index (as there is no other appropriate deflator). A similar approach has been used in other studies (e.g. Pain and Wakelin, 1998; Sun, 2001; Zhang and Song, 2000; Zhang, 1995). The real effective exchange rate (REER) is used as the exchange rate variable. The data on REER were obtained from the IMF. We expect the coefficients on  $LogFDI_{t-1}$  and  $LogR_{t-1}$  to have positive signs.

Of particular interest is the coefficient of  $LogFDI_{t-1}$ , as this indicates the elasticity of exports with respect to inward FDI (of the previous year). The use of lagged dependent variables in examining the impact of FDI on export performance has long been established (e.g. Orr, 1991). The first-order lag structure is also adopted for the exchange rate variable ( $LogR_{t-1}$ ) to take into account the time taken for demand to respond to price changes in international markets. The time variable ( $TIME$ ) is included in order to capture the time trend. To assess the impact of FDI on exports by domestically-owned firms, the model in equation (1) is estimated using exports by domestically-owned firms, denoted as  $EX(D)_t$ , as the dependent variable (table 3).

Two further variations of the model in equation (1) are estimated to examine the nature of the relationship. First, the model is estimated by separating the data for the dependent variable into two groups: exports of labour-intensive goods and those of capital-intensive goods (table 4). Second, the model is estimated by separating the data for FDI by country of origin (table 5).

#### 4. Empirical results

The results of the estimations are presented in tables 3-5.<sup>8</sup> Column (1) in table 3 shows that the coefficient on the FDI

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<sup>8</sup> As indicated by adjusted  $R^2$  and D.W. statistics, most of the regressions fit the data well. All our calculated  $d$  values but one (column (5) in Table 3) lie well between  $d_u$  (0.998) and  $4 - d_u$  (2.324) at the usual 5% level of significance. Therefore, there appears to be no general problem of autocorrelation.

variable is positive and statistically significant, confirming the contribution of FDI to China's overall export expansion in the period under study. The result shows that a 1% increase in FDI leads to a 0.2% growth in exports in the following year. This finding is consistent with H1. It is also consistent with Thoburn (1997), Sun (1999, 2001) and Zhang and Song (2000), which found evidence of a positive role for foreign TNCs in promoting China's export growth.

**Table 3. FDI and Chinese export performance, 1983-2002**

Dep. variable	$LogEX_t$ (1)	$LogEX(D)_t$ (2)
Constant	5.613(36.31)	6.058(38.26)***
$LogFDI_{t-1}$	0.196(4.06)***	0.179(3.62)***
$LogEX(F)_{t-1}$	---	---
$LogR_{t-1}$	0.369(3.15)***	0.532(4.44)***
$TIME$	0.132(8.62)***	0.087(5.56)***
$R^2 - adj$	0.99	0.98
D.W.	1.95	2.34

Source: authors' analysis.

Figures in parentheses are t statistics (two-tailed tests); \*, \*\*, and \*\*\* denote significance at the 10%, 5% and 1% levels respectively.

The variable  $LogFDI_{t-1}$  is also significant in column (2), which presents the estimation of the model with exports from domestically-own firms as the dependent variable. This result confirms the existence of externalities. It is also in line with the findings by Buckley *et al.* (2002), Kokko *et al.* (1997) and Aitken *et al.* (1994).

The significant results for the exchange rate variable ( $LogR_{t-1}$ ) confirm that a depreciation of the RMB yuan promotes the growth of exports. These results are also consistent with Wang (1993), Wu (1994) and Zhang (2001), which provide accounts of the contribution of the exchange rate policy to export growth in China. Table 3 shows that the price responsiveness of

exports by domestically-owned firms appears greater than the average for all Chinese exports.

Table 4 shows the impact of FDI on exports of different categories of goods, namely exports of labour-intensive goods, denoted by  $EX(L)_t$ , and exports of capital-intensive goods, denoted by  $EX(C)_t$ . Although it would have been better to examine the impact that FDI in labour-intensive industries had on labour-intensive exports (rather than the effect of total FDI on labour-intensive exports), this was not possible in our case as the data were not available.

**Table 4. FDI and Chinese export performance by category of exported goods, 1983-2002**

Dep.variable	$LogEX(L)_t$ (1)	$LogEX(C)_t$ (2)
Constant	4.756(18.37)***	2.850(9.96)***
$LogFDI_{t-1}$	0.220(2.73)***	0.152(1.71)*
$LogR_{t-1}$	0.711(3.63)***	0.426(1.96)*
$TIME$	0.135(5.27)***	0.236(8.32)***
$R^2 - adj$	0.98	0.98
D.W.	1.16	1.01

Source: authors' analysis.

Figures in parentheses are t statistics (two-tailed tests); \*, \*\*, and \*\*\* denote significance at the 10%, 5% and 1% levels respectively.

The aggregate FDI is shown to have a positive and significant impact on both groups of Chinese exports. What is interesting, however, is the difference between the coefficients; the size of the coefficient (and the level of significance) of the FDI variable is greater for the labour-intensive group than the capital-intensive group. Thus, the results provide support for hypothesis 3.

Table 5 presents the results of the estimation in which FDI is separated by home economy. The coefficient of FDI is positive and statistically significant for all home economy groups.

**Table 5. FDI and Chinese exports by major source countries, 1983-2002**

Dependent variable: exports by China ( $LogEX_t$ )			
FDI origin	Hong Kong and Macau (China)	United States	EU
Constant	5.624(36.77)***	6.125(70.91)***	6.377(46.27)***
$LogFDI_{t-1}$	0.180(3.77)***	0.220(5.45)***	0.165(3.50)***
$LogR_{t-1}$	0.449(4.05)***	0.710(9.09)***	0.825(7.56)***
$TIME$	0.146(11.14)***	0.125(9.84)**	0.129(7.08)***
$R^2 - adj$	0.99	0.98	0.99
D.W.	2.04	2.24	1.83

*Source:* authors' analysis.

1. Figures in parentheses are t statistics (two-tailed tests); \*, \*\*, and \*\*\* denote significance at the 10%, 5% and 1% levels respectively.

Since the dependent variable used in the analysis is aggregate exports from China, the results do not allow us to say whether the positive impact of FDI from western economies on exports is due to their affiliates' exports or through spillover effects that stimulate exports from domestically-owned firms. But the impact of FDI from western countries on Chinese exports is no less than the impact of FDI by overseas Chinese firms. Hence, hypothesis 4 is not supported by the data.

## 5. Discussion

The results show that foreign affiliates in China appear to be acting as a platform for exports, which is in line with the findings in Zhao and Zhu (2000). The location advantages of China are likely to centre on the exploitation of cheap labour and land. Inward FDI realizes export potential of the economy through transferring either entire production processes or labour-intensive and less technology-intensive segments of high technology industries (Lee, 1992). Further investigation is required to understand better which intangible assets are being transferred and through what mechanisms.

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It is noted that the exchange rate has a larger coefficient for labour-intensive goods than for capital and technology-intensive goods. This is to be expected as labour-intensive export goods are likely to be more standardized, competing in foreign markets on price rather than on quality. Consequently, they are more sensitive to changes in the price caused by exchange rate movements. This explanation can also account for the findings presented in table 3 that the exchange rate has a greater impact on exports by domestically-owned firms, since they are exporting more standardized goods than the affiliates of TNCs.

In contrast with previous findings that European Union and United States affiliates in China were mostly local market-oriented operations, we found (by using more recent data) that their impact on Chinese exports were comparable to those of FDI from Hong Kong (China) and Macao (China). This finding may be explained by two possible factors. First, the export-oriented approach of western TNCs might have taken longer to implement, perhaps because TNCs under pressure to satisfy local content requirements (Bjorkman and Osland, 1998) have not found many local subcontractors and suppliers with capabilities to meet their quality requirements. Second, those TNCs that entered the country primarily for servicing the local market might have changed their strategy to focus more on exports following intensifying competition and local market saturation in China.

Finally, the results concerning Hong Kong (China) and Macao (China) in table 5 are in line with the findings in De Beule *et al.* (2001). It is likely that investment from Hong Kong (China) and Macao (China) in mainland China is undertaken to establish labour-intensive operations on imported intermediate goods for re-export.

## **6. Conclusion**

We found that inward FDI exerted a considerable effect on overall Chinese export expansion. This export expansion comprises the growth of exports by foreign affiliates as well as

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those by domestic firms that have benefited from externalities associated with the presence of foreign affiliates. We also found that the impact of inward FDI on Chinese exports was stronger for labour-intensive goods than for capital-intensive goods. This finding is consistent with the observation that while there is an increasing share of capital-intensive goods in exports, China's exports of manufactures still consist mainly of products with low value-added and a low level of technology (e.g. textiles, garments, shoes and low-value electronics and machinery).

We also examined whether there are differences in the impact of FDI on Chinese exports by the investors' home economy. We found that the differences were insubstantial. The dominant view in the past was that western TNCs that invest in China were primarily domestic market-oriented (in contrast with overseas Chinese FDI), and had been little concerned with exports. The more recent data used in this study indicate that this has changed.

The findings also have implications for Chinese policy towards the encouragement of inward FDI and the promotion of exports. The results show that FDI had a more marked impact on the exports of labour-intensive goods than the export of capital-intensive goods. This reflects China's current comparative advantage, and signals the potential for the development of China's exports in more capital-intensive activities. TNCs are increasingly locating research and development in China. This is likely to result in the gradual rise of the impact of inward FDI on exports of goods in this category.

The study has also shown that the policy of the Government of China to allow the exchange rate to depreciate stimulated Chinese exports. This policy was criticized abroad for rendering Chinese goods "too cheap". However, the findings suggest that this policy has been important to China's export performance. With the accession of China to the World Trade Organisation, the Government of China has lost discretion to discriminate between national and foreign firms. Our results suggest that this loss will have lesser impact than might have

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been expected from earlier studies. In fact, whatever the home economy of the investors, inward FDI is found to stimulate Chinese exports. Hence, from the perspective of export promotion, FDI from all economies should be equally welcomed.

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