

Acknowledgements

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Preface

China's economic miracle over the last three decades has generated enormous interest across both developed and developing nations. Many are curious to know what led China to achieve an average double digit growth rate over the period. During the same period, China emerged as the largest foreign direct investment (FDI) host nation in the developing world receiving an enormous amount of FDI inflows. China's economic miracle: does FDI matter?

In this book, we present a comprehensive analysis of FDI and its impact on China's economic development and growth over the period 1978 to 2005. We contribute to the theory of FDI by extending the existing theoretical framework to be useful in analysing the impact of FDI on the economic development and growth in a host country. With the extended FDI theoretical framework, we empirically analyse FDI location-specific determinants and the impact of FDI on domestic investment, income distribution, consumption and tourism in China. The analytical work has been carried out by using a stationary multi-equation system of time series models with statistical data for the period 1978 to 2005. The results show that FDI has indeed played a crucial role in creating China's economic miracle. Nevertheless, FDI does come with both benefits and costs. Therefore, China should develop appropriate and effective economic development policies and regulations to ensure positive FDI externalities.

To investigate the location-specific determinants of FDI in China, we explore China's FDI inflows in a comprehensive and meaningful way by using a Vector Auto Regression (VAR) model. The results show that good infrastructure, openness, low labour costs, market demand and labour quality have been the driving forces in advancing FDI in China, while the exchange rates have no impact on China's FDI inflows.

To examine the causal link between FDI, domestic investment and economic growth in China, we employ a multivariate VAR system with Error Correction Model (ECM) and the innovation accounting (variance decomposition and impulse response function analysis) techniques. The results show that while there is a bi-directional causality between domestic investment and economic growth, there is only a single-directional causality

from FDI to domestic investment and FDI to economic growth. Rather than crowding out domestic investment, FDI is found to be complementary to domestic investment. Thus, FDI has not only assisted in overcoming shortage of capital, it has also stimulated economic growth through complementing domestic investment in China.

We also investigate the causal link between FDI, growth and tourism in China by employing the Granger causality test under a VAR framework. From the empirical results on FDI and tourism, only a one-directional causality is found from FDI to tourism. This explains the rapid growth in the tourism market in China during the last decade. China's tourism industry has demonstrated robust growth and is seen as one of the cornerstones of the Chinese economy and a major source of job creation during the period 1978 to 2005. The results on the analysis of growth and tourism indicate that there exists a two-way directional causality between international tourism and economic growth, which in turn supports the widely believed tourism-led growth hypothesis.

China is the largest FDI recipient country in the developing world, which arouses concerns over the impact of FDI on rising inter-regional income inequality in China. Thus, we examine the relationship between FDI inflows and income inequality in China using data for the period 1978 to 2002. We find that FDI inflows are one of the main factors responsible for the increase in income inequality in China. In addition, empirical evidence presented in this book suggests that the level of economic development, education and agricultural transformation are also crucial determinants of income inequality in China.

The most shining example of China's economic reforms in the last thirty years has been the opening of its door to the rest of the world thus facilitating a transformation from socialism to capitalism and announcing China as a participant in world globalization. Adopting the cointegration approach, an ECM and on the basis of the life-cycle and permanent-income hypotheses, we examine international spill-over effects on Chinese household consumption behaviour. We found that international spill-over effects have substantially changed Chinese household consumption behaviour. Chinese consumers have also adopted new consumption values and patterns. Simultaneously, consumer confidence and consumption in China have continuously declined and plunged to an extremely low level. The empirical results reveal that uncertainty is responsible for the lower level of consumer confidence.

The overall conclusion of the study is that FDI plays a crucial role in the Chinese economic development, mostly in a positive way. However, China should develop appropriate economic policies and regulations in order to ensure positive FDI externalities.