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The economic impact of Special Economic Zones: Evidence from Chinese municipalities ☆

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ABSTRACT

The paper exploits a unique Chinese municipal dataset to assess the impact of Special Economic Zones on the local economy. Comparing the changes between the municipalities that created a SEZ in earlier rounds and those in later waves, I find that the SEZ program increases foreign direct investment not merely through firm relocation, and does not crowd out domestic investment. With dense investment in the targeted municipality the SEZ achieves agglomeration economies and generates wage increases for workers more than the increase in the local cost of living. The effects are heterogeneous: for zones created later the benefits are smaller while the distortions in firm location behavior are larger than those for the early zones. Municipalities with multiple SEZs experience larger effects than those with only one SEZ.

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1. Introduction

Economists have long debated the potential benefits and distortions associated with the spatially targeted programs.[1] More recently, the agglomeration economies have been rigorously identified that explain productivity advantages for firms located in denser areas (Combes et al., forthcoming; Greenstone et al., 2010; Kline and Moretti, 2011), while the efficiency losses from mobile workers and firms relocating across the boundaries of targeted areas are found to be modest in the case of US Federal Empowerment Zones (Busso et al., forthcoming). Despite the increasingly sophisticated work on place-based policies, there is a tremendous lack of empirical evidence for evaluating such programs in the context of developing countries.[2]

To fill that gap this study takes advantage of the gradual establishment of Special Economic Zones (SEZs) across Chinese municipalities since 1979, which constitutes a unique laboratory for a large-scale study of SEZs. Special Economic Zones are contained geographic regions within a country with more liberal laws and economic policies to encourage foreign-invested manufacturing and services for export (Shah, 2008). Fig. 1 displays the significant correlation between the SEZ experiment and FDI outcome in China.[3] Worldwide there were approximately 3000 SEZs in 135 countries in 2008, accounting for over 68 million direct jobs and over US$ 500 billion of direct trade-related value added within the zones (World Bank, 2008). Like many place-based programs, the SEZs attempt to foster agglomeration economies – they promote firm interactions that increase productivity in dense areas – by building clusters or attracting technologically advanced industrial facilities (Combes et al., 2011).

The question of whether SEZs have meaningful effects on the local economy therefore has great policy relevance, and yet previous research on SEZs consists mainly of case and theoretical studies.[4] My main objective in this paper is to quantify the impact of the SEZ programs and explore the mechanisms through which the effects work. Kline (2010) and Busso et al. (forthcoming) are the two closest predecessors to my investigation in framework and method. In the

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[1] See Glaeser and Gottlieb (2008), Glaeser et al. (2010), Greenstone and Looney (2010), and Moretti (forthcoming).

[2] See Peters and Fisher (2002) for reviews on the UK enterprise zones and more recent US empowerment zones and regional development initiatives.

[3] See Prasad and Wei (2007) and Feenstra and Wei (2010).

[4] See Willmore (1996), Kung (1985), Ge (1999), Park (1997), Rolfe et al. (2004), Aggarwal et al. (2008), Aggarwal (2005) and Litwack and Qian (1998).

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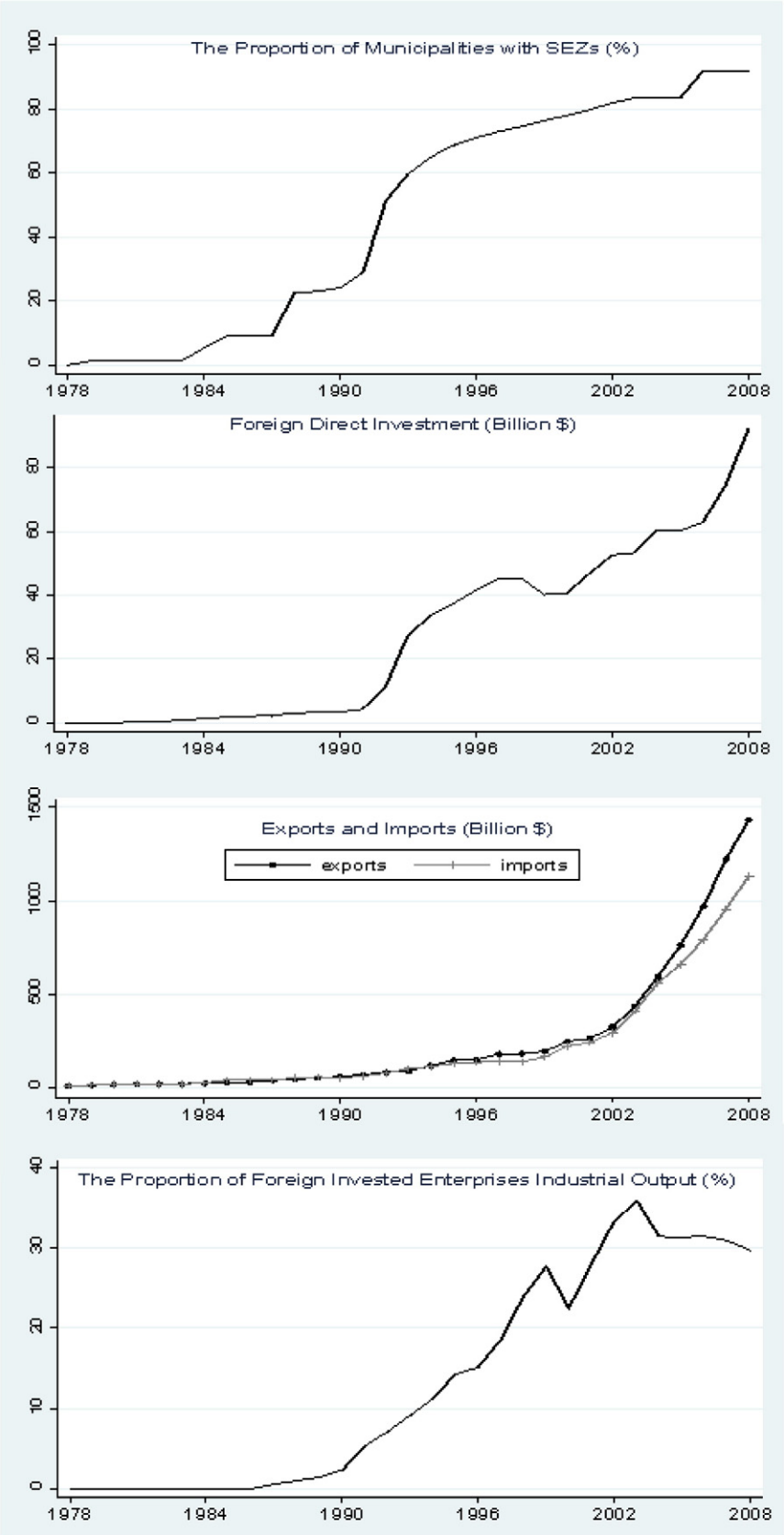

Fig. 1. SEZs, FDI and trade outcome: national aggregate statistics. *Notes*: the graph displays the significant correlation between the SEZ experiment and FDI related outcome including Foreign Direct Investment, Exports, Imports and the proportion of foreign invested enterprises' industrial output in China.

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