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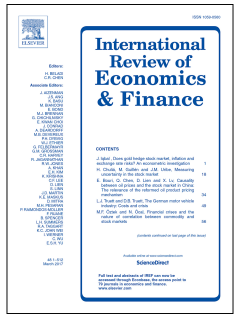

Foreign direct investment and export quality upgrading in China's manufacturing sector

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ABSTRACT

Using a Melitz-type theoretical model of firm heterogeneity, we show that (i) the presence of foreign firms within an industry affects the industry export quality and (ii) the industry export quality is directly related to the industry export price. As the industry export price can be approximated by the industry export unit value, our work provides a rigorous theoretical justification for several empirical studies that use export unit value as a proxy for export quality. We then convert our theoretical model-based structural relationships into a system of equations. Using industry level panel data from China's manufacturing sector, and measuring the industry export quality by the industry export unit value, we find that an increase in foreign presence in China's manufacturing sector contributes to a significant increase in China's export quality. We also distinguish between foreign presence in China originating from the Hong Kong, Macao and Taiwan (HMT) and non-HMT regions. We find that foreign presence in China's manufacturing sector that originates from the HMT region leads to a much larger increase in China's export quality. The main empirical result is found to be robust with respect to alternative measures of foreign presence and aggregate demand.

Keywords: Export unit value; export quality; FDI; productivity spillovers; China