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Multinational exposure, export variety and price: Evidence from Chinese electronics exporters

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ABSTRACT

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Using a matched firm-transaction dataset on the electronics industry in China, we provide one of the first attempts to examine whether foreign direct investment (FDI) has direct impacts on the export prospects of domestic firms, in terms of export variety and unit price. Using measures of multinational presence constructed at region and industry levels, our results reveal little evidence of multinational spillovers arising from an increase in the export variety of domestic firms. The growing presence of multinational firms has a strongly negative association with the export unit value of domestic firms, suggesting that exposure to multinational firms may intensify the competition in the product market and force local firms to offer lower-value products in the international markets. This adverse influence is mainly driven by processing trade as opposed to ordinary trade, with private firms being less affected by export spillovers than state-owned enterprises. We also find that the productivity of firms can mitigate the negative effect of the exposure to multinational firms on the unit value of exports. *J. Japanese Int. Economies* **38** (2015) 93–110. Department of Economics, National Central University, Taiwan; Graduate Institute of Industrial Economics, National Central University, Taiwan.

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1. Introduction

Success in attracting foreign direct investment (FDI) is a strategy which is crucial to the ongoing economic development of most developing countries, essentially because it not only creates jobs and contributes to greater outputs, but also generates spillover effects through various channels. Although numerous studies have examined the productivity spillovers of FDI on local firms, it is only more recently that researchers have begun to pay more attention to the trade-facilitating role of FDI (Sun, 2010; Fu, 2011; Mayneris and Poncet, 2013; Swenson and Chen, 2014).[1] In the present study, we define the export spillover effects from FDI as an externality passed on to indigenous firms by the exporting activities of multinational enterprises (MNEs). Hence, our primary focus is on the question of whether the growing presence of MNEs engaging in export production can broaden the product lines of domestic firms and enhance their product quality in international markets.

Multinational presence can influence the export activities of local firms through a number of channels. On the positive side, given that domestic firms may be faced with significant informational barriers to trade, the presence of MNEs may help reduce such barriers through the observation and imitation of the sophisticated export operations of foreign firms, an issue which is referred to the 'information spillover effect' (Aitken et al., 1997; Kneller and Pisu, 2007; Iwasaki et al., 2011). The vital role played by MNEs in providing better information, which helps facilitate trade, has been demonstrated in a number of theoretical and empirical studies, with local firms benefiting from information spillovers through: (i) increased opportunities for interacting and matching with new foreign customers and suppliers; (ii) obtaining knowledge of potential product markets; and (iii) learning about the quality level that they will be required to achieve if they wish to succeed in international markets (Rauch and Watson, 2003; Bastos and Silva, 2010; Swenson and Chen, 2014).[2]

On the negative side, MNEs can potentially intensify the competition within the product market which can have the adverse effect of constraining export opportunities for domestic firms. The presence of multinationals may also bring about congestion effects if it increases the demand for labor or overcrowds the utilization of the local infrastructure, with such factors increasing the production and/or export costs of domestic firms. Therefore, it remains an empirical issue as to whether FDI generates a positive or negative spillover effect on exports.

To take advantage of the country's lower labor costs, various policies have been adopted by China aimed at attracting FDI and becoming directly involved in the export of labor-intensive and final assembly products. China's entry into the World Trade Organization (WTO) in 2001 has further enabled it to integrate its manufacturing base into the global system to become the so-called 'World's Factory'. Since the country's share in international trade has grown exponentially, from approximately 1.7 percent in 1990 to 12.6 percent in 2011, China has now succeeded in overtaking the US to become the world's largest trade economy. From the perspective of fragmented global production, 'export-platform FDI' has emerged as the primary focus of the electronics industry in China, with Foxconn, the main manufacturer for Apple, providing a typical example of export-platform FDI involving the use of imported intermediate goods for final goods assembly in China and subsequent export into the global market.

A striking feature of export-platform FDI in China is that foreign firms are now primarily undertaking processing trade, as opposed to ordinary trade (Yang and Hayakawa, 2015). Although information spillovers through the mechanisms of the demonstration effect and worker movement remain available to firms engaging in FDI in processing trade, technology spillovers are considered to be limited, essentially because production activities relating to processing trade generally involve low-skilled and labor intensive work. Furthermore, the growing presence of MNEs engaging in processing trade may generate a strong negative competition effect on domestic firms in the international markets. Researchers have argued that the strength of spillovers from both export-platform FDI and

[1] A comprehensive review is also provided by Wooster and Diebel (2010).

[2] In a very recent study, Swenson and Chen (2014) find that contact with multinational firms has a stronger effect on new private firm transaction prices for differentiated goods, which is consistent with the information trading models of Rauch and Watson (2003).