Does Foreign Direct Investment Lead to Industrial Agglomeration?

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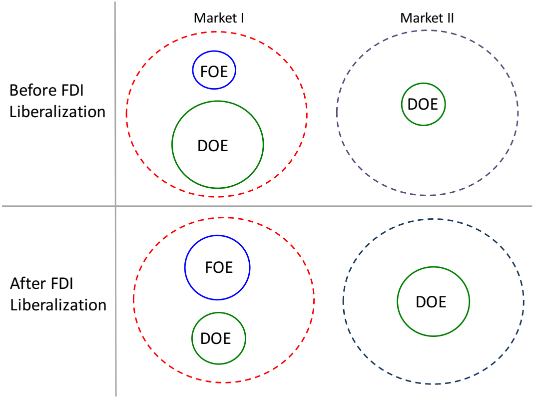
To Recap...

- Convincing empirical evidence that FDI affects industrial agglomeration *negatively*
- Two competing forces: (i) Knowledge spillovers, and (ii) Intensified competition

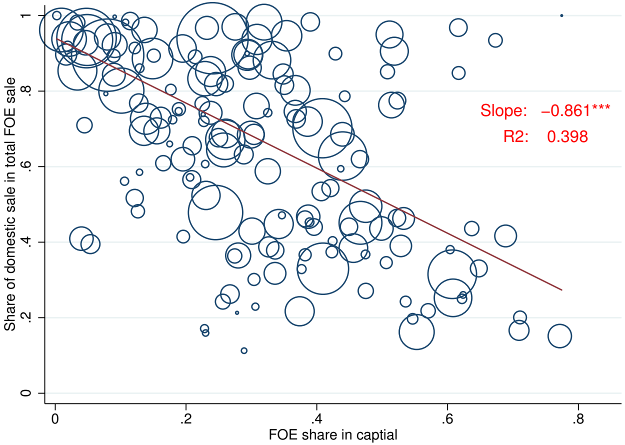


This Discussion...

- How much does FDI intensify competition in domestic market?
- Where does the competition come from? Where to escape competition?
- 2001 and 2007 Annual Surveys of Industrial Firms. Two key variables:
  - Share of sale that is allocated to Chinese market by FOEs at the industry level
  - Share of foreign equity at the industry level

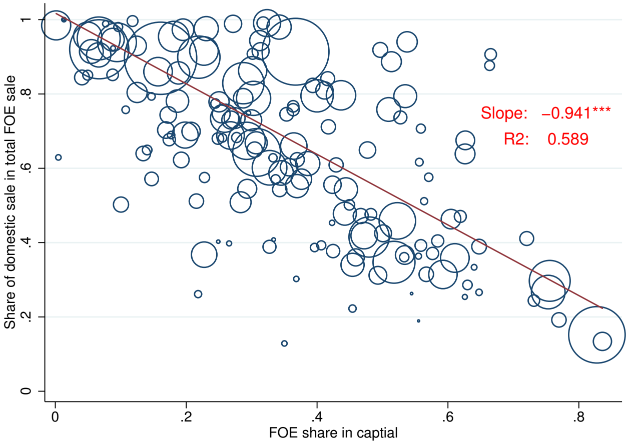
How Much Does FDI Intensify Competition in Domestic Market?

Figure: 2001



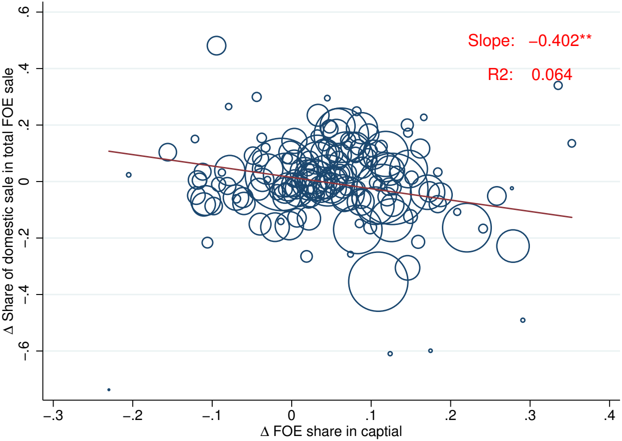
How Much Does FDI Intensify Competition in Domestic Market?

Figure: 2007



How Much Does FDI Intensify Competition in Domestic Market?

Figure: 2001-2007



How Much Does FDI Intensify Competition in Domestic Market?

To recap:

- FOEs in sectors with greater FDI openness sell less in Chinese market. Such inverse relation is more pronounced in 2007.
- The first-difference result suggests that foreign capital steps further away from selling to Chinese market in exchange for their entry into China. Why?
- These findings do not reject that FDI intensifies the competition in *goods market*. However, empirical evidence substantiating the role of FDI in intensifying competition is useful.

Where to Escape Competition?

- Quality differentiation (Bloom et al, 2016), processing innovation (Bombardini et al, 2018)
- In this paper, escaping competition is through relocating production to another market with a smaller FDI penetration and hence less competition in goods market.
- How strong the incentive is hinges on whether FOEs sell to the regional market or to China as a whole.

Where to Escape Competition?

- To get some idea, using 2007 data
  - Group industries into 10 bins based on FOE share in equity
  - For each bin, estimate the model

$$\ln DomSale_i = \beta FOE_i + \gamma_j + \phi_p + \varepsilon_i$$

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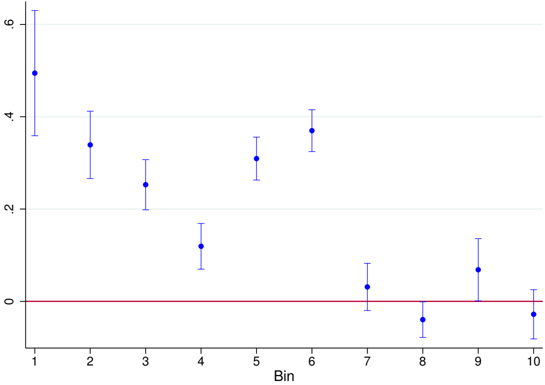
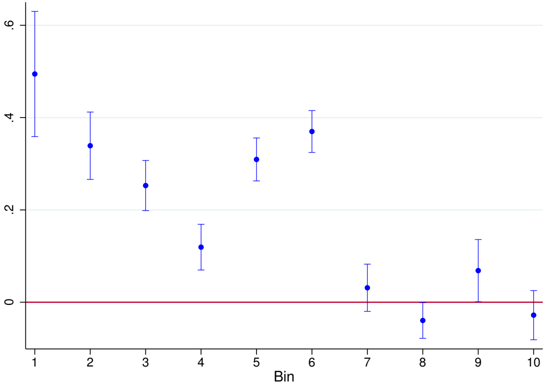


Where to Escape Competition?

- For sectors with relatively smaller FDI penetration, sale to China is larger for FOEs than Chinese domestic firms
- For sectors with relatively larger FDI penetration, there is no statistically significant difference.



Where to Escape Competition?

- It appears that FOEs sell beyond the regional market in sectors where competition are intensified by FDI.
- Low incentive of relocating from Shenzhen to Guangzhou
- With information on county where the establishment is located, one may consider distance-based measure of industry agglomeration.

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Competition arises in the *factor markets*, e.g. rising labor cost:

- Firms escape competition in the factor markets?
- In MO model, wages are exogenous due to the "outside good" sector that produces freely traded homo. good