The impact of FDI between Japan and China: A dynamic multi-regional general equilibrium analysis

Topic: Trade, global value chains and foreign direct investment: measurement issues and impact evaluation

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This paper analyzes the impact of the foreign direct investment (FDI) evolution of Japanese multinational enterprises (MNEs) operating in China during the recent financial crisis. The study is conducted by means of a three region (Japan-China-ROW) recursive dynamic computable general equilibrium (CGE) model of MNEs. Particulary detailed data from the METI on the operations of Japanese MNEs are used. Thus, we model Japanese MNEs taking into account their export and import propensity, the value added and production they generate, as well as, their capital intensity patterns. These features stand out among the few CGEs that consider the presence of MNEs. The FDI decrease would seem to produce rather small adjustments in the aggregate variables of China and Japan. However, their bilateral trade patterns are considerably affected by the evolution of FDI. Furthermore, in the case of Japanese MNEs operating in the Chinese transport equipment sector, in which Japanese presence is the most important among all sectors accounting for 13% of overall production and 14% of overall exports in China, the fall in FDI would bring about a reduction in exports to the rest of the world region. This would suggest a potential conduit by which FDI patterns between China and Japan would also impact world trade flows.