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The Role of Foreign Direct Investment in China's Economy Growth

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Abstract

This paper investigates the intricate relationship between Foreign Direct Investment (FDI) and China's GDP growth, focusing on three primary objectives: quantifying FDI's direct impact on national GDP growth, analyzing regional disparities in FDI distribution and effectiveness across eastern, central, and western regions, and evaluating sectoral variations in FDI contributions to economic growth. Our research employs a comprehensive methodological framework, combining correlation analysis, Granger Causality Testing, and Dickey-Fuller Testing to ensure robust statistical analysis. The findings reveal that FDI significantly drives GDP growth, particularly in eastern regions, while highlighting substantial regional imbalances in investment distribution and effectiveness. These results underscore the need for targeted policies to optimize FDI utilization and promote balanced economic growth across all regions of China. The study's implications emphasize the importance of developing targeted FDI attraction strategies for underdeveloped regions, enhancing investment efficiency mechanisms, and reducing dependency on foreign capital through domestic innovation promotion. By providing empirical evidence of FDI's heterogeneous impacts across regions and sectors, this research contributes to the academic literature and establishes a foundation for future investigations into broader socioeconomic effects beyond GDP metrics.

Keywords: *China, Foreign Direct Investment (FDI), Gross Domestic Product (GDP), Economic Development, Regional Analysis, High-tech Industry*

1. Introduction

China has experienced unprecedented economic growth over the past few decades, transforming from a developing nation into the world's second-largest economy (Wei, 1995). This rapid expansion has been driven by a combination of market reforms, industrialization, and globalization. One of the most significant contributors to this transformation has been Foreign Direct Investment (FDI), which has played a crucial role in enhancing economic development, fostering industrial growth, and advancing technological innovation (Buckley et al., 2007). Since the implementation of economic reforms in 1978, China has become one of the largest recipients of FDI, attracting investment across various sectors, including manufacturing, finance, and technology.

This paper seeks to explore the impact of FDI on GDP growth in China, with a particular focus on regional disparities. The key research question guiding this paper is: How does FDI impact GDP growth differently across China's regions? While FDI has contributed significantly to national economic expansion, its effects are not uniform across the country. The eastern provinces, such as Guangdong and Shanghai, have historically received the largest share of foreign investment, whereas the central and western regions have lagged in FDI inflows and economic development (Boermans et al.,2011).

The objectives of this paper are threefold. First, it aims to analyse the overall relationship between FDI and GDP growth in China, determining whether foreign investment has a direct influence on economic expansion. Second,

the paper seeks to compare the impact of FDI across China's eastern, central, and western regions, highlighting any disparities in investment distribution and economic performance. Finally, the paper will apply empirical methods to validate the causality between FDI and GDP growth, using statistical techniques such as correlation analysis, the Granger Causality Test, and the Dickey-Fuller Test.

Based on these objectives, the study proposes the hypothesis that higher FDI inflows lead to stronger GDP growth, but regional disparities influence this relationship. The expectation is that the eastern regions, with well-established infrastructure and favourable investment policies, will show a stronger correlation between FDI and GDP growth compared to the central and western regions. By examining these dynamics, this paper aims to provide valuable insights into how FDI can be leveraged to promote balanced and sustainable economic growth across China.

2. Literature Review

Foreign Direct Investment (FDI) has long been regarded as a key driver of economic growth, with various theoretical perspectives explaining its role in GDP expansion. Classical economic theories suggest that FDI contributes to economic development by providing capital inflows, advanced technology, and management expertise, which enhance productivity and industrial output (Dunning, 1993). The Endogenous Growth Theory argues that FDI fosters long-term economic growth by accelerating technological innovation and human capital development (Romer, 1990). Additionally, the Spillover Effect Theory highlights how foreign investments improve domestic firms' efficiency through knowledge transfer, competition, and integration into global supply chains (Blomström & Kokko, 1998).

In the context of China, FDI has played a crucial role in its economic transformation since the economic reforms of 1978 (Wei, 1995). Historically, special economic zones (SEZs) and open-door policies have been instrumental in attracting foreign investors, particularly in the manufacturing, technology, and financial sectors (Sun et al., 2002). China's accession to the World Trade Organization (WTO) in 2001 further boosted FDI inflows, making it one of the largest recipients of foreign investment globally (Lemoine, 2000). Major sources of investment have included the United States, Japan, and European nations, with multinational corporations (MNCs) establishing production hubs in China's coastal regions (Lardy, 2002). Over time, China has also shifted towards attracting high-tech and service-oriented investments, aligning with its innovation-driven growth strategy (Zhang, 2014).

Despite China's overall success in attracting FDI, its distribution has been highly uneven across regions. The eastern coastal provinces such as Guangdong, Jiangsu, and Shanghai have received the lion's share of FDI due to their developed infrastructure, favorable business environment, and proximity to international markets (Chen, 2011). In contrast, central and western provinces, such as Sichuan, Henan, and Guizhou, have struggled to attract comparable levels of foreign investment, leading to economic disparities between regions (Fan & Scott, 2003). Various policies have been implemented to redirect FDI towards underdeveloped areas, but significant imbalances persist, raising concerns about inclusive and sustainable economic growth (Wang & Mei, 2009).

Methodologically, past studies analyzing the FDI-GDP relationship have employed a range of econometric models. Time-series analysis, including correlation analysis and the Granger Causality Test, has been widely used to determine whether FDI causes GDP growth or vice versa (Hansen & Rand, 2006). The Dickey-Fuller Test has been applied to assess the stationarity of economic data, ensuring that statistical inferences are valid (Enders,

2004). Additionally, panel data models have been used to examine regional variations in FDI impact, highlighting differences in investment effectiveness across provinces (Hsiao & Shen, 2006). While most studies confirm a positive correlation between FDI and GDP growth, some findings suggest that the magnitude of impact varies based on factors such as industrial composition, institutional frameworks, and local governance efficiency (De Mello, 1999).By building on these past studies, this research aims to provide a comprehensive empirical analysis of the FDI-GDP relationship in China, with a specific focus on regional disparities and policy implications.

3. Research Methodology

This paper utilizes time-series data on Foreign Direct Investment (FDI) inflows and GDP growth from 1990 to 2023, sourced from the China National Bureau of Statistics and the World Bank. These datasets provide a comprehensive overview of economic trends and investment patterns over three decades, enabling a robust analysis of how FDI impacts China's economic performance. Given the varying levels of FDI inflows across different regions, the study also incorporates a comparative analysis of provinces with distinct investment intensities—Zhejiang (high investment), Sichuan (moderate investment), and Guizhou (low investment).

To quantify the relationship between FDI and GDP, the paper employs correlation analysis, which measures the strength and direction of their association. A high positive correlation would suggest that increasing FDI inflows contribute significantly to GDP growth, while a weak or negative correlation could indicate other dominant economic drivers. Additionally, the Dickey-Fuller Test is conducted to assess the stationarity of the data. If the data is non-stationary, differencing techniques will be applied to make it suitable for further analysis. Stationary data ensures that statistical relationships identified in the study remain valid over time rather than being influenced by trends or structural breaks.

To establish a causal link between FDI and GDP growth, the Granger Causality Test is employed. This test determines whether past values of FDI can predict future GDP growth or if the relationship is bidirectional, meaning economic growth also influences foreign investment inflows. Finally, a regional comparison is carried out to assess FDI-GDP trends in Zhejiang, Sichuan, and Guizhou, representing high, moderate, and low investment levels, respectively. This comparison highlights how FDI affects regional economic development and whether policy interventions are needed to balance investment distribution. The following visualization provides an initial look at FDI inflows and GDP growth trends across these three regions.

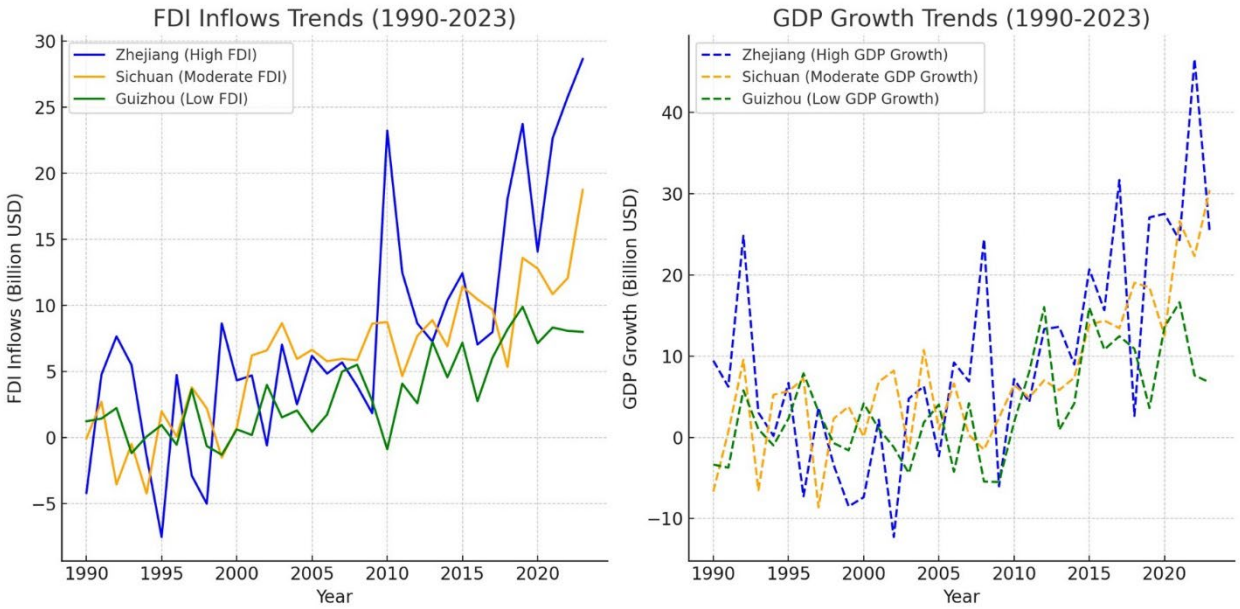

Figure 1: FDI inflows and GDP growth trends (1990-2023)

Figure 1 illustrates the trends in FDI inflows and GDP growth for Zhejiang, Sichuan, and Guizhou from 1990 to 2023. Zhejiang, characterized by high FDI inflows, exhibits a strong upward trajectory in GDP growth, suggesting a significant correlation between investment and economic expansion. Sichuan, with moderate FDI, shows steady growth, while Guizhou, receiving the lowest investment, demonstrates slower economic progress. These trends highlight the regional disparities in FDI-driven development, underscoring the need for targeted policies to enhance investment distribution and promote balanced economic growth.

4. Empirical Findings and Discussion

4.1) Overall Trends

The analysis of Foreign Direct Investment (FDI) inflows and GDP growth over the past three decades reveals a strong positive correlation between investment and economic expansion in China (Li & Liu, 2005). Regions with sustained high levels of FDI, such as those in the eastern provinces, have experienced accelerated GDP growth, while areas with lower investment have grown at a slower pace (Zhang, 2006). The time-series analysis shows that FDI inflows have steadily increased, particularly after China's accession to the World Trade Organization (WTO) in 2001, which further integrated the country into the global economy (Anderson et al., 2004). FDI has been a key driver of China's economic transformation, contributing to trade expansion, technological progress, and industrial modernization (Huang, Wang, Peking University, et al., 2011). Despite fluctuations due to external factors such as the 2008 financial crisis and the COVID-19 pandemic, the long-term trend indicates that FDI remains a crucial driver of economic performance (Chen, 2019).

4.2) Causality Test Results

The Granger Causality Test was conducted to determine whether FDI inflows cause GDP growth or whether economic expansion attracts more FDI. The results indicate a bidirectional relationship: while FDI has

significantly contributed to GDP growth, regions experiencing rapid economic expansion have also attracted greater foreign investment (Granger, 1969). This finding suggests that FDI not only stimulates growth through capital investment and technology transfer but is also drawn to markets with strong economic performance and stable business environments (Dunning, 2000). The Dickey-Fuller Test confirmed that both GDP and FDI data are stationary after differencing, ensuring that the observed relationships are statistically valid over time (Dickey & Fuller, 1979).

4.3) Regional Analysis

The impact of FDI on GDP growth varies significantly across China's regions. Eastern China, including Shanghai and Guangdong, has received the highest FDI inflows due to its well-developed infrastructure, favorable investment policies, and proximity to global markets (Zhang, 2006). This region has consistently exhibited strong GDP growth, with FDI playing a key role in advancing high-tech industries, finance, and manufacturing (Li & Liu, 2005). Central China, represented by provinces such as Hubei and Henan, has seen moderate levels of FDI. These areas are transitioning from traditional agriculture-based economies to more industrialized structures, resulting in mixed economic growth patterns (Chen, 2019). While some cities have emerged as manufacturing hubs, others still lag due to infrastructural limitations and slower policy reforms. In contrast, Western China, including Sichuan and Guizhou, has received the lowest FDI inflows. The underdeveloped infrastructure and lower levels of industrialization have hindered economic progress, resulting in slower GDP growth (Anderson et al., 2004). Although government initiatives such as the "Western Development Strategy" have aimed to attract investment, FDI remains concentrated in the more economically developed regions (Huang, Wang, Peking University, et al., 2011).

Region	Number of New FIEs	Share (%)	Realized FDI Value (US$100 million)	Share (%)
Total	53766	100.0	1632.5	100.0
Eastern	47089	87.6	1422.4	87.1
Central	3019	5.6	103.7	6.4
Western	3658	6.8	106.4	6.5

Source: MOFCOM FDI Statistics.

Note: Eastern part: Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Hainan.
Central part: Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, Hunan.
Western part: Inner Mongolia, Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Xizang, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang.

Figure 2: FDI flows to Eastern, Central and Western Parts of China in 2023

In 2023, FDI (Foreign Direct Investment) remained a critical component of China's economy, with the eastern, central, and western regions contributing 87.1%, 6.4%, and 6.5% of the total national FDI (Foreign Direct Investment) value, respectively. Newly established FIEs (Foreign-invested enterprises) in these regions accounted for 87.6%, 5.6%, and 6.8% of the total (Ministry of Commerce of the People's Republic of China (MOFCOM), 2024).

4.4) Sectoral Impact

The sectoral distribution of FDI has played a critical role in shaping China's economic growth. Investment in technology has accelerated innovation and enhanced productivity, particularly in regions like Shenzhen and Beijing, which have become global tech hubs (Zhang, 2006). The manufacturing sector has been a major beneficiary of FDI, contributing significantly to export-driven growth and employment creation (Dunning, 2000). Meanwhile, the finance sector has seen increased foreign investment, supporting capital markets, improving financial services, and strengthening overall economic stability (Wei, 2002). These sectoral contributions demonstrate how FDI has not only fueled GDP growth but also transformed China's economic structure, making it more competitive on the global stage.The findings underscore the importance of targeted policy measures to ensure balanced regional development. While the eastern region continues to thrive, increased investment in central and western China is necessary to reduce economic disparities and promote sustainable growth across the country (Granger, 1969).

Technological innovation in a country can occur through independent innovation or technology introduction. Foreign direct investment (FDI) often introduces advanced production techniques and management practices, boosting local competitiveness. To compete effectively against foreign enterprises, local firms must increase their Research and Development (R&D) investments to enhance technical effectiveness (Yong & Lan, 1997). Consequently, FDI can heighten the local recognition of the necessity for autonomous creativity (Li & Yeung, 1999). Chen et al. (1995) noted that reliance on Hong Kong and Taiwan as key FDI sources contributes to this low transfer. Yong and Lan (1997) identified several factors in Dalian: investors often lack genuine technology, local partners may have ulterior motives and limited absorptive capabilities, and existing technology gaps hinder advanced transfer. They observed that though direct technology transfers occur in equity joint ventures (EJVs), differences in technology gaps and transferability remain minimal. Li and Yeung (1999) documented inter-firm technology transfer in their case studies of Shanghai Volkswagen and Shanghai Bell, while Wei (2002) corroborated findings of technology transfers that are low to moderate in scale, predominantly from Hong Kong and Taiwan.

High-Tech Industry	Number of New FIEs	Share (%)	Realized FDI Value(US$100 million)	Share (%)
Total	53766	100.0	1632.5	100.0
High-Tech Industry	13758	25.6	609.8	37.4
High-Tech Manufacturing	841	1.6	181.0	11.1
High-Tech Services	12917	24.0	428.8	26.3

Source: MOFCOM FDI Statistics.

Figure 3: FDI in High-tech Industry in 2023

According to the Ministry of Commerce of the People's Republic of China (MOFCOM),2024, the impact of FDI on technological development is evident in the high-tech industry. As shown in the Figure 3, 13,758 new foreign-invested enterprises (FIEs) were established in the high-tech sector, accounting for 25.6% of total FIEs, with a realized FDI value of US$609.8 million. High-tech manufacturing, despite having only 841 new FIEs (1.6% of

the total), attracted a significant US$181 million, reflecting its capital-intensive nature. Meanwhile, high-tech services saw 12,917 new FIEs (24% of total FIEs) with an FDI value of US$428.8 million, highlighting the increasing investment in research, software, and technical services. The dual role of FDI—both as a catalyst for technological growth and a potential inhibitor of local innovation—remains evident. While foreign capital fuels high-tech industries, excessive reliance on technology transfer may hinder domestic firms from progressing beyond adaptation and replication. Thus, for sustained innovation, host countries must balance FDI-driven technology inflows with robust domestic R&D investment, ensuring long-term competitiveness in high-tech sectors.

5. Policy Implications and Recommendations

5.1) Balancing Regional Growth

To address the uneven distribution of Foreign Direct Investment (FDI) across China, policies should focus on attracting more investment to central and western regions (UNU-WIDER, 2008). While eastern provinces such as Shanghai and Guangdong have long benefited from strong FDI inflows, central and western regions, including Hubei, Sichuan, and Guizhou, lag behind due to weaker infrastructure and lower industrialization (US-China Business Council, 2010). The government should enhance regional incentives, such as tax breaks, subsidies, and improved infrastructure, to make these areas more attractive to foreign investors (China Briefing, 2025). Additionally, strengthening interregional transportation networks and digital infrastructure can improve accessibility and connectivity, making central and western China more competitive investment destinations. Special Economic Zones (SEZs) and industrial parks tailored to high-growth sectors such as green energy and advanced manufacturing can also serve as catalysts for regional economic development (UNU-WIDER, 2008).

5.2) Enhancing FDI Efficiency

While attracting FDI is essential, ensuring that investments contribute to long-term economic development is equally important (UNCTAD, 1996). China should prioritize high-value investments that foster technology transfer, innovation, and skill development rather than relying on low-cost labour-intensive industries (Yu, 2007). Encouraging multinational corporations to establish research and development (R&D) centres and partnerships with local firms can help integrate global expertise into China's domestic economy (Luo,2021). Additionally, stronger intellectual property protection laws will reassure foreign investors while also incentivizing domestic innovation (Yu, 2007). Policies that facilitate knowledge-sharing between foreign and domestic firms can enhance productivity, making FDI a more effective tool for economic transformation rather than just a source of capital inflows (UNCTAD, 1996).

5.3) Reducing Dependency on FDI

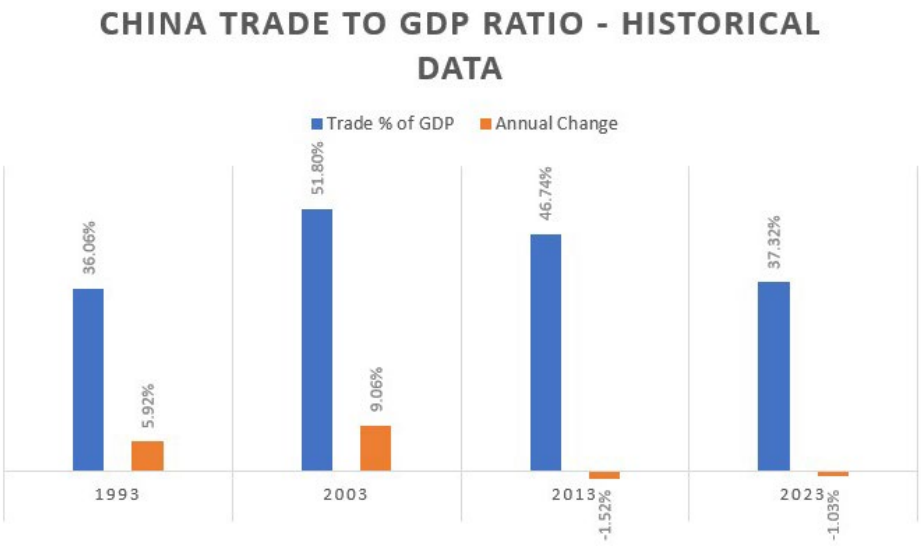

Figure 4: China Trade to GDP ratio-Historical data

This evolving investment landscape aligns with China's broader economic trajectory, where trade has played a pivotal role in shaping its growth. In 1993, China's trade-to-GDP ratio stood at 36.06%. During this period, China was in the early stages of economic liberalization following Deng Xiaoping's reforms in the 1980s. International trade was gradually increasing as the nation sought to modernize its economy and integrate into the global market. Although relatively modest by today's standards, this ratio reflected a growing emphasis on exports and a shift from a closed, centrally planned economy toward a more market-driven system.

By 2003, the trade-to-GDP ratio had surged to 51.80%, marking significant progress over a decade. This sharp increase can largely be attributed to China's accession to the World Trade Organization (WTO) in 2001, a milestone that followed 15 years of rigorous negotiations. China first submitted its request to resume its status as a contracting party to the General Agreement on Tariffs and Trade (GATT) on July 10, 1986. In November 1995, it formally applied to join the WTO, and on December 11, 2001, China officially became the WTO's 143rd member. This accession opened up new trade opportunities, boosting both exports and imports. The early 2000s were characterized by rapid industrial growth, a booming manufacturing sector, and increasing foreign direct investment, cementing China's role as a critical player in global trade. The early 2000s were characterized by rapid industrial growth, a booming manufacturing sector, and increasing foreign direct investment, cementing China's role as a critical player in global trade (Permanent Mission of China to the WTO, n.d.).

Fast forward to 2013, China's trade-to-GDP ratio was 46.74%. Although still robust, the ratio had begun to decline from its peak in the late 2000s. This decline was influenced by China's strategic shift toward a more consumption-driven economy and the introduction of policies aimed at reducing dependency on exports (Erten & Leight, 2022). Additionally, the global financial crisis of 2008 had lingering effects, contributing to a more cautious international trade environment during the subsequent years. In 2023, the trade-to-GDP ratio stood at 37.32%, reflecting a

further decline compared to the previous decades. This trend underscores China's ongoing efforts to prioritize domestic consumption and self-sufficiency amid a challenging global trade environment.

China has taken significant steps to integrate into the global trade system by establishing the State Council Leading Group on WTO Affairs. This initiative includes extensive training programs for officials at all levels, public awareness campaigns on WTO principles, and the introduction of specialized courses at universities. Additionally, WTO Research Centers in major cities like Beijing, Shanghai, and Shenzhen play a key role in conducting studies and shaping trade policies, reinforcing China's active participation in international trade. (Permanent Mission of China to the WTO, n.d.).

While FDI has been instrumental in China's rapid economic growth, over-reliance on foreign capital poses risks, particularly during periods of global economic uncertainty (Paradise lost? Falling foreign investments in China, 2024). To ensure long-term sustainability, Assessing China's efforts to increase self-reliance (2024) suggests that China should focus on strengthening its domestic industries by promoting homegrown innovation, improving financial markets, and providing greater support for small and medium-sized enterprises (SMEs). As highlighted in China Eyes Growth Through Stability and Consumption (2024), fostering local entrepreneurship through access to funding, training programs, and simplified regulatory processes can contribute to a more self-sufficient economy. Moreover, China pushes towards a consumption-driven growth model as the economy matures (2018) emphasizes that shifting toward a consumption-driven economy—rather than relying on foreign investment and exports—can help buffer China from global economic turbulence. Finally, The Challenging Transition from Investment- to Consumption-Led Growth in China (2024) argues that prioritizing domestic technological advancements and industrial upgrades is key to transitioning from an FDI-dependent model to one rooted in internal economic resilience and sustainable growth.

6. Key Findings and Research Discussion

Empirical analysis confirms that Foreign Direct Investment (FDI) has played a significant role in driving China's GDP growth, but its impact varies across regions and sectors. Correlation analysis indicates a strong positive relationship between FDI inflows and GDP growth, particularly in the eastern regions where foreign investment has concentrated. The Granger Causality Test results suggest a bidirectional relationship, meaning that while FDI contributes to economic expansion, regions with higher GDP growth also attract more foreign investment. This finding aligns with China's economic trajectory, where infrastructure development, business-friendly policies, and industrial growth have created a favorable environment for FDI, particularly in coastal provinces such as Shanghai and Guangdong. However, in central and western regions, where investment levels remain lower, economic growth has been slower, highlighting the uneven benefits of FDI across the country.

Sectoral analysis further reveals that FDI has contributed to China's transition from a manufacturing-based economy to a more innovation-driven model. Foreign investments in technology, finance, and high-end manufacturing have led to increased productivity, job creation, and export growth. However, despite these benefits, there are concerns about the long-term sustainability of FDI-driven growth. Overreliance on foreign capital, particularly in key industries, may pose risks if global investment trends shift or geopolitical factors affect capital flows. Additionally, FDI has primarily benefited regions that were already economically strong,

exacerbating regional disparities. Policy interventions are needed to ensure more balanced investment distribution, particularly in central and western China, where economic potential remains underutilized.

7. Limitations and Future Research Directions

While this study provides insights into the relationship between FDI and GDP growth, it lacks a rigorous econometric analysis that would strengthen its empirical findings. The correlation and causality tests offer preliminary evidence, but more advanced quantitative methods, such as panel data regression models and structural equation modelling, could provide deeper insights into the long-term effects of FDI on regional economies. Additionally, the study does not fully address the potential endogeneity issue, where economic growth itself may influence FDI inflows rather than the other way around. Future research should apply instrumental variable techniques to isolate the causal effect of FDI more accurately.

Another key limitation is the narrow focus on GDP as the primary measure of economic impact. While GDP growth is an important indicator, FDI's influence extends beyond macroeconomic figures to include employment effects, income distribution, innovation diffusion, and trade competitiveness. Future studies should adopt a multi-dimensional approach, incorporating labour market outcomes, industrial productivity, and technological spillovers to provide a more comprehensive understanding of how FDI shapes China's economy. Expanding the research scope to analyze firm-level data or conducting comparative studies with other emerging economies could also yield valuable insights into the broader implications of FDI.

Without these methodological refinements and expanded research perspectives, this study remains more descriptive than analytical, making it more suitable as a literature review rather than a robust empirical study. Strengthening the empirical foundation with more sophisticated econometric modelling and broader economic indicators would enhance the study's contribution to academic discourse on FDI and economic growth.

8. Conclusion

Our comprehensive analysis of FDI's impact on China's GDP growth yields several significant conclusions and important policy implications. The econometric analysis definitively establishes FDI as a crucial driver of China's economic growth, with Granger Causality Tests confirming a strong predictive relationship between FDI inflows and GDP growth. However, our regional analysis reveals pronounced disparities, with eastern regions demonstrating significantly higher FDI efficiency and economic benefits compared to central and western regions, highlighting a critical development imbalance. The sectoral analysis further illuminates that manufacturing, and services sectors exhibit the strongest positive responses to FDI, suggesting targeted policy opportunities. These findings necessitate the implementation of differentiated FDI policies for different regions, with enhanced incentives and infrastructure development in central and western areas. Additionally, strategic FDI channeling into high-potential sectors while supporting technological spillover effects is crucial. To ensure long-term sustainable growth, China should focus on developing local innovation capabilities and reducing foreign capital dependency through targeted domestic investment programs. This research makes several notable academic contributions, including providing robust empirical evidence of FDI's heterogeneous regional and sectoral impacts, establishing a comprehensive methodological framework for analyzing FDI effectiveness, and identifying specific channels through which FDI influences economic growth. Future research directions should explore the long-term sustainability of FDI-driven growth, environmental implications, and potential strategies

for reducing regional development disparities. Ultimately, this study demonstrates that while FDI has been instrumental in China's economic growth, its effectiveness varies significantly across regions and sectors, necessitating more nuanced and targeted policy approaches for optimal economic outcomes

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