

# The place of FDI in China's regional economic development: Emergence of the globalized delta economies

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## Abstract

China's remarkable economic development and sustainable high growth rates since the 1980s have stimulated much discussion in recent literatures. Among the augments of China's rapid growth, voluminous recent literatures have emphasized that foreign direct investment (FDI) may best explain its recent growth record at both national and regional level. To understand how such sustained rapid regional growth happened in a huge country such as China, this paper examines the possible explanations of FDI absorption from the perspective of regional agglomerations by investigating (1) the emergence of two major globalized delta economies (GDEs), namely, Pearl River Delta (PRD) and Yangtze River Delta (YRD), due to FDI inflows; (2) the critical effects and functions of a core city in promoting FDI into GDEs; and (3) industry structure specialization in the periphery cities/counties in GDEs. Estimations were performed with a set of panel data at the city/county level for 1993–2003. Research results show that both core cities in GDEs have played significant role in attracting FDI. Compared with PRD, YRD had relatively higher estimated elasticities in FDI absorption and more diversified industry structure similarities among its cities and hence, possible higher intra-regional competition in terms of industry production. The possible formation of any effective city link in GDEs was also investigated. Reflections and policy implications regarding FDI promotion and regional growth in China were discussed.

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## 1. Introduction

China's remarkable economic development and sustainable high growth rates since the 1980s have stimulated much discussions and vigorous debates among academics during recent years.

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To understand how such a sustained rapid annual GDP growth of 9.6% has continued for the past quarter of a century during 1978–2004 in such a huge country as China, recent researches have attributed inward foreign direct investment (FDI) as the reason for this remarkable growth record. The huge FDI influx recorded to increase at an annual rate of more than 10% since 1985 and its spatial agglomeration/diffusion may best explain China's recent regional growth. Given the concern regarding the accuracy of government statistics on GDP and FDI made known by the academic community (Rawski, 2001; Young, 1995), most of the empirical studies have supported the positive contributions of inward FDI to China's economic performance in general, and rapid growth in particular. Some recent studies have reconfirmed the critical importance of inward FDI upon future sustainable growth in China using a two-stage growth accounting decomposition approach (Whalley & Xin, 2006; Yao, 2006) while a regional growth perspective in other countries such as Russia (Brock, 2005) is also emphasized (Mullen & Williams, 2005).

To investigate the determinants of FDI flows and its regional agglomeration behavior, factors commonly cited by studies included costs of production factors, market size, agglomeration effects, financial incentives, and investment environment (such as in Lim, 2001; Ng & Tuan, 2002; Taube & Ogutcu, 2002; Tuan & Ng, 1995). A series of studies examining factors affecting FDI regional agglomerations and its impacts on regional economic development suggested two key approaches in understanding the issue of the economic development of Pearl River Delta (PRD) region: (1) The impacts of regional agglomerations following Krugman's (1991a) concept of core-periphery system (CPS) or the city link, and (2) an institutional approach emphasized on economic reform in terms of timing of opening and the role of institutional reform. Selected major studies included Tuan and Ng (1995, 2001, 2002, 2003, 2004a, 2004b) and Ng and Tuan (2001, 2002, 2005, 2006). Following the steps of institutional reform in China, it is likely that the remarkable economic performance in GDP growth and FDI inflows in Yangtze River Delta (YRD) recorded since 1990s may well be explained by the same approach as in the early opened PRD.<sup>1</sup>

### *1.1. Timing of institutional reform: PRD versus YRD*

China's institutional reform and continuous improvements of her investment environment, among other external global factors, have also played significant roles in inducing FDI into China (Ng & Tuan, 2001, 2002; Tuan & Ng, 2003, 2004a, 2004b). During the first half of the post-1980 economic opening in China (1980–1992), institutional reform and FDI inflows enhanced each other mainly in PRD, Guangdong which was first designed and opened up as a showroom to receive FDI. New cities such as Shenzhen, Dongguan, and Zhuhai where manufacturing firms of

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<sup>1</sup> From official definitions, Yangtze River Delta (YRD) economic region has 16 cities/counties including Shanghai and eight cities/counties in Jiangsu province and seven cities/counties in Zhejiang province. It has a total area of 109.6 thousand square kilometers and a registered population of 82.1 million in 2004. Pearl River Delta (PRD) economic region which comprises of nine cities of Guangdong province has an area of 41.5 thousand square kilometers and a registered population of 24.5 million in 2004. YRD and PRD, which account for 1.1 and 0.4%, respectively, of China's national area, produced 21 and 10%, respectively, of national GDP in 2004. Starting from the late 1990s, rapid growth in YRD has been observed. After China's WTO accession in the year of 2001, YRD has taken over the predominant role of Guangdong as the top national regional FDI recipient to become the top ranked regional FDI destination in the nation. It was recorded that in year 2000, YRD received 27.5% of the national inward FDI and PRD 27.7%. However, in 2004, YRD exceeded PRD by receiving 34.6% while PRD 16.5%. Together, both delta economies had accounted for more than half of the total national FDI receipts. For a visual inspection of GDEs by GIS, please see Tuan, Ng, and Lin (2006).

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