



Location decisions of manufacturing FDI in China: implications of China's WTO accession

Linda F.Y. Ng^{*}, Chyau Tuan

*Department of Decision Sciences and Managerial Economics, Faculty of Business Administration,
The Chinese University of Hong Kong, Shatin, Hong Kong*

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Abstract

This study aims at investigating empirically the spatial location development of foreign direct investment (FDI) in Guangdong in the context of a core-periphery system (CPS) using firm (micro)-level data. Attempts would be made to explain (1) the significance of agglomeration effects arising from CPS, especially that of the small/medium businesses (SMEs); (2) to exploit agglomeration economies, firms location decisions would follow a relationship described by the gravity model in choosing their plant locations. With given distance from the core, firms would prefer sites with higher firm agglomeration; (3) the degree of completeness of regional division of labor (plant relocation) being affected by institutional factors in the form of trade constraints (quota). In this connection, China's WTO accession is expected to significantly affect FDI firm location decisions, in particular those previously subject to trade constraints; and (4) geographical hardship of FDI locations transmitted in the form of transaction costs is significant to firm location choice.

The hypotheses were tested by utilizing a 1998-database consisting of a population of 30,195 manufacturing joint ventures in Guangdong in which 8985 firms investing in electronics, garments, and textiles were chosen. Special reference will be given to the experience of outward relocation of Hong Kong manufacturing enterprises in the Hong Kong (core)–Pearl River Delta (periphery) region. Conclusion derived from the study and respective policy implications with regard to further facilitation of FDI into the region will be discussed. The implications of China's WTO accession on FDI flows on location choice were elaborated.

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^{*} Tel.: +852-2609-7774; fax: +852-2603-5104.

E-mail addresses: lindang@cuhk.edu.hk (L.F.Y. Ng), tuan@baf.msmail.cuhk.edu.hk (C. Tuan).

1. Introduction

The classical theory for profit maximization¹ describes the basic motives of foreign direct investment (FDI) or firms to invest abroad as the exploitation of the market imperfections and prospective gains in operation efficiency (Hymer, 1976; Kindleberger, 1970). In fact, such motives would involve firms' strategic decision to identify a favorable investment environment (location) from abroad for their investment. The compatibility of the host country in geographical proximity, among others, is considered as a crucial external component in the attraction of FDI by the host country (Kravis & Lipsey, 1982).

Following the theories of the pattern of land use well consolidated and described by Alonso (1964) and the avocations of economies and diseconomies of urban agglomeration studies (Henderson, 1988; Krugman, 1991; Richardson, 1995), the function of a city core (center) and its relations with the peripheral (suburban) areas can be well conceived. Such a core-periphery (CP) relation is a system where the pattern of land use can be described by the land-saving activities to stay at the core (center) with the land-intensive activities to move to the nearby peripheries (sub-urban) for cost-savings purpose. As a typical case of firm relocation from the city core to its suburban, the causes and pattern of relocation of manufacturing firms from New York to its peripheral areas was intensively studied by the American Regional Plan Association in the late 1960s² (Hall, 1960).

To emphasize on the effects of agglomeration economies in city growth, Quigley (1998) considered four major factors, namely, scale economies, shared inputs, transaction costs, and statistical economies, have contributed to the agglomeration implications of size and diversity in cities.³ Agglomeration effects (or thick market effects) to generate externalities in production leading to short- and long-run externalities and supply and demand (customer) externalities were well pursued (Bartlesman, Caballero & Lyons, 1994; Caballero & Lyons, 1992). Evidence suggested that such agglomeration (externalities) effects of industries had accounted for the prevalence of scale economies of the industry (Paul & Siegel, 1999).

Hence, the effects of agglomeration economies/diseconomies generated by a CP relation following Krugman's (1991) view, would be important in directing firms' investment with respect to their plant site location decisions. Then, how far apart in distance between the manufacturing facilities (relocated to the periphery) and service facilities (to remain in the center) would be kept will be determined by balancing various transaction costs associated with the economies and diseconomies due to agglomeration. In this connection, choosing a favorable location for investment in the context of CP-system should become a prime concern of business firms in realizing their basic business motives.

Firm location choice should also have significantly affected firms' strategy and competitiveness especially in a global context. Porter (1990) forwarded a theory of

¹ A comprehensive review is found in Fischer (1985).

² A brief discussion of the evolution of the spatial patterns of manufacturing activity and the growth of cities and metropolitan of the New York Metropolitan region and the corresponding literature of development were studied by Quigley (1998).

³ For detailed description of the theoretical arguments of the rationale behind the agglomeration implications of size and diversity of cities and the corresponding sources of literature, please refer to Quigley (1998).

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