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Analysing China's foreign direct investment in manufacturing from a high–low technology perspective

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ABSTRACT

Since China opened its economy to foreign investment in 1979, it has become the second largest foreign direct investment (FDI) destination in the world after the USA. Over the past three decades, the manufacturing sector has dominated China's FDI inflow, however, when manufacturing activity is bifurcated into low and high technology classes, it becomes evident that China is in a transition stage moving from FDI in traditional low-tech activity to a high-tech manufacturing environment. This paper attempts to analyse the key determinants of FDI inflow across low and high technology manufacturing industry across four geographical regions of China. In the paper we empirically investigate the determinants of FDI high–low tech inflow by market size, labour cost, labour quality, and government spending on human capita.

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1. Introduction

Since China reformed and adopted its 'open up' policies in 1979, inward foreign direct investment (FDI) increased dramatically, Fig. 1 shows that in 2012 China had attracted foreign direct investment worth USD 111.7 billion, which increased from US \$0.057 billion in 1980 to \$20 billion in 1993 and to \$53.5 billion in 2003. FDI inflow to China has attracted a great deal of interest within

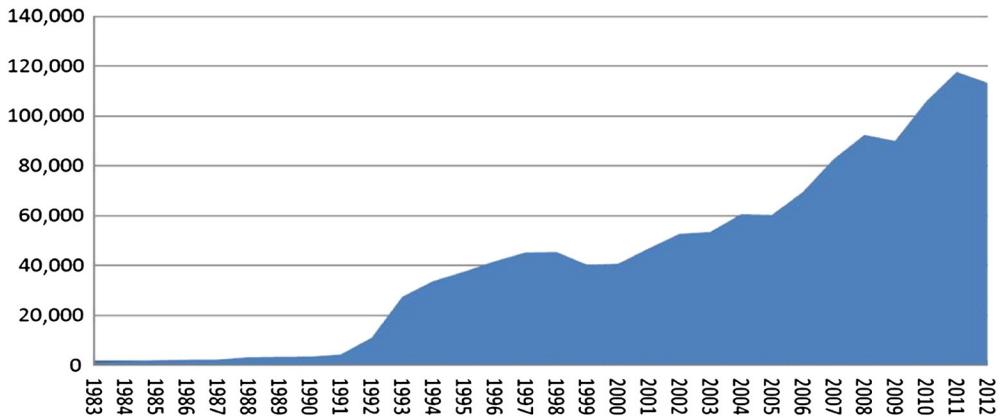
both academia and the policy-making arena and today ranks as one of the major researched issues in emerging markets [Kearney \(2012\)](#). FDI is widely recognized as the major driving force behind China's phenomenal economic growth. Several studies capturing the spill-over effects of this growth are available; [Whalley and Xin \(2010\)](#) examine the effects on productivity, [Wei and Liu \(2006\)](#) analyse the contributions to efficiency,

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Source: MOFCOM website: www.fdi.gov.cn.

Fig. 1. Annual FDI inflows to China, 1982–2012 (USD millions).

Source: MOFCOM website: www.fdi.gov.cn.

Liu's (2008) study provides an account of technological innovations while Yao's (2006) research investigates the effects of FDI on management know-how. More general FDI studies by Groh and Wich (2012) provide evidence as to why FDI flows are concentrated in advanced economies, which still account for 75% of inward FDI while Jadhav (2012) explores the role of economic, institutional and political factors in attracting foreign direct investment to BRICS (Brazil, Russia, India, China & South Africa) economies by providing comparative weightage for these factors in attracting FDI.

By contrast few recent studies have researched the economic effects of the regional distribution of FDI across China. Location factors are pronounced in China, where there are wide regional differences in socioeconomic development and many internal barriers to resource mobility. Previous studies by Wei et al. (2008) and Pan and Tse (2000) indicated that specific regions in China (typically along the coast) are preferable not only because they are prioritized by the central government of the People's Republic of China (PRC) but also because a majority of these regions have historically been commercial and industrial centres. The government of the PRC provides incentives for FDI in areas such as special economic zones and open cities. To contribute to the literature this study investigates the economic effects of the uneven regional distribution of FDI across China. In particular we investigate the disparities of FDI allocation as well as the comparative advantages of China's coastal and non-coastal regions viz the northeast region, central region and western region. Our objective in this study is to highlight the unbalanced distribution of FDI regionally across China and discuss the consequence of the latter for the economic development of the less developed hinterland. In particular our results suggest that a more balanced distribution of FDI based on exploiting regional comparative advantage has the potential to reduce the geographic unbalanced nature of FDI with the consequences of reducing China's regional development disparities which in turn could benefit both the whole of China and foreign investors. This research identifies the regional determinants of FDI inflows according to high and low tech intensive activities. In particular our research suggests that a policy of matching China's regional resources particularly labour to the demands of FDI designated by high-low technologies would realise a more balanced economic development of China providing employment opportunities across China's newly created hinterland of urban centres. This reallocation of FDI would in turn reduce the migration and concentration of labour particularly low or unskilled labour across the already densely populated and congested coastal or eastern regions of China.

This paper focuses on the regional determinants of China's manufacturing industry by performing a bifurcation of manufacturing into high and low technology categories. Our study confirms that inward FDI flows to China are predominately concentrated within the manufacturing sector to the extent of approximately 60% of total utilised FDI inflow. Our research objective is to assess the determinants of this FDI inflow along the lines of assessing the regional distribution of FDI inflows across both high and low technologies.

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