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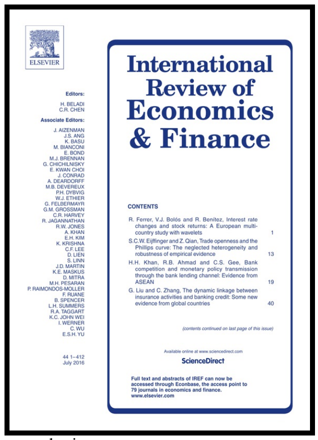

Total Factor Productivity or Labor Productivity? Firm Heterogeneity and Location Choice of Multinationals

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Total Factor Productivity or Labor Productivity? Firm Heterogeneity and Location Choice of Multinationals*

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Abstract

This study considers total factor productivity and labor productivity as different proxies for firm heterogeneity, although they are often used interchangeably in the literature. I argue that the productivity measures are related to the foreign integration strategies adopted by the multinationals and should reflect a different productivity sorting. Using a panel data of Taiwanese multinationals, the empirical results show that the number of their investing locations increases with labor productivity but decreases with total factor productivity. The MNEs with higher total factor productivity were more likely to invest in countries with higher prices or wages. Empirical results also show that China is the top choice for the MNEs with either increasing total factor productivity or labor productivity. If their labor productivity is further increased, they would consider to invest in the U.S. or Hong Kong and Singapore.

Keywords: productivity; location choice; multinationals; foreign direct investment
JEL classification: D24, F14

1. Introduction

Since Melitz (2003) introduced the importance of firm heterogeneity in analyzing international trade behavior, empirical trade studies have turned their focus to firm-level data. For example, Helpman et al. (2004) established the "pecking order" hypothesis such that only the most productive firms engaged in *horizontal* foreign direct investment (FDI), while the less productive

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