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AN EMPIRICAL STUDY ON THE IMPACT OF ECONOMIC AGGLOMERATION ON FDI LOCATION CHOICE IN CHINA

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ARTICLE DETAILS

ABSTRACT

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FDI of multinational corporations is one of the most dynamic factors of economic growth in the world. All countries and regions in the world are trying to adopt various preferential measures to attract foreign investment to maintain economic growth. There are many factors that determine the location selection of FDI, but the economic agglomeration plays a decisive role. This paper analyzes impact of economic agglomeration factors about FDI location choice in China and East, Middle and Western region, by econometric model, using data from 1985 to 2016. The results show that market capacity, infrastructure, labor costs, regional openness and pre-concentration of foreign direct investment have different degrees of impact on FDI location selection, among which infrastructure has the greatest impact. In addition, for different regions, different economic agglomeration factors also have different influence degree for the location choice of FDI.

KEYWORDS

Foreign Direct Investment, Economic Agglomeration, Location Choice.

1. INTRODUCTION

Foreign direct investment (Foreign direct investment, FDI) developed rapidly after the second World War. Its theory first came into being in the 1960s, and scholars' research mainly focuses on three aspects: investment motivation, investment location and investment decision-making. Among them, the location choice of FDI of multinational corporations is one of the more research aspects. British economist named Dunning founded the compromise theory of international production when studying the theory of foreign direct investment, focusing on the influence of location factors on foreign direct investment in 1977. His research shows that location advantage is a sufficient condition for multinational corporations to invest abroad [1].

The important research direction of FDI location choice is spatial economics. Guimaraes and Figueiredo (2000) based on the theory of new economic geography, this paper probes into the main driving forces and factors of FDI layout of transnational corporations through concrete empirical research, and holds that industrial association, knowledge spillover, labor force and market factors play a major role [2]. Kang and Lee (2007) shows that infrastructure, market potential, labor costs, aggregation effects and government policies are the main conditions for attracting TNCs' investment [3]. Delis and Kyrkilis (2017) applied the spatial clustering method to study and explain the spatial hierarchy of China's FDI attraction. The research results show that the agglomeration benefits brought by investment, infrastructure and market growth are the main determinants of China's spatial FDI concentration, while the spatial distribution of China's FDI attraction is highly uncertain [4].

It is also a main direction to analyze the location choice of FDI through empirical research. Mary and Javorcki (2007) made a depth analysis on the inflow of FDI from China's economic system, labor

wage, infrastructure and other factors [5]. Timothy and Jorge (2011) comparing the case studies of many developed and developing countries, it is considered that taxation, infrastructure and government efficiency are the most important factors in attracting FDI entry [6]. Hansson et al. (2012) focuses on the industrial agglomeration in the United States and Europe, emphasizing that industrial agglomeration is an important basis for attracting the investment of transnational corporations [7]. The empirical study of Yang et al. (2013) shows that industrial agglomeration effect is one of the important factors to attract FDI [8]. In addition, the economic system and national policy for multinational corporations FDI location choice has gradually attracted the attention of scholars. Wei (2000) believes that corruption in the host government has prevented the inflow of FDI [9]. Adamoglou and Kyrkilis (2018) focuses on the location choice of foreign direct investment (FDI) in Turkey, an emerging economy. The results show that the economic system and geographical distance are the important factors affecting the choice of FDI entry mode [10]. Asongu et al. (2018) when studying the factors of foreign investment entering BRICS and MINT (Mexico, Indonesia, Nigeria and Turkey), a fixed effect model was constructed by using time series cross section analysis. The results show that market scale, infrastructure availability and trade openness play the most important role in attracting foreign direct investment. However, the role of natural resource availability and institutional factors is not significant [11]. Riet and Lejour (2018), on the other hand, analyzes the global investment situation of transnational corporations, and holds that transnational corporations always want to pay the least tax when their profits are remitted back to China, so the tax system of the countries in which transnational corporations are located has a significant impact on foreign direct foreign investment [12].

The study of FDI in China is based on the introduction of FDI theory of foreign transnational corporations. Lu Minghong (1997) used data

from 29 provinces and municipalities from 1988 to 1995 to analyze it, and showed that labor costs were negatively correlated with FDI [13]. Wei Houkai et al. (2001) analyzed the location factors of FDI in Qinhuangdao by means of field investigation and questionnaire survey [14]. Wang Jingjing et al. (2013) used provincial panel data from 2004 to 2010 to carry out empirical research. The results show that both service industry agglomeration and manufacturing agglomeration are conducive to attracting FDI to all regions [15]. Based on the theory of new economic geography, Huang Xuan and Ren Wanzhu (2017) studied the industrial agglomeration effect of Japanese enterprises investing in China. The results show that the transfer payment of the central government and the land preference policy of the local government are the significant influencing factors of the location decision of Japanese investment enterprises in China [16]. The research of Zeng Peng and Qin Yanhui (2017) shows that although there are many factors of location choice of FDI, the agglomeration effect has the greatest influence [17]. Qu Tao et al. (2018) took the provinces and municipalities directly under the Central Government as the experimental groups, and based on the panel data from 2012 to 2016, analyzed the influencing factors of FDI. The results showed that the influence of consumption-driven effect on foreign direct investment was significantly positive, while the effects of service factor agglomeration effect, trade-driven effect and market scale expansion effect on foreign direct investment were not significant [18].

FDI is mainly distributed in the eastern coastal areas of China. From 1985 to 2016, the FDI attracted by the eastern coast accounted for 85 per cent of the country's FDI attraction, reaching 90 percent in individual years. Although the central and western regions have increased their efforts to attract investment in recent years and transnational corporations have also strengthened their investment in the central and western regions, the overall situation of foreign direct investment in the eastern region has not changed significantly. The main reason is caused by economic agglomeration. Because of the high degree of economic agglomeration in the eastern region, it has the characteristics of perfect infrastructure, high quality of labor force, huge market and high openness. This paper hopes to explore the impact of these economic agglomeration factors on FDI, and compare the different degrees of influence of these economic factors on FDI in the whole country and in the eastern, central and western regions. This is of great strategic significance to the high-quality introduction of foreign capital by the government.

This paper is divided into four parts. The second part is the variable selection and model setting, through the analysis, the market capacity, infrastructure, labor costs, openness and early foreign direct investment as economic agglomeration elements and independent variables, foreign direct investment as dependent variables to construct the measurement model. The third part is empirical analysis, mainly using eviews software to calculate the regression model of FDI economic agglomeration factors in the whole country and the East, the middle and the West. The fourth part is the basic conclusion, on the basis of the previous, through the regression model analysis, to compare the impact of the economic agglomeration factors between the whole country and the east, central and western regions on the location choice of foreign direct investment.

2. VARIABLE SELECTION AND MODEL SETTING

2.1 Variable selection

The factors of location agglomeration of FDI mainly focus on the analysis of traditional economic geography and new economic geography, in addition, institutional economics also pays more attention to it. Traditional economic geography mainly pays attention to the attraction of resource endowment, such as the advantages and disadvantages of geographical location, while the new economic geography focuses on the influence of historical accidental factors and path dependence. In addition to factor endowment conditions, it also includes market growth potential, industrial agglomeration level and other non-factor characteristics. In order to be closer to the purpose of the study and reduce the multiple collinearity, this paper will select the following variables to analyze the role of different economic agglomeration factors in the process of location selection of foreign direct investment.

(1) Market capacity

One of the main reasons for FDI's entry into China for investment is that it attaches importance to China's huge market capacity, and the large

market capacity has broad consumption prospects and sales volume. This variable is mainly expressed by GDP. The larger the GDP value, the greater the purchasing power, the larger the market capacity, and the more prosperous the market. The growth of market capacity can attract more multinational investment.

(2) Infrastructure

Infrastructure is one of the most important factors in the economic development of a region, and it is also the main factor in attracting foreign investment. Infrastructure refers to the material engineering facilities that provide public goods and services for social production and life. It is the general material condition on which human society depends for its survival and development. Infrastructure includes not only water, electricity and gas, roads, railways, canals, airports, communications and other public facilities, but also social infrastructure such as culture, education, medical and health, science and technology, sports and other social infrastructure. Good infrastructure can effectively reduce the construction cost and investment risk of foreign-funded enterprises, which is an important guarantee to attract FDI entry. Infrastructure is represented by fixed asset investment (FAI).

(3) Labor costs

In a narrow sense, the labor cost mainly refers to the average wage of the workers. In a broad sense, the labor cost not only includes the wages of the workers, but also covers the expenses of welfare, provident fund, insurance and education and training. Generally speaking, the establishment of enterprises in the investment areas of multinational corporations is more inclined to the regional agglomeration of lower labor costs, but at the same time, multinational corporations will also have a certain impact on the wage level of the region. However, some studies have found that the higher labor cost reflects the high quality of employees to a certain extent, so that there is a positive correlation between labor cost and FDI. In this paper, WAGE (average wage of workers) is selected as the variable to measure the cost of labor.

(4) The degree of openness

Openness is an important index for a country or region to participate in economic globalization, and it is an important guarantee for developing international trade, attracting talents, and obtaining the management experience and science and technology of transnational corporations. When multinational corporations enter China to invest, a large part of their products are exported. In addition, many raw materials of foreign-funded enterprises also come from imports. Therefore, the extensive and close relationship with the world has become an important factor for multinational companies to enter China. In this paper, the total amount of foreign trade import and export (TRADE) is used to indicate the degree of openness.

(5) Foreign direct investment

FDI indicates the level of foreign direct investment, FDI (-1) indicates the previous period of foreign direct investment. Generally speaking, the causality of explanatory variables and dependent variables cannot occur at the same time, usually there is a time lag, interpretation variables often take a period of time to affect the changes of dependent variables. At the same time, because of the inertia law of economic activities, the current changes of dependent variables are often greatly affected by their own past value level. Therefore, this paper uses the previous period of foreign direct investment as an explanatory variable to establish the dynamic economic model of FDI.

This paper studies the influence of economic agglomeration factors on FDI location choice in China, the East, the West and the East. The determination of the east, central and western regions is particularly important. The division of economic belt and economic region in China has been in the process of becoming, but the great influence is to divide the mainland of China into three economic zones, namely, east, middle and west. This paper adopts this method, and the specific eastern regions include Liaoning, Beijing, Tianjin, Hebei, Shandong, Jiangsu, Zhejiang, Shanghai, Fujian, Guangdong and Hainan. 11 provinces and cities; The central part includes Heilongjiang, Jilin, Shanxi, Henan, Anhui, Jiangxi, Hubei and Hunan. 8 provinces; The western regions include Chongqing, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang,

Tibet, Inner Mongolia and Guangxi, 12 provincial and urban areas.

2.2 Model setting

According to the analysis of the above variables, and in order to eliminate heteroscedasticity and logarithm treatment of variables, this paper uses the following model to analyze the location factors of FDI:

$$LnFDI = C + a_1LnGDP + a_2LnFAI + a_3LnTRADE + a_4LnWAGE + a_5LnFDI(-1) + \mu \tag{1}$$

The above GDP, FAI, WAGE and TRADE represent market capacity, infrastructure, labor cost and openness variables in each region, respectively. C denotes constant term. a₁, a₂, a₃, a₄ and a₅ are regression parameters of GDP, FAI, TRADE, WAGE and FDI (-1), respectively, and μ is random disturbance term.

In this paper, the time series statistical method will be used to study for the variable data from 1985 to 2016. The variable data of the year to carry on the empirical research. Among them, GDP, FAI, WAGE, TRADE and FDI of China, the East, the west, the East and the West are summed up according to the data of each province in the China Statistical Yearbook, all of which are calculated according to the price of that year, with the unit of 100 million yuan. The data used here are all from the China Statistical Yearbook compiled by the National Bureau of Statistics. (1986-2017) New China 60 Compilation of Annual Information. The data used here are all from "China Statistical Yearbook (1986-2017)" and "Data collection of 60 years of new China" collection compiled by the national bureau of statistics.

3. EMPIRICAL ANALYSIS

In order to avoid false regression of time series model, unit root test and cointegration test should be carried out on each variable data of time series, and then whether the long-term equilibrium model between variables can be established.

First, the unit root test of variable data. Before building the regression model, we need to test the stationarity of the time variables from 1985 to 2016. if all the variables are stationary sequences, we can carry out regression analysis, otherwise we have to carry out the co-integration test. Therefore, the common ADF unit root test method is used to test the time series variables LnFDI, LnGDP, LnFAI, LnWAGE, LnTRADE and LnFDI (-1) in China and eastern and western regions. The results show that these variable data are non-stationary time series and cannot directly establish regression model, but the first order difference of these variable data is stationary series, whether there is a stable long-term equilibrium relationship between them. Cointegration tests are also required.

Second, the cointegration test between variables. The cointegration test of modern econometrics is generally divided into Johansen test and EG test. The former is mainly based on the cointegration test of the regression coefficient of the model, while the latter is based on the cointegration analysis of regression residual. In this paper, Johansen test is used to analyze the variable data. Through the test, there is a cointegration relationship between LnFDI, LnGDP, LnFAI, LnWAGE, LnTRADE and LnFDI (-1) in China and East and West China, and there is a long-term equilibrium relationship among the variables. The regression model can be established by the least square method.

Third, the model regression results. OLS analysis of variables was carried out by Eviews9.0, and the models of the whole country and the east and west regions were regressed. the regression results were as follows (see Table 1).

According to the above regression analysis, the following regression equations can be established:

$$LnFDI = 1.01158 + 0.70708LnGDP + 1.21196LnFAI + 0.06925LnTRADE - 2.05461LnWAGE + 0. \tag{2}$$

$$LnFDI = 2.96166 - 0.050650LnGDP + 1.37281LnFAI - 0.00180LnTRADE - 0.70449LnWAGE + 0.2650 \tag{3}$$

$$LnFDI = 15.0755 + 7.19765LnGDP - 1.17339LnFAI - 0.28849LnTRADE - 4.70548LnWAGE + 0. \tag{4}$$

$$FDI = 5.63685 + 0.52279LnGDP + 2.11024LnFAI - 0.29462LnTRADE - 2.96405LnWAGE + 0.74415 \tag{5}$$

The above four regression equations R² and adjusted R² all of them are high, which indicates that the fitting degree of the equation is better. The F values of the four equations are 171.9217, 156.3552, 202.1529 and 63.4150, respectively, and the probability of F statistics is 0.0000, which indicates that the global coefficients of the four equations have passed the 1% significance test. After the generalized difference treatment, the DW of the four equations are 1.82566, 1.91148, 2.20447 and 1.85485, respectively, which also eliminates the autocorrelation.

Table 1: Regression results of FDI factor analysis in East, Central and West regions.

Explanatory variable	China	Eastern China	Central China	Western China
C	1.0115 (0.1567)	2.9616 (0.5340)	-15.0755*** (-6.1710)	5.6368* (1.7418)
LnGDP	0.7070 (0.4568)	-0.5065 (-0.2904)	7.1976*** (8.9088)	0.5227 (0.6523)
LnFAI	1.2119** (2.4722)	1.3728** (2.5647)	-1.1733** (-2.1591)	2.1102** (2.7161)
LnTRADE	0.0692 (0.1405)	-0.0100 (-0.0187)	-0.2884 (-1.0135)	-0.2946 (-0.5773)
LnWAGE	-2.0546* (-1.7507)	-0.7044 (-0.5306)	-4.7054*** (-4.8130)	-2.9640*** (-3.0338)
LnFDI (-1)	0.40303 (1.6456)	0.26503 (1.0965)	0.04346 (0.3299)	0.74415*** (5.4140)
AR (1)	0.8540*** (5.6516)	0.8247*** (6.2036)	1.1639*** (12.7939)	
AR (2)			-0.7588*** (-10.350)	
R ²	0.9837	0.9822	0.9895	0.9434
Adjusted R ²	0.9780	0.9759	0.9846	0.9285
Statistics of F	171.9217	156.3552	202.1529	63.4150
DW statistics	1.7256	1.9114	2.2044	1.7548

Note: *, **, *** indicates that it has passed the significance test of 1%, 5% and 10%, respectively, and the values in parentheses represent the statistical values of the coefficient t of each variable.

4. CONCLUSION

The choice of investment by foreign transnational corporations has a certain contingency, but it is more the result of comprehensive consideration. The most important reason for foreign investment to enter the Chinese market is to open up the market, occupy more shares, and make more profits. According to the above regression results, combined with several factors of economic agglomeration variables, we can get the following basic conclusions:

First, market capacity has always been an important factor valued by

foreign investment. Generally speaking, the larger the GDP, the larger the market capacity, which can attract more FDI to enter. The elasticity coefficients of market capacity factors in China, the Eastern China, the Central China and the Western China are 0.707, -0.507, 7.198 and 0.523, respectively. The elasticity coefficient of GDP of the whole country, the East and the West has not passed the statistical test of 5%, which shows that the attraction of GDP of the whole country, the East and the west to FDI is not obvious, and GDP is not the main reason for foreign investment. However, the regression coefficient of the central market capacity has passed the significant test of 1%, and the elasticity coefficient is high, which indicates that the central market capacity has a certain impact on the entry of foreign FDI. Especially in recent years, the economy of the central provinces of China has developed rapidly, and the scale of GDP in Changsha, Wuhan, Zhengzhou and other provincial capitals has been expanding. Wuhan and Zhengzhou have become the central cities of the country, attracting more and more foreign investment, and foreign investment has also made high profits in the central region.

Second, infrastructure is the first element of foreign investment, infrastructure is not only manifested in transport facilities, but also in the service industry, financial industry, living facilities, urban construction in all aspects. The more perfect the urban infrastructure, the more guaranteed the foreign investment and the higher the interest in investment. The elasticity coefficients of infrastructure factors in China and the Eastern, central and Western regions of China are 1.212, 1.373, -1.173 and 2.110, respectively, which have passed the significant test of 5%. The results show that for every one percentage point increase in fixed asset investment under other conditions, FDI in China, Eastern China and Western China will increase by 1.212, 1.373 and 2.110 percentage points respectively. The attraction of fixed assets investment in the west to FDI is greater than that in the whole country and the east, which shows the importance of infrastructure to attract FDI in the west. At the same time, it does not mean that fixed assets are less important to the whole country and the east than to the west, but other factors in the whole country and the east also play a great role, replacing some of the importance of infrastructure elements. However, the regression parameters of the central infrastructure are negative, which indicates that the quality of fixed asset investment in the central region is poor and needs to be improved, which may be the reason why the attraction of the central market capacity to FDI replaces some of the infrastructure attraction.

Third, economic opening is important for countries and regions to attract foreign investment. Since the reform and opening up, China has gradually opened up its market and attracted more foreign investment. In recent years, it has been second only to the United States in attracting FDI. In this paper, the total amount of foreign trade imports and exports is used to represent the degree of market openness. However, the results of model regression show that the elasticity coefficient of openness in the whole country and the eastern and western regions has not passed the 10% statistical test, which shows that the continuous increase of import and export is not significant to attract FDI. The initial reform and opening up policy have a strong attraction to foreign capital, but the attraction of economic opening to FDI obviously follows the law of decreasing benefits, and the role of attracting foreign capital is declining. At the same time, this may also be caused by China's foreign investment policy, because, although China's opening up is gradually increasing, but mainly in open regions, many industries and fields still have strict control over foreign investment, which has caused difficulties for China to further attract foreign investment. For example, the world's foreign investment is mainly concentrated in the services sector, but China is concentrated in manufacturing.

Fourth, the cost is an important reason for the foreign capital to choose to enter the region, in which the labor cost is a focus that scholars often study. It is generally believed that labor costs are a major hindrance to FDI entry. The regression coefficients of labor force in China and the eastern, central and Western China are -2.055, -0.705, -4.705, -2.964, respectively. Among them, the elasticity coefficient of the eastern labor force has not passed the significant test, which shows that for the east, the labor cost is no longer the main influencing factor to attract FDI. However, the elasticity coefficient of labor force in the whole country and the central and western regions has passed the 10% significance test, and the central and western regions have also passed the 1% significance test. It shows that labor cost is still one of the influencing factors to attract FDI in the central and western regions, and the labor

cost in the middle region has a greater impact on attracting foreign investment than in the west. When other conditions remain unchanged, FDI will be reduced by 4.705 percentage points for every 1 percentage point increase in labor costs in the central region, and 2.964 percentage points for every 1 percentage point increase in labor costs in the western region.

Fifth, the lag of economic variables often exists, and it is no exception for foreign investment to enter China. Multinational corporations' investment in China will have a certain demonstration effect and follow-up effect, and the early entry of FDI sometimes has a decisive impact on the stagnant foreign investment. The dynamic model of this paper shows that the early entry of FDI sometimes does have a certain impact on foreign direct investment. The elastic coefficients of FDI in the previous period were 0.403, 0.265, 0.043 and 0.744, respectively, but the elastic coefficients of the whole country, the east and the middle did not pass the significant test. The results show that the previous period of FDI in the whole country, the eastern region and the central region has no obvious effect on the FDI entered later, while the elasticity coefficient of the previous FDI in the western region has passed the statistical test of 1%. For every 1 percentage point increase in the previous FDI in the western region, the foreign investment can be increased by 0.744 percentage points in that year. The western region of China is vast in geography, rich in labor, mineral, coal, oil and other resources, and the investment demonstration effect of multinational corporations is remarkable. In particular, in recent years, China has implemented the "Belt and Road Initiative" national strategy, and most of the western region borders with other countries, attracting a sharp increase in investment from ASEAN and "Belt and Road Initiative" countries, and foreign businessmen from other developed countries have also actively participated in Belt and Road Initiative construction. Therefore, the demonstration effect and follow effect in the western region continue to expand.

5. COUNTERMEASURES AND SUGGESTIONS

The empirical study of this paper shows that economic agglomeration has a significant impact on the location choice of FDI investment of multinational corporations. Combined with China's current economic policy and the actual situation of attracting foreign investment, this paper puts forward the following suggestions:

(1) Strengthen the rational layout of regional industries and promote the further development of economic agglomeration. Economic agglomeration includes not only industrial agglomeration, but also business agglomeration, talent agglomeration, logistics agglomeration and information agglomeration. Economic agglomeration is not only the process of regional economic development, but also the inevitable result of economic growth. Only by implementing various economic policies, financial policies and talent strategic policies to attract more economic factors into countries and regions can countries and regions effectively attract more foreign investment. (2) the eastern coastal areas used to be the focus of foreign investment, and the policy effect in the past is not attractive. Therefore, we should enhance the soft power of the investment environment, strengthen institutional construction and financial reform, further relax the industries and fields that attract foreign investment, steadily open more free trade zones, reduce negative lists, and improve the quality of FDI investment attraction. (3) the intensity of attracting foreign investment in the central and western regions is still insufficient, and it is still necessary to vigorously strengthen infrastructure construction and maintain a relatively low labor price advantage. The central and western regions should firmly grasp the national strategic policy of "Belt and Road Initiative," copy some financial policies and tax policies in the eastern free trade area, attract foreign investment, and undertake the FDI transferred from the eastern region and the developed countries.

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