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Siegfried Schultz*

East Asian FDI in Europe and Germany

During the 1980s foreign direct investment (FDI) expanded remarkably. Simultaneously, the regional structure of foreign direct investment changed. This relationship is discernible among industrial countries, as well as between industrial and developing countries. Of particular importance is the interface of foreign trade relations between the "Triad" and the economically dynamic East Asian and Pacific area. This article highlights, in particular, foreign investment coming from Eastern Asia into Europe and Germany.¹

The foreign direct investment of industrial countries (inward and outward) increased fourfold during the 1980s and at a far more dynamic pace than that of domestic investment, GDP and world trade. Internal deregulation, international liberalisation, as well as deeper integration, constituted a good breeding-ground for this increase in cross-border investment flows.

An important element in this process was the increasing number of countries of origin and destinations involved in foreign direct investment. As a consequence, the geographical structure of foreign direct investment has changed. Japan, alongside the USA and UK, was the main contributor to the surge of direct investment and turned into one of the most important countries of origin. Diversification and globalisation became general keywords during the 1980s, even more so when referring to the strategy of Japanese firms. By the end of the decade, nearly a quarter of all the OECD's new foreign direct investment stemmed from Japan, making it the most important country of origin.

There are a number of approaches which partially explain the determinants of foreign direct investment, but a general, cogent and comprehensive theory does not exist. The "flying wild geese" hypothesis is the most common approach used to explain investment patterns. Making an analogy between an image and the suspected progression of industrial development, it describes a staggered formation with Japan in front, followed by the newly industrialising countries ("the four little tigers") and the other dynamic developing countries of Asia (Malaysia and Thailand), which, for

their own part, supposedly are a model example upon which China should base its economy with respect to foreign trade. As a result, an explicit relationship is established between industrial growth and the changing patterns in the structure of foreign economic relations. The dynamic components of this relationship are such that the leading member(s) of the formation can only maintain the front position – and the permanent advantage compared to the other members of the unit – by technological innovation.

This image of a flock of wild geese, which is often to be found in Asian literature, does have a certain suggestive power, but merely illustrates the basic pattern in the evolution of international competitiveness. To assume that the technological content of products will increase rapidly and, therefore, have a noticeable impact on the structure of foreign trade for all countries of the region is not realistic. Rather, a non-competitive range of goods and services, insufficient infrastructure, geographical handicaps and restrictive currency controls due to consecutive current account deficits in some countries, constitute, *inter alia*, hindrances to the speedy catching-up process of the entire region. As for the "trickle-down" of growth stimuli to the poorest countries, which development policy-makers had anticipated in vain, there is no proven, systematic structural evolution

¹ In addition to Japan, here the following countries are subsumed to East Asia: Hong Kong, Republic of Korea, Singapore and Taiwan, as well as Malaysia, Thailand and China. "Europe" is taken to mean, primarily, Western Europe; references will be made to Central and Eastern Europe when the opportunity presents itself and suitable data is available. The data used stems from various sources (international organisations, national authorities and estimates from specialists in this field). Therefore, differences in definition emerge which lead, partially, to substantial differences in empirical data. In this respect, the focus should be rather on emerging trends than on the absolute size of given values.

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whereby all countries of the region are coupled up to the world economy.

A more suitable theoretical approach is the concept that multinationally active firms organise cross-border production and sales largely within their own firm, if the services required are not made available by the market or the terms under which they can be obtained are not acceptable. Additional costs resulting from these cross-border activities can be absorbed, if firm-specific advantages, together with location-specific ones, outweigh geographical disadvantages and transaction costs to such an extent that a profit is probable. Costs deriving from the inclusion of other firms in the chain of production and sales are avoided and the so-called internalisation advantages are taken full advantage of ("eclectic paradigm").²

With respect to Europe, the following aspects rank highly among the most important determinants for direct investment from East Asia: securing existing markets and opening up new ones, promoting trade, providing auxiliary services for local subsidiaries, avoiding trade barriers, and strengthening technological contact with leading industrial countries.

Development of East Asian Direct Investment

Although investment flows from some Asian countries – in particular those from Japan – shrank considerably in the period under consideration, "stocks" (measured in terms of accumulated flows) went up further. This increase has been particularly marked in the case of China and Korea (see Table 1).

Japanese and Korean companies have focused their attention on North America and Europe while Hongkong, Singapore and Taiwan have put the accent

on investment in the Asian region. Nonetheless, the share of investment going to Western industrialised countries was rising. While North America was and still is the main destination, Europe's share of Asia's capital transfers also increased temporarily in the run-up to the completion of the European Single Market. Among this direct investment the following sectoral pattern is discernible: in the Asian countries of destination and in North America the aspect of cutting costs is overriding, and it was mainly a matter of establishing new production facilities, whereas in Europe investment in services played a strong role. Germany participated in particular in direct investment from the more important newly industrialising countries.

In a world-wide context, new foreign investment took place on a considerably lower level since 1991. This contrasts with the figures given for China. The official amount, however, is probably exaggerated, as it includes funds which were injected into Chinese subsidiary companies abroad. In a kind of roundabout fashion, these funds were subsequently channelled back into China, making full use of the preferential treatment given to foreign investors. The rest of the Asian countries remained at about the previous level, with one important exception: Japan experienced a significant decline, and within three years the flow of new investment shrank to somewhat more than one fourth of its previous volume. In comparison to other newly industrialising Asian countries, Taiwan had the

² Cf. John H. Dunning: Trade, Location of Economic Activity and the MNE: A Search for an Eclectic Approach, in: Bertil Ohlin et al. (eds.): The International Allocation of Economic Activity, London 1977; Explaining the International Direct Investment Position of Countries. Towards a Dynamic or Developmental Approach, in: Weltwirtschaftliches Archiv, Vol. 117 (1981), pp. 30-64; Explaining International Production, London 1988.

Table 1
East Asian Overseas Direct Investment
(cumulated flows, in US-\$ million)

Country of origin	1980	1985	1990	1992	1993	Average annual increase (%)	
						1990/85	1993/90
Japan	16,570	42,030	202,450	250,430	264,170	36.9	9.3
Hong Kong ¹	148	640	1,511	–	2,015 ²	18.7	10.1
Korea	142	487	2,056	4,460	5,516	33.4	39.0
Singapore	652	1,320	4,276	5,468	6,235	26.5	13.4
Taiwan	97	204	12,888	16,443	18,854 ²	129.1	13.5
Malaysia ³	414	413	753	763 ⁴	–	14.4	–
Thailand	13	4	399	702	–	95.4	–
China	–	131	3,686	8,599	–	94.9	–

¹ In 1995 the time series for Hong Kong was drastically revised by the UN; the values are now about one tenth of those given in the year before. For 1992 there is no revised figure. ² Preliminary. ³ Stocks. ⁴ 1991.

Sources: IMF: Balance of Payments Statistics, Part 1, Washington, D.C., 1994; for Hong Kong, Taiwan: UN: World Investment Report, 1995; DIW calculations.

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best performance over the whole of the period 1981-93 (see Table 2).

Perspective of the Countries of Origin

For Asia's dynamic economies – as was the case for the old industrial countries before – foreign direct investment is one of the ways to successful integration into the world economy. They became actors in this field as, on the one hand, consecutive export surpluses had fulfilled an important prerequisite for the exportation of their own capital and, on the other, pressure to keep costs down and to secure markets forced more and more firms also in newly industrialising countries to establish foreign bases. Corresponding with the development of the balance of current accounts and depending on the repayment of public debt – not considering special factors (Korea's "Northern policy" and Taiwan's relations with mainland China) – phases of increasing liberalisation of capital transactions abroad can be observed.

As protection against actual, or simply against expected, protectionist measures, investors from East Asia increased their presence with respect to foreign direct investment in the USA and Western Europe in the second half of the 1980s. Towards the end of this period, the imminent completion of the European Single Market triggered a surge of additional

investment flows. There is also an incentive for newly industrialising countries to establish foreign branches in order to ensure continuous access to advanced technologies, production techniques and organisational structures. Investment does not have to replace exports; instead, both may be mutually supportive. This occurs in two ways: firstly, investment supports the export of services; secondly, secure and growing markets ensure returns to scale which enable firms to remain competitive in their traditional product areas and to increase their financial scope for acquiring advanced technological capability. In addition to this, there is design and quality improvement, where market proximity is advantageous.

In as far as East Asian firms have constructed their own production plants in Europe, the supplier system has already been partially "exported". Small and medium-sized suppliers tend to follow large multinational firms – their main customers. In some cases the Japanese effectively transplant their *keiretsu* networks abroad. Also, with the local production of components in the host country the political demand for increased use of domestic intermediate goods and higher shares of value added can be met. In fact, Japanese companies are the most advanced on this way to globalising production; however, competitors from Korea and of various Chinese origin (People's Republic, crown colony,

Table 2
Outward Direct Investment Flows
(US-\$ million)

Region/Country of origin	Average		1989	1990	1991	1992	1993	1981-1993
	1981-1985	1986-1988						
World Total	45,191	133,870	228,613	241,215	193,971	183,914	187,982	1,663,260
of which:								
Europe	25,656	75,706	124,128	144,124	113,600	111,684	100,557	949,490
North America	11,344	25,216	41,417	34,675	37,157	44,660	65,025	355,303
Asia								
of which:								
Japan	5,094	22,737	44,160	48,050	30,740	17,240	13,740	247,611
Hong Kong	705	1,798	2,921	2,397	3,014	–	–	–
Korea	77	148	305	820	1,357	1,047	1,056	5,414
Singapore	143	168	882	1,570	444	748	767	5,630
Taiwan	52	1,630	6,951	5,418	1,854	1,691	2,421 ¹	23,485
Malaysia	71	–50	121	191	10 ¹	–	–	–
Thailand	2	65	50	140	167	136	–	–
China	180	648	780	830	913	4,000	–	–

¹ Preliminary.

Sources: IMF: Balance of Payments Statistics Yearbook, Part 1, Washington, D.C., 1994; DIW calculations.

Taiwan, Singapore) are moving in the same direction. Dominated by large associations, the organisational structure of Japanese enterprises is in favour of this trend. A similar structure can be observed in Korea ("*chaebol*") and in China ("*guanxi*") although they are less significant yet.

Manufacturing is indeed the standard starting-point for extensive investment in industrial countries, but a comparatively high proportion of Japanese and Korean firms have ventured into Europe in the services sector. Besides trade-related investment (banking, distribution), the EU's increased attractiveness – particularly with respect to (Japanese) financial services – was a result of the completion of the Single Market.

Perspective of Host Countries

In the past, the UK undisputedly was the preferred country for direct investment from East Asia in Europe. According to data from the countries of destination (which are considered to be more reliable compared to those from the countries of origin) in recent years, however, there has been a marked change. In 1991/92 the decline in net investment by Japanese firms hit the UK harder than the continent. As a result the Netherlands and Germany moved into first place in 1991 and 1992 respectively with France taking third place on the investment league table. In 1993 Germany, too, experienced large reductions in net investment from Japan. Due to the volume of Japan's foreign ventures, newly industrialising

countries could only rarely fundamentally influence the pace and direction of foreign direct investment from East Asia; by comparison, their share is (as yet) of little significance. As far as the total intake of foreign direct investment is concerned, Japan's direct investment abroad has been of greater importance in Germany than it has in other European countries (see Table 3).

In industrialised countries, the ratio of foreign direct investment to domestic capital formation in the second half of the 1980s was a good 4% on average and has declined somewhat since; in Japan and Germany it is considerably lower. With the exception of Japan, the ratio of foreign investment to domestic capital formation increased during the 1980s in industrial countries, whereas it decreased, in general, in developing countries due to their increased propensity to invest.

In manufacturing the differences in the corresponding ratio are similar to those for the economy as a whole. However, in Germany – in contrast to the whole economy – the ratio in manufacturing has not just declined, but has veered into negative figures. This net disinvestment in the manufacturing sector reflects that foreign ventures have shifted towards services. The ratio is particularly high in the UK. Britain's propensity to invest in fixed capital is low by international standards; it is practically only half as high as Japan's.

The spectrum of coefficients for Asian investment – in as far as data are available – is smaller in the

Table 3
Japan's Share in Total Foreign Direct Investment Flowing into a Particular EU Country
(based on flows (%))

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Belgium and Luxembourg	4.7	2.3	12.0	7.2	14.5	1.6	2.1	17.6	4.3	2.5	1.2
Denmark	1.6	1.2	15.3	0.7	1.1	5.6	2.9	2.5	0.4	0.8	0.6
France	3.4	4.9	3.0	3.3	4.7	3.6	4.0	6.4	12.0	4.9	2.8
Germany ¹	11.4	3.3	28.7	31.7	13.3	20.5	33.0	12.7	32.1	–	32.0
Greece	n.a.	n.a.	n.a.	n.a.	n.a.	–	–	–	1.4	–	–
Italy	2.6	0.5	0.8	–3.0 ²	– ³	1.1	1.2	9.8	3.7	1.7	1.7
Netherlands	9.7	6.5	–0.8 ²	2.8	2.8	2.4	8.5	4.2	3.3	11.0	3.2
Portugal	2.7	3.5	6.4	–	0.6	2.5	0.9	0.8	3.1	1.5	0.5
Spain	1.9	2.7	5.8	5.0	2.5	4.6	1.6	1.9	2.0	2.1	1.3
United Kingdom	–4.2 ²	8.2	2.4	3.2	0.9	9.5	9.8	7.1	12.2	0.6	–0.4 ²

¹ Until the end of 1990, Western Germany. ² Repatriation exceeds new investment from Japan. ³ Due to severe repatriation to the Middle East the entire new investment became negative in 1986.

n.a.= not available; – = not applicable or breakdown not available or data suppressed for reasons of confidentiality. For Ireland no data.

Source: OECD: International Direct Investment Statistics Yearbook 1994, Paris 1994; DIW calculations.

individual host countries than for total direct investment from abroad (see Table 4). At the beginning of the 1990s the coefficients for Germany do not differ substantially from those of other industrial countries.

For years, more than 92% of Germany's stock of foreign direct investment stemmed from Japan. However, investors from other countries have joined. This trend can be expected to persist. For a number of years now Korean firms have belonged to this group; in 1993 their investment doubled. Since 1989 firms from Taiwan have also been active to a considerable extent in Germany, but recently there have been signs of slackening dynamism. New investments from China and Hong Kong taken together exceed those from Taiwan (see Table 5).

On the whole, East Asian investors' interest in Germany as a target country is concentrated on the tertiary sector. Although trade is extremely buoyant, investment in financial services is also to be found. Again, this picture is typified by firms from Japan.

Conclusions and Outlook

Direct investment and exports are interlinked: trade liberalisation with the effect of increased sales opportunities attracts investment which, in turn, contributes to export expansion touching off demands for further opening up of markets. Investors with global commitments are highly interested in liberal trade and investment rules in order to be able to distribute their production among various sites on a world-wide scale.

The characteristics of some services require the presence of the producer in the vicinity of the customer. This necessitates subsidiaries in the sales area. Foreign investment in the context of financial

services has, as a consequence of liberalised conditions in the host country, expanded dynamically in the past. Furthermore, a number of companies would like to be able to continue their usual banking practices with their house banks abroad.

The intensifying network of mutual direct investment is a sign of the deepening integration of the world economy. Foreign direct investment is generally welcome in as far as it increases employment and, over a differentiated range of products, promotes the intermediate demand of domestic firms and the final demand of consumers at favourable prices. Foreign direct investment from East Asia forms part of this network of relations. Europe was not and is not the main focus of interest for firms from the Far East seeking to invest but Europe did benefit from the wave of new ventures towards the end of the last decade.

The economic weight of Japan has moulded the development of direct investment from the entire region. In the short term, a further decline in the total volume of direct investment is not to be excluded; however, the pace of the decline will slacken off. The medium-term perspective looks more favourable, because the safeguarding of Japan's competitive economic position and the intention of newly industrialising countries to penetrate foreign markets require renewed and increased involvement. In any case, criticism is voiced in Japan with reference to the risks involved in the further expansion of overseas plants and the subsequent import of parts and accessories for production. On a permanent basis, this could affect domestic employment and hollow out the industrial structure. The continuous development of new production lines with a high domestic value-added component is seen as the way out of this deadlock.

Table 4
Ratio of Foreign (Asian¹) Direct Investment to Domestic Gross Fixed Capital Investment in Selected² Member Countries of the EU
(in %)

	France		Germany ³		Netherlands		Spain		United Kingdom	
1990	3.5	(0.5)	0.8	(0.3)	14.7	(0.6)	14.8	(n.a.)	16.1	(1.9)
1991	4.4	(0.2)	1.2	(0.2)	10.8	(1.7)	17.2	(n.a.)	8.7	(0.1)
1992	6.0	(0.2)	0.6	(0.2)	7.8	(0.2)	14.8	(n.a.)	9.9	(0.4)

¹ Japan, as well as South and South East Asia: data in brackets. ² As far as data is available in the sources used. ³ Until the end of 1990, Western Germany.

n.a.= not available.

Sources: OECD: International Direct Investment Statistics Yearbook 1994; and National Accounts, Vol. 2, 1994; DIW calculations.

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The large enterprises from East Asia which are permanently active abroad are trying to effect a long-term orientated strategy with the aim of continuously expanding investment abroad – largely independent of the economic situation in the country of origin and in the host country. Of course, there is a hierarchy in the geographical preference. Asia remains the preferred region, with particular attention being paid to China. Recently, investment in EU countries had not necessarily been given high priority, because some major projects had just been completed and Europe's economic slow-down had begun to take its toll. Because of their long-term interest in the opportunities to participate in a growing market, most firms actively engaged in Europe are gearing themselves towards increased sales and reducing distribution costs. The greatest changes are being witnessed by the manufacturing sector in respect of the discontinuation of passport controls and customs clearance and the establishment of general standards for safety, health and environmental protection.

The volume of direct investment from East Asia into the EU will also be dependent in the end on how the foreign trade and payments regime looks in practice. The more restrictive the import procedures, the greater the attraction for foreign investors to conquer the market from within the Single Market. Firms from

Japan and other dynamic Asian countries appear on the European markets as rivals, as everywhere else. In anticipation of income, revenue and employment, national and local authorities offer regional and local enticements to settle, to which investors from the Far East are responsive.

Germany as a location for foreign direct investment cannot compete with the labour cost advantage of the UK and certainly not with Spain and Portugal. The quality of a location, however, encompasses more than merely labour cost advantage; it is a bundle of conditions concerning production, financing and sales. Individual indicators only ever contain a part of these factors, which are, however, interdependent in a complex manner. For instance, factors which would normally be considered as burdensome, such as tax and social insurance contributions, also serve to finance improvements in infrastructure and ensure conditions for social stability, which are – although this is almost impossible to quantify – directly or indirectly to the benefit of the enterprises. According to opinion polls of firms, Germany has – as have both the UK and France – the advantage of size with respect to its national market. Centrality and good infrastructure are advantages which benefit both Germany and France; this is also true for the level of training of their workforces. Language and socio-cultural familiarity is

Table 5
East Asian Direct Investment¹ in Germany²
(stocks, by investor country; DM million)

Balance at the end of each year	Japan	Hong Kong	Korea	Singapore	Taiwan	Malaysia	Thailand	China
1980	2,359	38	165	x	1	x	11	–
1981	2,884	68	64	x	1	x	12	x
1982	3,050	43	90	x	1	x	9	x
1983	3,492	51	70	x	2	x	14	x
1984	4,330	71	101	0	2	x	24	3
1985	5,295	91	107	0	2	x	24	16
1986	6,200	87	145	–1 ³	2	x	25	25
1987	6,438	72	170	8	3	–	25	22
1988	8,048	78	254	4	11	–	22	40
1989 ⁴	9,557	56	277	0	71	–	25	53
1990	11,910	113	518	2	113	x	27	70
1991	14,454	80	528	19	137	x	33	79
1992	15,262	92	458	19	147	x	32	106
1993	15,221	119	973	26	132	x	36	118

¹ Immediate direct investment. ² Until the end of 1990, Western Germany. ³ Reported losses exceeded capital employed. ⁴ New method of calculation since 1989.

x = Unknown due to the withholding of information; – = no data/no transactions.

Sources: Deutsche Bundesbank: Die Kapitalverflechtung der Unternehmen mit dem Ausland nach Ländern und Wirtschaftszweigen. Supplement to "Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank, Series 3, Zahlungsbilanzstatistik", all April editions between 1983 and 1990. Kapitalverflechtung mit dem Ausland, Supplement to "Zahlungsbilanzstatistik" May 1995 ("Statistische Sonderveröffentlichung 10").

a great benefit for the UK, in particular when the investors are American or Japanese.

Despite the upswing of the economy, in recent times Germany was hardly in the position to attract new foreign investment. This is an indication of structural impediments – irrespective of the business cycle. The biggest handicaps seem to be troublesome administrative procedures and, recently, a deteriorated position with respect to the taxation of enterprises. Large-scale improvement in terms of more foreign direct investment may only come about if potential investors meet with institutional and macroeconomic conditions which do not appear substantially less favourable than elsewhere.

Regarding the future, the following assessments will be justified:

Judging on the basis of the slump after the last downswing of the economy, expectations with regard to the future trend of Japanese direct investment certainly are more modest than before. Considering the slowdown of economic growth on a world-wide scale, no immediate recovery of direct investment abroad may be expected. However, long-term planning concepts concerning market presence and increasing globalisation do remain valid and will thus safeguard an increasing base volume of investment abroad.

Even after the eradication of customs duties, taste and consumer preferences in the countries and regions of Europe will be so differentiated that, from the point of view of foreign companies, adjustment of their products would be worthwhile. According to statements by firms active in Europe, the number of design centres as well as some R&D activity in the

vicinity of large markets and already existing production centres will probably increase.

Recent ventures into Germany by Japanese investors in particular were motivated by the larger market resulting from unification, but also by their desire to create a base for the opening up of East European markets. Admittedly, after an initial phase of intensive interest the feelers put out towards the East have been withdrawn – at least for the time being – in view of the lack of support from public authorities and unresolved ownership questions. False expectations with regard to the time required for the relocation of Germany's capital city, which has been dragging on, and disillusionment with the pace of transformation in the new German Länder and in Eastern Europe also played a role in this context. In the medium term, Germany will profit due to its generally stable economic situation and there will be renewed interest on the part of East Asian investors, as they are most likely to wish to coordinate their activities in Eastern Europe for the time being via their German subsidiaries.

It can be anticipated that the future spectrum of foreign investment from newly industrialising Asian countries will be complex. On the one hand, their outward direct investment – and above all that of Korean firms – has now developed a momentum of its own. Medium-sized firms, which are engaged in strong competition with each other, as well as firms with an oligopolistic position on their home market, create a "pull effect" on their way abroad: firms from the same branch follow in order not to lose ground to their rivals. On the macro level, on the other hand, judging on the basis of tentative figures the present trend in Korea towards a current account deficit – and thus to net capital imports – seems set to continue; the same is true of Thailand. Taiwan's and China's surpluses may well decline. Only Singapore, Hong Kong and Malaysia are moving in the direction of sustained current account surpluses (see Table 6).

The aim of the development of global entrepreneurial ventures is clearly discernible in the strategy of firms from Korea. The latter, as well as firms from China and Taiwan, have focused their eyes on the dynamic growth area in East Asia and the Pacific region. At the same time, however, they do not refrain from participating, by means of direct investment, in the economic potential of other important regions. In doing so they act, while maintaining their own profile, in accordance with the Japanese example of shaping foreign economic relations in such a way as to evade protectionist barriers and to avoid trade conflicts during a long period of export surpluses.

Table 6
Balances on Current Account
(US-\$ thousand millions)

Country	1992	1993	1994 ¹	1995 ²
Japan	117.6	131.5	129.2	120.0
Hong Kong	1.4	1.8	0.7	1.4
Korea	-4.5	0.4	-4.3	-1.9
Singapore	3.7	2.0	2.1	3.6
Taiwan	8.2	5.8	5.1	4.7
Malaysia	-1.8	-2.5	0.3	0.6
Thailand	-6.4	-6.9	-7.4	-7.8
China	6.4	-11.6	4.5	2.0

¹ Partly estimated. ² Forecast.

Sources: IMF: International Financial Statistics, July 1995; FAZ/Ostasiatischer Verein: Informationsdienste; DIW-Wochenberichte, Nos. 11/95 and 23/95; DIW calculations.