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Competing for Foreign Direct Investment: The Performance of East and Southeast Asian Countries in the 1980s

Rolf J. Langhammer

I. Introduction

Successful development is comprised of three elements of resource formation: first, to activate domestic idle capacities (capacity utilization), second, to generate new productive domestic capacities (capacity expansion), and third, to attract the inflow of foreign resources (access to foreign private savings). Doubtlessly, East and Southeast Asia have economies with outstanding results with respect to the first two elements. Rates of economic growth as the major indicator of capacity utilization were consistently higher than in other developing areas during the last three decades. Similarly, since the Seventies, investment ratios and average capital productivity (proxies for capacity expansion) have also been higher in East and Southeast Asia than in most Latin American, South Asian, Middle Eastern and certainly Sub-Saharan African countries.¹

Only since the early Eighties has the third element received more attention. This latecomer position is due mainly to two facts. First, the sequence of financing domestic capital formation traditionally starts with tapping local financial resources followed by imports of equity and loan capital at a later stage.²

Second, trans-border flows of private risk capital have been considerably encouraged by liberalization of national investment regulations and capital

¹ See for a comparison of Asian countries' investment ratios and productivity rates with Latin American economies *Sachs*, External Debt; *Göbel / Langhammer / Weiss*, Wachstum, pp. 41-47; *Bacha*, Economic Trends, p. 40.

² We disregard access to external public savings like aid flows which are subject to different criteria compared to private risk capital.

transactions during the Eighties. Yet, while more financial funds have become available for capital exports from OECD countries to the rest of the world, they have not become abundant. Rather, the number of competitors for such funds has increased since the opening of Eastern Europe to the world economy. Furthermore, potential foreign lenders and investors exhibit more reluctance to transfer funds outside the OECD because of the debt overhang and macroeconomic malaise in many non-OECD countries. This more intensive "locational" competition coincides with mounting difficulties in developing countries to mobilise badly needed domestic savings.

As a result, access to foreign private risk capital is likely to become a prime bottleneck factor for future economic growth. -

This paper tackles the position of East and Southeast Asia with respect to this issue. The analysis is confined to equity capital, partly for reasons of data availability as home-host country flows are inaccurate for private credits, and partly for conceptual reasons as the link to physical capital formation is less direct for loan than for equity financing.

Chapter II illustrates the performance of the region in competition for investment from five major OECD home countries during the Eighties, in comparison to other hosts. Chapter III analyses the degree of flexibility in investment shifts among Southeast and East Asian countries witnessed by the leading home country Japan. As flexibility differs by sectors of investment, a sectoral breakdown of changes is presented in order to detect different motives of investment, e.g. domestic market orientation versus world market orientation, and to highlight different comparative advantages of individual Asian hosts. Chapter IV tries to group Asian host countries by their different policies to encourage and to channel the inflow of investment into the area. The discussion of policies and policy changes is related to the empirical findings presented in the preceding Chapter. Chapter V summarizes the results.

II. Asian Countries' Performance in Competition for Foreign Direct Investment

Compared to their record of economic growth and domestic investment expansion, Asian countries have not been as impressive in attracting foreign capital if they are compared to OECD countries.

To be brief, within a decreasing segment of foreign direct investment channelled to developing countries (including the NIEs) in the Eighties, Asian countries accounted for a larger share. Losses were to the detriment of Latin American countries. Yet, the net effect of the two diverging trends (decline of

developing countries and rise of Asian countries as hosts within developing countries) was clearly negative for Asia in the case of the leading home country Japan and was widely balanced for the other four OECD countries. However, the latter countries had not invested more than seven per cent of their total foreign funds at the maximum in total Asia by 1988 (Table 1).³

Changes were remarkable for Japanese investors who shifted from Asia to OECD countries, particularly to the US, during the period under observation.

Additionally, the observed trends suggest a distinction between investment in manufacturing and non-manufacturing to be relevant. For instance, the relative decline of Asia as a host of Japanese investors is partly due to the fact that investment in mining (particularly in Indonesia as the most important recipient of investment funds for the mining sector) lost impetus probably as a result of declining world market prices. This negative effect upon investment in Asian non-manufacturing industries was so large that it could not be outweighed by higher investment in the service industries of countries like Singapore or other non-manufacturing industries (e.g. the Thai agricultural sector).

In total, investment patterns seem to have exhibited more stability in the manufacturing than in the non-manufacturing sector, and this may be partly due to technical peculiarities of the non-manufacturing industries, such as the need for lump-sum investment, indivisibilities, and longer gestation periods.

As far as the European and US investment in Asia is concerned, traditional links between the US and the Philippines, or the UK and the Asian Commonwealth countries Malaysia, Singapore, Hong Kong, and India determine the pattern of investment. Such links were intensified rather than new ones established. For West German investors East and Southeast Asia almost remained a "terra incognita" not only in comparison to investment in OECD countries but also with respect to the stocks of investment in Latin America which exceeded those in Asia by almost four times in 1988.

Host country statistics underline the general outcome that East and Southeast Asian countries have increasingly competed for equity capital from the region itself (including Japanese capital of course) rather than from outside. In 1988, 80 per cent of approvals of foreign investment in Thailand originated from Asia. Corresponding figures for the Philippines are 56 per cent and 66 per cent for Malaysia.⁴ The Indonesian percentage was only 42 per cent but

³ Table 1 includes India, Pakistan, Sri Lanka, and Bangladesh as hosts but as the four hosts account but for a small fraction of total OECD countries' investment in the region, they do not influence the results.

⁴ Asian Development Bank, Asian Development Outlook 1990, Table 1.5, p. 41.

Table 1

**Share of Asian Developing Countries in Major OECD Countries' Stocks
of Foreign Direct Investment, 1978-1988 (in per cent)**

Netherlands (a)	1978	1982	1984	1988
Manufacturing (excl. mining, oil, petrochemicals)	3.3	5.4	5.4	5.3
Non-manufacturing	4.1	4.8	3.4	3.4
All industries	3.6	5.0	3.8	3.9
Japan (b)	1978	1982	1985	1988
Manufacturing	38.4	34.9	31.4	25.0
Non-manufacturing	26.4	25.6	21.1	14.9
All industries	29.6	28.1	23.7	17.6
United Kingdom (c)	1978	1981	1984	1987
Manufacturing	5.7	5.3	5.5	6.5
Non-manufacturing	8.6	13.2	7.2	5.4
All industries	6.7	8.3	6.7	5.7
United States (d)	1978	1982	1985	1988
Manufacturing (excl. petroleum)	2.7	3.2	3.9	4.7
Non-manufacturing	5.0	7.6	8.6	6.6
All industries	4.0	5.8	6.7	5.8
West Germany (e)	1978	1981	1985	1988
Manufacturing	n.a.	1.9	2.0	2.0
Non-manufacturing	n.a.	2.3	2.4	2.5
All industries	1.7	2.1	2.3	2.3

(a) Includes Western Asia. Data are based on annual surveys conducted by the Central Bank and are defined as year-end position.

(b) Defined as approved accumulated investment at end of fiscal year.

(c) Book values of United Kingdom outward direct investment attributable to UK companies. Figures for 1978 and 1981 exclude oil companies, banks and insurance companies.

(d) Book value of US direct investor's equity in, and net outstanding loans to their foreign affiliates.

(e) Position at year-end including investments of holdings.

Sources:	The Netherlands:	De Nederlandsche Bank, Quarterly Bulletin, current issues.
	Japan:	Ministry of Finance, Zaisei; Kingu Tokei Geppo (Monetary and Financial Statistics Monthly), current issues.
	United Kingdom:	Business Monitor, Census of Overseas Assets, MA4, 1981 Supplement, London 1986; MO4, 1984, London 1988; 1987, London 1990.
	United States:	Department of Commerce, Survey of Current Business, current issues.
	West Germany:	Deutsche Bundesbank, Statistische Beihefte zu den Monatsberichten Reihe 3, Zahlungsbilanzstatistik, current issues.

this was due to the fact that in 1988 the country suffered from a stagnation of Japanese investment and that it generally hosts a large amount of investment from "combined countries" which may also include investment from Asia. Doubtlessly, during the last decade Korea, Hong Kong, Singapore, and in particular Taiwan ranked next to Japan as more important investors in Indonesia than all European countries.⁵

To identify winners among the Asian host countries, irrespective of the origin of the equity capital, brings us to Singapore as the most attractive economy followed by Thailand. No other Asian country compares with Singapore if flows from all OECD countries are taken into consideration. This holds for investment in services as well as manufacturing. The Singapore example suggests factors other than the size of the domestic market as relevant motives to invest, e.g. macroeconomic stability, skill availability and openness to foreign investment. For the latter policy-determined factor, it is essential to distinguish between two types of economies: first, economies which for several years restricted foreign investment, such as Korea, Taiwan, and to a more limited degree, Malaysia, and second, countries which encouraged foreign investment, such as Singapore, Hong Kong, and Thailand. Yet, this distinction is by no means equivalent to that between macroeconomic failure and success. The extraordinary performance of Korea and Taiwan in terms of economic growth and structural change indicates that lack of foreign equity capital is not a binding constraint if endogenous substitutes can be made available.

There is another reservation to be made if Asian economies and OECD countries as hosts are compared. One may assume that because of the different resource endowment of the two groups the sectoral specialization of foreign investment will differ as well. For instance, if OECD hosts attract foreign investment in relatively capital-intensive machinery while Asian countries would specialize in relatively labour-intensive light industries, e.g. textiles, any "across-the-board" conclusion saying that Asia failed to meet the competition for foreign equity capital in the manufacturing sector could be misleading. To channel more equity capital per unit of production in OECD countries would then be fully consistent with the relative resource endowment of each host. In other words, the fact that Asian economies attracted less foreign equity capital than OECD countries *prima facie* points at a correct product mix of the two groups given relative labour abundance in Asia and capital abundance in the OECD countries.

To clarify this assumption, a deeper sectoral breakdown of investment patterns is necessary in order to exclude different average capital-output coeffi-

⁵ For details see *Thee*, Investment Surge.

cients in different industries as the major explanation for the investment performance of OECD hosts versus Asian hosts. This is done in the following chapter by making reference to Japanese investment patterns.

III. The Relative Attractiveness of Asian Host Countries to Japanese Foreign Investment in Selected Industries

There are two reasons which qualify Japanese investment for an in-depth analysis of the direction of shifts in sectoral investment between Asian hosts, again in comparison to competitors from outside Asia. First, Japan is by far the leading foreign investor in all host countries and the pacemaker for potential investors from other countries. Second, as Table 1 showed, among OECD investors Japan has witnessed the largest degree of flexibility in the direction of its investment, mainly in favour of non-Asian hosts in the Eighties.

Two questions arise here. First, did such "revealed preferences" hold for all countries of the region and for all industries, and second, did some Asian host countries suffer or benefit from a large volatility in short-term changes in investment flows? As far as the latter question is concerned, a distinction should be made between two kinds of volatility. There is an industry-specific volatility which may be inherent in so-called footloose industries with little capital input. In such industries, inter-host country flows may occur rapidly in response to changing relative factor prices, for instance. Light industries may be cases in point. Such volatility could be measured by means of a ratio between the volatility of investment in a specific industry and that of investment in all industries irrespective of individual host countries. A ratio exceeding unity would suggest industry-specific volatility to be relevant.

However, there is also a country-specific volatility which may reflect changes in the investment environment of individual host countries, e.g. macroeconomic instability. It can be empirically approached if the volatility of investment in a specific host country is normalized by the volatility of Japanese investment in all host countries.

Table 2 addresses the first question by ranking incremental Japanese investment (changes in stocks between the end and the beginning of the period) during two sub-periods (1980-84, 1984-88) in all major host countries. As a result important differences emerge between sub-periods as well as between industries although in general the US and the EC arise as preferred host countries for Japan.

First, in resource-oriented industries like mining, iron and non-ferrous metals as well as chemicals, but also in textiles, countries other than the US

top the list of host countries. Indonesia in mining and textiles, Singapore in (petro)chemicals, and Brazil in iron and non-ferrous metals were leading hosts for Japanese investors during one sub-period at least.

Second, in comparison between the two sub-periods Asian hosts scored gains in terms of ranks rather than shares particularly in the later period 1984-88. Such gains were to the detriment of the Latin American hosts (Brazil, Argentina, Mexico) mainly but were not large enough to challenge OECD countries as preferred hosts. The EC member countries improved their attractiveness as hosts after 1984, probably as a consequence of the internal market program announced in 1985 and of the business upswing during the following years. So did the US probably for two reasons. The depreciation of the dollar after 1985 made foreign investment more profitable than direct Japanese exports to the US and fears about increased US protectionism were widely shared in Japan. In general, there was much more concentration on few hosts in the second than in the first sub-period.

Third, not surprisingly, Asian hosts kept top positions in textiles (mainly Indonesia, Thailand, Korea) over the entire period but also underwent considerable shifts in the rankings between two sub-periods. For instance, Malaysia incurred losses in textiles, iron and non-ferrous metals, and also agriculture; Singapore lost in machinery, as did Saudi Arabia in chemicals. Gains were collected by China, Korea, and Thailand in textiles, by Korea in chemicals, by China in services, and by Thailand in the agricultural and forestry sector, respectively.

Fourth, some countries did not move at all in the rankings. They remained unattractive hosts during the full period, for instance, the Philippines and India.

Fifth, a comparison between the two city economies is germane. Hong Kong's position remarkably differs from that of Singapore. Hong Kong kept a leading position only in services during the early Eighties but lost ground considerably after 1984, probably after the decisions were taken on its post-1997 political status. Singapore's ranking remained stable in services but deteriorated in manufacturing due to a stagnation of Japanese investment in the chemical industry.

Sixth, for total investment the most dramatic changes in the rankings between the early and the late Eighties were on the one hand the losses of Indonesia and on the other hand the Chinese gains. The latter can easily be explained by past trends towards more outward orientation in Chinese foreign trade and investment regimes. Yet, the former changes pose interesting questions as investment in mining and textiles — the two sectors in which Indonesia incurred losses in particular — are subject to very different conditions and

Table 2
Share of Individual Host Countries in Changes of Stocks of Japanese Investment,
1980-1984 and 1984-1988, by Industry (in per cent)

All industries											
Rank- ing	Manufacturing										
					Textiles		Chemicals		Iron & non-ferrous metals		Machinery
	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984
1	USA 31.8	USA 45.3	USA 41.4	USA 59.8	Indon 33.0	USA 41.6	Singa 32.5	USA 63.9	Brazi 31.2	USA 58.0	USA 43.3
2	EC 11.9	EC 17.2	Brazi 10.6	EC 10.4	USA 14.9	EC 17.6	USA 28.7	EC 14.4	USA 23.6	Brazi 14.6	Singa 19.0
3	Indon 10.4	Austr 4.3	EC 9.4	Thail 3.4	Thail 12.2	Indon 12.2	Saudi 14.8	Singa 7.6	Indon 20.9	Indon 7.4	Brazi 12.1
4	Hongk 4.9	Hongk 2.9	Indon 7.9	Taiwa 3.3	Brazi 12.1	Thail 6.9	EC 8.0	Taiwa 2.6	Malay 5.0	Thail 5.2	EC 9.0
5	Brazi 3.9	Singa 1.6	Singa 7.1	Brazi 2.7	EC 9.2	Korea 5.1	Indon 4.1	Indon 2.3	Mexic 2.8	Taiwa 2.9	Thail 5.6
6	Singa 2.9	China 1.6	Mexic 3.8	Indon 2.5	Malay 7.7	Brazi 3.7	Brazi 3.8	Korea 2.2	Austr 2.5	EC 2.2	Taiwa 3.4
7	Austr 2.9	Indon 1.6	Malay 3.2	Korea 2.5	Hongk 2.4	China 3.6	Taiwa 2.7	Thail 1.6	EC 2.3	Malay 1.8	Korea 2.0
8	Korea 1.2	Korea 1.5	Taiwa 2.4	Singa 2.3	Taiwa 2.3	Hongk 1.7	Korea 1.6	Malay 1.3	Taiwa 1.2	Singa 1.5	Austr 1.7
9	Mexic 1.2	Brazi 1.2	Thail 2.3	Austr 2.2	Korea 1.6	Taiwa 1.3	Malay 1.0	Brazi 1.1	Thail 0.7	Austr 1.2	Indon 1.3
10	Malay 1.1	Thail 1.1	Saudi 2.0	Malay 2.1	Singa 1.3	Malay 1.1	Thail 1.0	China 0.9	Korea 0.5	Korea 1.0	Hongk 0.5
11	Thail 0.9	Taiwa 1.0	Austr 1.7	Mexic 1.2	Argen 0.5	Phili 0.9	China 0.6	Phili 0.9	Singa 0.5	China 0.8	Mexic 0.4
12	Taiwa 0.8	Malay 0.7	Korea 1.4	China 1.1	Mexic 0.4	Austr 0.8	Mexic 0.4	Austr 0.4	Phili 0.4	Hongk 0.7	Malay 0.3
13	Saudi 0.7	Mexic 0.4	Phili 0.8	Hongk 0.9	China 0.3	Mexic 0.3	Austr 0.3	Hongk 0.3	Saudi 0.3	Saudi 0.3	China 0.1
14	Phili 0.6	Phili 0.3	Hongk 0.5	Phili 0.7	Austr 0.2	Singa 0.1	Hongk 0.2	India 0.1	China 0.1	Phili 0.1	Iran 0.1
15	China 0.5	India 0.1	Argen 0.4	India 0.2	India 0.1	India 0.1	Phili 0.1	Mexic 0.1	Hongk 0.0	Mexic 0.0	Phili 0.0
16	Argen 0.3	Argen 0.1	China 0.3	Argen 0.1	Phili 0.0	Argen 0.0	India 0.0	Argen 0.0	India 0.0	India 0.0	India 0.0
17	India 0.1	Saudi 0.0	India 0.3	Saudi 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Argen 0.0
18	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Saudi 0.0	Saudi 0.0	Argen 0.0	Saudi 0.0	Argen 0.0	Argen 0.0	Saudi 0.0

Rank- ing	Manufacturing				Agriculture & forestry				Fisheries				Mining				Services			
	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	1980-1984	1984-1988	
1	USA 66.9	USA 28.9	USA 41.0	USA 22.1	USA 38.7	USA 37.3	USA 32.2	USA 67.9	Indon 34.6	USA 34.0	Indon 34.6	USA 41.6								
2	EC 13.5	EC 12.1	EC 18.9	Brazil 7.2	Austr 32.6	Argen 25.9	China 19.4	Austr 10.2	USA 24.3	EC 14.6	Hongk 8.0	EC 19.5								
3	Thail 6.0	Indon 11.6	Austr 5.1	Malay 7.7	Thail 6.4	Argen 13.0	Indon 10.5	Phil 9.0	USA 24.3	Austr 15.4	Hongk 4.7	Austr 4.7								
4	Singa 3.1	Hongk 6.6	Hongk 3.6	Austr 3.8	Brazil 3.9	Austr 5.9	Argen 9.0	Phil 2.5	EC 2.0	Brazil 2.0	Hongk 3.7	Hongk 3.7								
5	Korea 2.3	Austr 3.4	China 1.7	Phil 3.5	Indon 2.9	Brazil 4.0	Austr 3.1	Phil 0.7	Phil 1.5	Brazil 1.5	Brazil 1.6	China 1.8								
6	Taiwa 2.1	Singa 1.5	Singa 1.4	Thail 3.3	EC 2.2	Taiwa 1.5	Thail 1.3	India 0.5	Brazil 1.2	Singa 1.2	Singa 1.5	Singa 1.5								
7	Malay 1.3	Brazil 1.3	Indon 1.3	Indon 3.2	China 2.0	Hongk 0.8	Phil 0.2	China 0.1	Malay 1.0	Korea 1.2	Korea 1.2	Korea 1.2								
8	Hongk 1.2	Phil 1.0	Korea 1.7	Singa 0.6	Malay 0.5	Korea 0.3	Phil 0.2	Singa 0.1	China 0.6	Thail 0.4	Thail 0.4	Thail 0.4								
9	Austr 0.6	Phil 0.6	Brazil 0.7	China 0.1	Singa 0.4	EC 0.1	Brazil 0.1	EC 0.1	Thail 0.0	Thail 0.0	Thail 0.0	Thail 0.0								
10	China 0.6	China 0.5	Thail 0.3	Korea 0.1	Argen 0.1	Thail 0.0	Taiwa 0.1	Mexic 0.0	Thail 0.0	Indon 0.4	Taiwa 0.3	Taiwa 0.3								
11	Brazil 0.4	Thail 0.4	Taiwa 0.2	EC 0.1	Taiwa 0.1	Malay 0.0	Korea 0.1	Korea 0.0	Korea 0.0	Mexic 0.0	Mexic 0.0	Indon 0.2								
12	Mexic 0.4	Malay 0.4	Malay 0.2	Taiwa 0.2	Mexic 0.1	Phil 0.0	Mexic 0.0	Thail 0.0	Mexic 0.0	Mexic 0.3	Indon 0.1	Indon 0.1								
13	Indon 0.2	Argen 0.3	Mexic 0.1	Hongk 0.0	Phil 0.1	India 0.0	EC 0.0	Hongk 0.0	India 0.0	Argen 0.2	Phil 0.1	Phil 0.1								
14	Phil 0.2	Mexic 0.2	Phil 0.1	India 0.0	Korea 0.0	Mexic 0.0	Singa 0.0	Argen 0.0	Taiwa 0.0	Saudi 0.2	Saudi 0.2	Saudi 0.2								
15	India 0.0	Saudi 0.2	Argen 0.0	Argen 0.0	Hongk 0.0	China 0.0	Malay 0.0	Taiwa 0.0	Singa 0.0	Phil 0.1	Argen 0.0	Argen 0.0								
16	Saudi 0.0	Taiwa 0.1	Saudi 0.0	Mexic 0.0	India 0.0	Singa 0.0	Hongk 0.0	Taiwa 0.0	Argen 0.0	Taiwa 0.1	Taiwa 0.1	Saudi 0.0								
17	Argen 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	Iran 0.0	India 0.0	India 0.0	India 0.0								
18	Iran 0.0	Iran 0.0	Saudi 0.0	Saudi 0.0	Saudi 0.0	Saudi 0.0	Saudi 0.0	Saudi 0.0	Saudi 0.0	Iran 0.0	Iran 0.0	Iran 0.0								

Source: See Table 1.

criteria. One could hypothesize that the general deterioration of Indonesia as a host after 1984 could be better explained by country-specific than by industry-specific factors.

This leads us to the second question of volatility and the distinction between industry-specific and country-specific volatility. To start with the latter, Table 3 introduces a ratio between two coefficients of variation of annual changes of Japanese investment in identical industries, with investment in a specific Asian host country as numerator and world investment of Japan in this industry as denominator. A ratio exceeding unity indicates a larger volatility of investment in the country than it is observed in this industry as a whole. Not surprisingly, the ratios exceed unity in general, as one can expect the volatility in a small sub-aggregate to be higher than in the aggregate. The extent of deviation from unity is also higher in primary and tertiary activities than in manufacturing which seems plausible for the technical reasons mentioned above. However, there are notable outliers which, however, do not allow for "passepartout" explanations.

In all manufacturing industries, Japanese investment in the Philippines, for instance, was much more volatile than on the average. One may argue that because of long-standing economic and political instability in this country Japanese investment, which was relatively insignificant in quantitative terms, rapidly adjusted to changes in the policy environment of the country. This environment was characterized by a deep stabilization crisis in the mid-Eighties followed by a temporary recovery under the Aquino government but with ongoing political disturbances.

Low foreign investment as a consequence of restrictive foreign trade and investment regimes are characteristics for the other host country which proved to be relatively unattractive for Japanese investors, that is India. Japanese investment was over-proportionately volatile in this country too.

A large country-specific volatility may furthermore indicate a surge of investment into an attractive market after the end of a period of inward orientation and excessive restrictions. China seems to be a case in point, to some extent Indonesia too. Both countries exhibit relatively high volatility ratios.

Other countries yield ambiguous results in the sense of high volatility in some industries and low volatility in other industries. Malaysia, Singapore, and Taiwan represent this type of host country. They may have introduced either industry-specific policies to attract investment (Malaysia in the machinery sector, for instance) and/or discouraged investment through general policies which imposed a heavy burden upon specific industries (e.g. the high-wage policies of Singapore which constituted a locational disadvantage for foreign investment in relatively labour-intensive industries).

Table 3

Country Specific Volatility^a of Japanese Foreign Investment in Asian Host Countries, 1980-1988, by Industry

	All industries									
	Manufacturing					Non-Manufacturing				
			Textiles	Chemicals	Iron & non-ferrous metals	Machinery		Agriculture & forestry	Mining	Services
China, PR	2.86	1.50	-	3.53	-	-	3.81	-	-	4.65
Hong Kong	1.34	1.74	1.48	2.10	3.57	2.57	1.47	-	2.43	1.75
India	1.64	1.05	2.24	3.90	4.14	3.18	9.36	-	-	9.10
Indonesia	4.78	1.51	2.25	1.04	3.85	2.25	6.19	2.18	1.67	2.11
Korea, Rep. of	2.01	1.71	1.90	1.78	2.88	1.99	2.01	1.70	1.98	2.36
Malaysia	1.49	1.38	2.12	1.78	3.50	4.93	2.08	1.40	2.34	1.80
Philippines	1.45	1.34	3.55	2.75	2.92	5.56	2.27	2.47	0.94	3.92
Singapore	0.90	1.16	3.47	2.13	1.46	1.62	1.61	1.32	-	1.94
Taiwan	1.42	0.96	1.82	0.86	1.61	1.08	3.76	2.76	-	4.47
Thailand	2.89	1.96	1.43	1.65	3.24	1.87	2.71	0.97	1.71	3.22

Note: ^a Defined as the ratio between the variation coefficient of annual changes of Japanese investment 1980-1988 in the Asia host country and the variation coefficient of Japanese world investment in the same industry.

Source: See Table 1.

In total, the country-specific volatility of Japanese foreign investment in East and Southeast Asia in the Eighties seems to be high and unequal among host countries. Only Singapore, the most successful capital importer, shows an inter-annual allocation of total Japanese investment inflows which equals that of Japanese world investment (ratio of 0.9 for all industries in Table 3). In the other countries conditions to invest seem to have been rather heterogeneous and changing. The figures suggest that Japanese investors deviated from a stable medium-term path of activities in the individual countries.

Apart from country-specific volatility there is a priori reason to assume that different preconditions to react flexibly exist for different industries. Foot-loose industries with little capital input will provide better possibilities to react than large-scale capital-intensive projects as those in the mining sector or in the chemical industry. Such industry-specific volatility is expected to exist in each Asian country and thus is defined as the ratio between the variation coefficients of annual changes of Japanese investment in an individual industry and in total investment in the country concerned (Table 4).

Yet, the findings do not support the hypothesis that an industry-specific volatility in the manufacturing sector was very relevant in East and Southeast Asia. There is no general pattern in the sense that the ratios in one industry were higher for all sample countries than those in another industry. In the textile industry, ratios ranged between 0.96 for Indonesia and 7.80 for Singapore and similar spans of ratios emerge for other sectors and industries including mining and services. Indonesia is the outlier in the sample. Almost all ratios are close to unity and thus indicate that annual fluctuations of sectoral investment in Indonesia were fairly equal to the fluctuations which held for total Japanese investment in this country.

If at all, industry-specific volatility can be observed in the mining sector as well as in the other resource-oriented sector of agriculture and forestry. This is not surprising as external conditions such as the changes in world market prices and technical indivisibilities are likely to foster drastical changes in investment flows from year-to-year.

Taken together, the two ratios introduced in Tables 3 and 4 support the view that in East and Southeast Asia country-specific reasons for investment volatility were more relevant than industry-specific ones.

Table 4

Industry Specific Volatility^a of Japanese Foreign Investment in Asian Host Countries, 1980-1988

	Manufacturing				Non-Manufacturing			
	Textiles	Chemicals	Iron & non-ferrous metals	Machinery	Agriculture & forestry	Mining	Services	
China, PR	0.80	-	2.27	-	1.23	-	1.26	
Hong Kong	1.98	2.24	2.88	2.70	1.01	6.56	1.01	
India	0.98	2.77	4.38	2.73	5.26	-	4.31	
Indonesia	0.48	0.96	0.40	0.66	1.19	1.26	0.34	
Korea, Rep. of	1.30	1.92	1.63	1.71	0.92	2.34	0.91	
Malaysia	1.41	2.89	2.20	4.66	1.29	5.68	0.94	
Philippines	1.41	4.97	3.50	5.40	1.45	4.72	2.10	
Singapore	1.97	7.80	4.34	2.53	1.64	4.05	1.66	
Taiwan	1.03	2.60	1.12	1.07	2.43	5.36	2.44	
Thailand	1.04	1.01	1.05	0.91	0.87	0.92	2.14	

Note: ^a Defined as the ratio between the variation coefficient of annual changes of Japanese investment 1980-1988 in a specific industry of an Asian host country and the variation of total Japanese investment in the Asian host country.

Source: See Table 1.

IV. Levels and Changes in Japanese Investment in Asian Hosts: Some Stylised Demand-Side Explanations

Why some Asian host countries figure prominently on Japanese investors' preference scale while others did not and why such changes in the ranking occurred as those discussed in Table 2 cannot be explained by a monocausal approach. Instead, there is a large number of institutional, political, macroeconomic, and industry-specific aspects which broadly comprise the availability and price of non-tradeable factors of production in the host countries concerned. A satisfactory analysis of them would go beyond the scope of this paper.⁶

However, some of the factors discussed in the literature can be linked to both the level of Japanese investment activities and their changes among Asian hosts:

First, there is the question of overall openness to foreign equity capital. Until the beginning of the Eighties this openness was low in Korea and, for other reasons of course, in China. As market prospects for export-oriented and domestic production were relatively favourable in both countries, it is not surprising that Japanese investment moved upwards from a low level when restrictions were relaxed but not fully abandoned. India would also fit into this box of countries with initially restrictive investment policies, yet with no major change to the liberal side.

Second, the aspect of macroeconomic and political instability coupled with traditional ties to a non-Asian country, the US, is an important feature to explain the very modest Philippine position in competition for Japanese equity capital. Instability and regional non-affiliation may have deterred Japanese investors from investment. It is likely to be due to this low profile of investment that the Philippines are also insignificant participants in intra-ASEAN or intra-Asian Pacific Rim trade.

Third, there are good reasons to include Hong Kong and Taiwan in a group of economies with open-door policies towards foreign investment (notably, at different degrees) and with a structure of production dominated by labour-intensive manufacturing. It is probably due to this structure that until recently demand for foreign equity capital was relatively low in both economies though links to foreign companies were important. The origin of such companies is often difficult to define because of the crucial role of "Overseas" and "Mainland" Chinese. In the second part of the Eighties both economies deve-

⁶ See for a comprehensive survey summarizing a vast body of literature *Hill*, Foreign Investment.

developed differently with respect to inflows of Japanese investment. Recent upswings of Japanese investment in Taiwan seem to reflect structural changes towards more capital-intensive industries (iron and non-ferrous metals, chemicals) while moderate downswings for investment in Hong Kong are net effects of increases in investment in manufacturing — often related to the neighbouring special economic zones in China — and larger losses in the service industries. The latter movement probably mirrors rising uncertainty about the economic status of Hong Kong after its accession to China.

Fourth, there is the preferred host for Japanese investment, that is Indonesia. Its importance for commodity sourcing was unchallenged in the Eighties and so was the size of its domestic market as an important incentive to invest. Yet, the economy does not only stand for oil price-driven fluctuations in the business cycle but also for selective stop-and-go investment policies. In the non-oil sector Japanese companies were clearly leading among foreign investors and thus were particularly affected when investment policies turned to the restrictive side in the first half of the Eighties. Some deregulation measures were taken in 1986 and later on when consistent policies were implemented to strengthen the non-oil sector and non-traditional exports. Without major delays, Japanese investment adjusted to Indonesian policies by reducing investment growth until 1985/86 followed by a recovery. The comparison between the two sub-periods laid out in Table 2 shows that the downswing in investment culminated in the second sub-period. The Indonesian case bears witness of rapid finetuning in Japanese investment when the policy environment changes visibly.

Fifth, Thailand resembles Taiwan in two aspects. Investment policies were fairly liberal and initial demand for foreign equity capital was low due to prevailing labour-intensive manufacturing. As in Taiwan the latter changed slightly when the government initiated some large-scale projects in heavy industries in the second half of the Eighties. The upswing in Japanese investment in these industries (iron, machinery) materialized fully by 1987/88 and explains the largest part of the rise in the investment ranking during the second sub-period.

Sixth, the other resource-rich country next to Indonesia, Malaysia, offers a fine example of extractive industries like mining as well as agriculture and forestry which are fairly closed to Japan because of traditional British dominance. In the manufacturing sector, Table 2 yielded that Malaysia declined in its ranking as a host during the second sub-period and was surpassed by Korea, Taiwan, and Thailand. There is reason to assume that the macroeconomic conditions which worsened for commodity exporters in the mid-Eighties can partly explain the deteriorating attractiveness of Malaysia as they exerted strong adjustment pressures upon the economy. But it is also plausible

not to underrate a possible negative effect of selective ownership policies ("bumiputera" policies) in favour of Malay investors. Such policies do not exist in the countries mentioned above.

Finally, there is Singapore as a major host of both Asian and non-Asian investors in East and Southeast Asia. Within an open market framework the government has set conditions for entry of foreign investment and was also an active player with its own companies. These two characteristics do not seem to have significantly relaxed in recent years and may have prevented more inflows than would have been possible otherwise. On the other hand, Singapore already presents an overproportionately high level of foreign investment compared to other Asian host countries and there might be tendencies of saturation and limits in the absorptive capacity for foreign investment in some industries (including services).

Admittedly, this enumeration of factors which are expected to have had some influence on Japanese investment is domestic policy-biased and thus does not claim to be exhaustive. Other more fundamental economic criteria, such as wage costs, the exchange rate regime, real exchange rate changes, availability of human capital, the existence of developed domestic capital markets, and finally the physical infrastructure are doubtlessly relevant as well. But openness to foreign investment is a necessary precondition to compete for equity capital. It is only after the decisions are taken to allow foreign capital to enter or not and under which conditions and in which sectors that home countries can choose among alternative hosts. It seems that in East and Southeast Asia investment policies in recent years were such that the number of options increased.

V. Summary

Four major results emerge from the analysis of the performance of East and Southeast Asia in competition for foreign equity capital. First, Asia was generally successful in out-competing Latin America as far as incremental investment in the Eighties was concerned. However, it failed to prevent capital from moving towards OECD countries, notably the US and the countries of the European Community. This movement was strong over the entire period but was especially relevant in the second half of the Eighties when Japanese capital in particular began to concentrate on the US, on the EC and to a lesser extent also on Australia. The segment of foreign equity capital available to developing countries and NIEs became smaller and within this segment Asian hosts succeeded to account for a rising share.

Second, more than in the past East and Southeast Asian hosts today compete for capital from the region itself with Taiwan, Korea, Singapore, and Hong Kong as newly emerging capital exporters. Capital supplied by "Overseas" and "Mainland" Chinese seem to play an increasing role.

Third, within Asia new competitors such as Thailand, Taiwan and recently Korea have complemented the list of the traditionally preferred hosts Indonesia, Singapore, Hong Kong, and Malaysia for two reasons mainly. First, they began to relax restrictions against foreign investment and second, their demand for capital (including advanced technology) rose when more capital-intensive projects were launched. The Philippines and — as the only South Asian country in the sample — India failed to improve their performance rates due to instability and restrictions, respectively.

Fourth, industry-specific peculiarities do exist, for instance in extractive industries (mining, agriculture, and forestry) where capital input is large and concentrates on few hosts, mainly Indonesia and Malaysia. But country-specific characteristics are believed to be more important in explaining the direction of inflows and their volatility. These characteristics comprise investment policies which were briefly introduced in their major trends and changes, as well as factor prices, resource endowment and indicators of macroeconomic performance which were not discussed because of lack of space.

In conclusion, to extrapolate recent trends in flows of equity capital among East and Southeast Asian countries would mean to expect both more regional suppliers and hosts of foreign investment in the future than in the past.

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