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Home country incentives and FDI in ASEAN countries

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I. Introduction

This paper deals with the effectiveness of incentives given to the investors by their home countries for undertaking direct investments in other countries. Incentives are naturally only one of the determinants of foreign direct investments (FDI). Others include firm specific competitive advantages such as propriety technology, patented trade marks, managerial or marketing know how, control on market entry etc., and locational advantages of host countries, e.g., lower wage costs, cheaper energy or raw materials, relatively high growth of domestic demand, preferential access for third country markets, political and economic stability, openness of the economy, availability of incentives for foreign investors, liberal exchange rate policies, etc. All these factors are integrated in the eclectic theory of international production (Agarwal, 1980) and home country incentives tend to determine FDI of the respective countries through improving the competitive position of their investors in the host countries.

The treatment of investment incentives in the literature usually includes fiscal, financial and some institutional measures available in the home countries. This analysis starts from a broader point of view of the definition of such incentives and includes also export promotion measures and economic aid as far as these are availed by the investors in connection with their production facilities abroad. Both of these measures tend to reduce costs of FDI in a similar way as fiscal or financial incentives provided by the home governments. Therefore, it is found appropriate to include them in this analysis.

It begins in Section II with a critical examination of various kinds of investment incentives granted by the selected home

This paper is a part of the research project on the competition among European, Japanese and American firms in ASEAN countries financially supported by the VW Foundation. Thanks are due to U. Hiemenz and R. Langhammer for useful comments on earlier drafts of this paper.
countries viz. Japan, West Germany, the UK and the USA. This is followed in Section III by a discussion of the effectiveness of the incentives in channelling FDI to the ASEAN countries. These countries have registered relatively very high rates of economic growth in the past two decades and Japanese investors have been able to penetrate ASEAN markets relatively more than investors from other competing developed countries (Table A2)\(^1\). An overview of the existing literature is also given in this section. In view of its relatively high importance in the context of this paper, economic aid has been analysed separately in Section IV. It should reveal if there is any functional relationship between FDI and economic aid and if ASEAN has been given differing priorities by the selected home countries in the disbursement of their aid. This would allow to draw some conclusions also on regional biases of these countries in the administration of their FDI-incentives. Finally, in Section V conclusions are drawn on the impact of investment incentives including economic aid on the flow of FDI from the selected home countries into ASEAN with a view to explain Japanese predominance in this region.

II. FDI-Incentives in the Home Countries

A detailed comparison (Appendix A) of the fiscal incentives shows that the German system is most liberal among the four home countries because in addition to allowing for crediting of taxes paid abroad against local tax liability it leaves the income saved on account of tax holidays and other such incentives in host countries untaxed even in those cases where no double taxation agreements exist to that effect with the respective host countries.

In the field of financial incentives Japan has a larger number of institutions granting assistance to investors going abroad

and these incentives are available to firms of every size whereas in other home countries such help is given primarily to smaller firms. Moreover, the UK and the USA as the traditional homes of multinational corporations appear to believe that firms willing to invest in other countries should be able to do it mainly on the basis of their own resources rather than making state subsidies to be the main support for their investment activities abroad (Appendix A).

It would be interesting to compare the relative importance of subsidised loans and capital in the FDI of the various home countries, but unfortunately the data for this purpose are not available. Japan is, however, an exception to some extent. It publishes data not on the basis of its actual FDI but according to projects reported to the government in preinvestment stage. Therefore, Japan has information how these projects are planned to be financed from different sources and these data are published. If it is assumed that all the loans granted to private foreign investors by Japanese government are subsidised, and this assumption seems to be quite realistic, then it can be said that financial incentives have facilitated the Japanese FDI considerably\(^1\). As shown in Table 1 the share of government loans in FDI of Japan amounted to 34 per cent in 1974. Since then it has, however, gone down to 11 per cent indicating the growing financial strength of Japanese firms and their increasing self confidence to establish production facilities in other countries on their own initiative and risk. This is supported also by the fact that Japanese investors have been financing their FDI more and more from their own resources. The share of FDI financed from internal liquidity of the investing firms in total FDI of Japan increased from 33 per cent in 1974 to 63 per cent in 1982. Now they depend less not only on government financing but also less on privately borrowed funds for financing their direct investments abroad.

\(^{1}\) The grant element in loans of OECF, which is the most important organisation in Japan for giving loans and equity capital to its foreign investors, amounted in 1981 to about 19 per cent (OECF, 1982; Ohlin, 1966; IMF, 1984).
Table 1 - Relative Importance of Various Sources for Financing of Japanese FDI, 1974, 1978 and 1982 (per cent)

<table>
<thead>
<tr>
<th>Branches</th>
<th>Agriculture, Forestry and Fishery</th>
<th>Mining</th>
<th>Manufacturing</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal liquidity</td>
<td>26.7</td>
<td>23.3</td>
<td>25.5</td>
<td>30.6</td>
<td>22.1</td>
</tr>
<tr>
<td>Government loans</td>
<td>32.7</td>
<td>31.4</td>
<td>47.9</td>
<td>29.1</td>
<td>55.4</td>
</tr>
<tr>
<td>Private loans</td>
<td>40.7</td>
<td>43.3</td>
<td>26.1</td>
<td>40.4</td>
<td>10.5</td>
</tr>
<tr>
<td>Others</td>
<td>0.0</td>
<td>2.0</td>
<td>0.5</td>
<td>0.0</td>
<td>12.0</td>
</tr>
</tbody>
</table>

Footnote: Figures may not add up to 100 because of rounding.

(Table 1). However, in agricultural and mining sectors, where investment risks are relatively high and in which the Japanese government is extraordinarily interested in promoting FDI, Japanese firms continue to take advantage of public funds for their direct investment activities in the other countries. In these two sectors government loans account for much higher shares in total FDI (agriculture 48 per cent and mining 39 per cent in 1982) than in manufacturing or all sectors taken together. A high share of private loans in trading sector is an indication of a strong involvement of Japanese Banks in FDI in this field. As far as FDI of Japanese trading houses are concerned, they act not only as borrowers but also as important lenders and equity holders in overseas investments (v. Kirchbach, 1985).

Among institutional incentives guarantees against political or non-commercial risk are most useful for foreign investors. In all the four countries these risks include (1) expropriation of property including nationalisation and confiscation without adequate compensation, (2) war including revolution, rebellion and civil war but not a general war involving major powers of the world and (3) currency inconvertibility resulting in impossibility or delaying of the repatriation of capital and earnings from the host countries.

Equity participation, loans to subsidiaries or firms in which the investors have equity participation and reinvested earnings up to varying extents are guaranteed by all the countries. Portfolio investments are insurable in Japan if they are made in the exploitation of mineral resources to be imported into Japan under long-term supply contracts, and in the UK if the investor has equity holding of not less than a given minimum (Appendix A). In the mineral sector, portfolio investments are guaranteeable in Japan even against commercial risks like bankruptcy.
In all the four countries guarantee is given only to new investments. These investments should help the economic development of the host countries. Some of them require that the investment projects should be useful also for the home economies.

More than half of the Japanese FDI in the Third World (53 per cent) was covered under investment guarantees in 1981. In the other three countries comparatively fewer investors have opted for getting their FDI in developing countries insured against non-commercial risks. In Germany the proportion of insured to total FDI in the Third World amounted in 1981 to 10 per cent and in the UK and the USA only to 2 and 7 per cent respectively (OECD, 1983b). Generally smaller investors care more to get their FDI insured against non-commercial risks than big multinational corporations. Since they have a higher share in the Japanese FDI (see Section III) they may also be responsible for the relatively higher coverage of Japanese investments by protection guarantees. Nevertheless, it is also possible that Japanese firms have been more aggressive in their FDI-activities in developing countries and the risks which have increased due to this aggressive policy have been taken care of by paying the costs of investment guarantees.

In addition to these guarantees, all developed countries have many organisations which provide informational and technical help to investors looking for investment opportunities in the Third World. This kind of institutional incentives are considered to be very useful for smaller investors with no or little experience in FDI. Most of the governments have established organisations which help right from the initial stage of finding suitable country of location until the execution of production and market-

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1 The Japanese figure is not quite comparable with the other three because the former include probably also the credits insured against selected commercial risks in the case of foreign companies in natural resources having supply agreements with Japan.
ing plans. In some countries these responsibilities are concentrated in a relatively few organisations (e.g., USA) and in others they are spread over a larger number of institutions (e.g., Germany). Japan is the only country where special agencies are found which promote FDI in ASEAN-countries. Whether regionally specialised agencies of Japan are more efficient in promoting FDI to Southeast Asia than global agencies of other countries cannot be said a priori. What they do however indicate is that Japan has devoted from the early stages of its FDI-activities more attention to this region than to others whereas the incentives policies and practices of other countries have been less selective in regional allocation of their FDI. This must have led at least partly to the said concentration of Japanese investments in ASEAN.

So far as export incentives are concerned, it may be mentioned that the relation between them and FDI is somewhat indirect but not less important than in the preceding cases. Export incentives in the developed countries usually consist of subsidised financing and insurance against political as well as commercial risks. They are given to promote exports of domestic

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1 See OECD (1983b) and BMZ (1982).

2 Three such agencies are: Japan ASEAN Investment Co., ASEAN Finance Corporation and ASEAN Japan Development Co. (Wagner et al., 1985). Establishment of additional three institutions has been announced only recently by the Japanese Ministry of International Trade and Industry. An industrial technology transfer centre to offer data and technology to ASEAN firms, an ASEAN investment promotion company which will probably be an expansion of the existing ASEAN Investment Company, and a new institute, tentatively named International Engineering University, to provide extensive training in Japan to local engineers from ASEAN countries are planned to be established for 90 billion yen to be contributed by the government and private companies. They should enable to counteract the declining share of ASEAN in Japanese FDI due to increased investments of Japanese firms in Europe and the USA (The Japan Economic Journal, 19 April 1986).
goods especially of machinery and equipment which often require longer periods of repayment. In so far as investors satisfy their needs for capital equipment and other inputs by importing from their home countries and finance these imports by borrowing there, they can avail themselves of export incentives and reduce their investment risks and costs. Sometimes it may not be very difficult to take advantage of export financing even in the case of those goods which are bought by the investor in his home country out of his own funds to be accounted as equity capital in his foreign firm. Many of developing countries impose restrictions on transfer of funds abroad and special permits have to be obtained by foreign investors there for repatriation of earnings and capital. Under such circumstances foreign investors would naturally prefer to bring their equity share in form of capital equipment and other importable inputs and satisfy their needs for working capital by borrowing in local currencies on domestic markets of their host developing countries. It is not known how much of their equity capitals and long-term loans are spent for imports from home countries by German, Japanese, British or American investors in ASEAN or in developing countries in general. Therefore, estimates of impact of export subsidies on their FDI in these countries are also not possible. A recent study of outward FDI of India, which uses such investments as an instrument of her export promotion strategy, showed that more than half of this investment was made in the form of exports of capital equipment and other inputs which were entitled for export subsidies (Agarwal, 1985). In India this is realised by means of legal obligations on persons seeking government permits for FDI. But in developed countries, whose currencies are freely convertible, there

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1 An example from the USA may illustrate this point further. Out of FDI amounting to US$ 1.9 billion made by the US corporations in 113 projects assisted by the OPIC in 1981 US$ 1.6 billion were in form of tied supplies of machinery and equipment from the USA. OPIC, Annual Report 1981 quoted in UNCTC, 1983. Further, according to a survey of Eximbank of Japan, 86 per cent of Japanese firms abroad import machinery and equipment from Japan and 58 per cent of their raw materials and intermediate goods come from the home country (Kojima, 1978, p. 100).
is no such legal restriction on investors going abroad. However, in view of the inconvertibility of currencies of most of their host developing countries and because of many other reasons such as existing experience of the investors in the use of production goods of their own countries, they may themselves be willing to maximise the ratio of imports of such goods in their capital contribution and to that extent be able to make use of export subsidies in their home countries.

As far as the costs of export credit and insurance facilities in different countries are concerned, the most important point to remember is that in 1978 an agreement called "Arrangement on Guidelines for Officially Supported Export Credits" was signed by the OECD-members (excluding Iceland and Turkey) in order to avoid undue competition among them in granting favourable terms to their exporters. This agreement sets minimum limits for interest rates and down-payments as well as maximum limits with regard to credit maturities and local-cost financing allowances, etc. Any country granting more favourable terms than stipulated in this agreement has to notify the terms and reasons for that to other members beforehand (OECD, 1982). As a result it can be expected that the costs of export financing in Japan, Germany, the UK and the USA would not differ significantly from each other.

However, the ratio of export credits insured against various kinds of risks and of those benefitting from preferential funding are substantially higher in Japan than in other countries considered here. In 1980 about 45 per cent of Japanese exports were covered by export credit insurance. In the case of capital goods which are relatively more important for FDI this ratio was higher. As far as preferential funding of export credits was concerned, most of the long-term export credits in 1981 benefitted from it in Japan. In Germany less than 1 per cent of total exports were financed on preferential interest rate in 1980. In the same year 12 per cent of the American exports benefitted from various export incentives of which more than half was in the form
of insurance and guarantees and the remaining as preferential credits (OECD, 1982).

To sum up, it may be said that due to lack of sufficient information it cannot be concluded that these incentives reduce the cost of exporting risk capital from Japan more than from other home countries. The structures of premiums for various kinds of risk insurance in the case of export of both capital and goods are very complicated in the home countries to allow for any generalisation on the relative costs of such insurance in these countries. What is quite clear is that Japanese firms have availed themselves of various incentives more than the investors from other three countries. Assuming that the average benefit conferred by the incentives schemes of the home countries is nearly the same or at least not significantly lower in Japan than in other countries, it can be safely said that Japanese firms establishing production facilities in developing countries have been subsidised through above incentives more than their counterparts from the other countries.

Notwithstanding the above conclusion, more important questions in the context of this paper are (1) whether incentives are able to influence the flow of FDI or are these incentives taken advantage of by the investors after the investment decisions have been made independent of the incentives and (2) why in the ASEAN-countries Japanese multinationals have invested proportionately more than the multinationals from Germany, the UK or the USA. In order to answer this question, it is not enough to have a positive answer to the first question, but it has to be further considered whether Japanese incentives were relatively higher for ASEAN-destinations (for which only one evidence was found that some institutions in Japan specialise in encouraging FDI exclusively towards ASEAN) or they were specially directed to FDI in this Area. Let us begin with the first question on the effectiveness of incentives.
III. Effectiveness of Incentives

The literature on the effectiveness of home country incentives on outflow of FDI is very thin. Generally these incentives are not found to be very effective. In their survey of eighty investment projects in the Third World undertaken by multinationals from eight developed countries including Japan, Germany, the UK and the USA Reuber et al. (1973) concluded that the impact of many of the home country incentives seems to be marginal at best, although they may be of some help to smaller and those firms who have relatively limited experience in the LDCs.

1 Most of the literature dealing with incentives is concentrated on those provided by host developing countries. The conclusion which can be drawn from it is that these incentives are usually accompanied with many preconditions (e.g., local equity participation, local content rules, locational restrictions, and fade-out agreements) and performance requirements (e.g., export quotas, employment of indigenous personnel and technology transfer) so that positive effects of the incentives may be cancelled by negative effects of these disincentives. Lim (1983) even found in a cross-country study of twenty-seven LDCs that inflows of FDI are negatively affected by fiscal incentives of the host countries. According to his interpretation investors may tend to think that the incentives are granted by the host governments to compensate for the absence of other factors such as natural resources and economic growth which are important for attracting foreign investors. A number of studies based on survey evidence found that incentives are not at all taken into consideration by firms at the initial stages of their foreign investment decisions. After these decisions have been taken, the incentives offered by the host countries may influence locational choices of the investors and thus the geographical distribution of total flow of FDI. In a very comprehensive survey of studies on incentives and their effects, the Committee on International Investment and Multinational Enterprises (CIME) of the OECD (1983a) concluded that besides locational choices, decisions concerning size and timing of investment may also be sensitive to incentives. All this does not, however, imply that the incentives offered by a country or a group of countries would attract FDI from one investing country more than from others provided the incentives are not regionally discriminatory for which there is no reason to assume in the case of ASEAN. See Barlow and Wender (1955), Ross and Christensen (1959), Robinson (1961), and Ahroni (1966). For more references particularly from the German literature see Jahrreiß (1984).
Recently CIME concluded that the economic circumstances after 1974 have tended to render enterprises in general and multinationals in particular more sensitive to costs and risk factors. Since incentives, among other things, directly affect these factors, their impact on investment decisions is believed to have increased, and if the competition among governments for international investments increases, the role of incentives in such competition would be strengthened (OECD, 1983a). This was concluded by the CIME in connection with the incentives policies of the OECD countries with regard to investments in their own economies. It seems, however, to be applicable also to their competition for cheaper investment locations in the Third World.

Thus, two points appear to be noteworthy for our purpose. Firstly, FDI by smaller firms is likely to be more responsive to incentives. But this does not mean that the investment decisions of these firms are determined differently than those of bigger multinational corporations. They all have at first to decide whether to invest at home or abroad, if abroad in a developed or developing country and then in what form as a subsidiary or joint venture or something else. Only when these and a host of other such questions have been answered leading to a final decision to go abroad, incentives granted by home and host countries come into picture (BIAC, 1981). Smaller firms have generally limited or no experience in FDI. They also lack enough means to procure reliable information about investment opportunities in other countries. Therefore their beforehand apprehensions of risks - commercial as well as non-commercial - involved in committing resources in production facilities in other countries, especially in the Third World which is the home of all kinds of political, economic and social instabilities, are likely to be higher than those of bigger multinational corporations, who are either already acquainted with investment conditions in developing countries or have their own resources to get the required information. Under these circumstances, incentives such as supply of necessary informations by specialised public agencies, financial
subsidies for feasibility studies and guarantees against political and other non-commercial risks could encourage smaller investors to give up their ultimate hesitations and invest abroad.\(^1\)

Secondly, some of the incentives (investment and export credits) tend to lower the costs of production for producers. Therefore, impact of these incentives must be more pronounced in those branches which are faced with a greater cost competition and in which a relatively larger amount of FDI has taken place primarily to take advantage of cheaper locations in LDCs. This is most likely to be the case where direct and indirect labour as well as environmental costs are relatively higher because they have increased rapidly in developed countries since the seventies. The acceleration of energy costs was also very strong and this could have encouraged investors to seek locations in oil-rich developing countries having also other locational advantages.

Since both of these points apply more to the Japanese than to the German, British or American FDI\(^2\) the incentives granted by Japan are likely to have been relatively more effective in promoting its FDI to developing countries. At least one out of every three Japanese firms engaged in FDI is of smaller or medium size (Table 2). Though comparative data for other countries are not readily available, there can be hardly any doubt that this is a very high share. FDI of traditional investing countries like the USA and the UK is dominated by larger corporations and even in the case of Germany, which began investing overseas more or less at the same time as Japan, the share of bigger companies appears to be higher (Berger, Uhlmann, 1985).

\(^1\) A survey of German firms having FDI in Brasil, Colombia, India, Indonesia, Mexico and Tunisia showed however that firms of medium and bigger sizes have tended to make a greater use of investment incentives than smaller firms. This may be because of a higher representation of the firms of the former category in the sample (Kayser et al., 1981).

Table 2 - Share of Small and Medium Size\(^1\) Firms in Japanese FDI According to Sectors, 1976/77

<table>
<thead>
<tr>
<th></th>
<th>Number of Firms</th>
<th>Share in Total (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry and Fishery</td>
<td>14</td>
<td>58.3</td>
</tr>
<tr>
<td>Mining</td>
<td>1</td>
<td>4.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>241</td>
<td>38.0</td>
</tr>
<tr>
<td>Trade</td>
<td>92</td>
<td>31.5</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>26</td>
<td>48.1</td>
</tr>
<tr>
<td><strong>All Sectors</strong></td>
<td><strong>374</strong></td>
<td><strong>36.5</strong></td>
</tr>
</tbody>
</table>

\(^1\) Firms with total capital of less than ¥ 100 million in agriculture, forestry, mining, manufacturing and miscellaneous, of less than ¥ 30 million in trade and of less than ¥ 10 million in retail sale and servicing.

In this connection it has to be remembered that a priori it cannot be said that smaller firms of Japan are more enterprising than their counterparts elsewhere. What presumably accounts for their substantial participation in foreign manufacturing is their very well functioning cooperation with the bigger manufacturing firms and financial conglomerates not only in domestic but also in foreign activities. It is commonly known that on the domestic market of Japan intermediary inputs to big manufacturing firms are supplied by a relatively large number of small and medium size firms. This kind of division of labour is carried along to foreign markets by Japanese investors (follow up hypothesis). This is further facilitated by the the host country requirements regarding minimum local contents (whereby the inputs manufactured by Japanese firms in the related host countries are considered as locally produced contents of the manufactures of the other Japanese firms) and by the facilities made available by the state (i.e. incentives) by way of information supply, pre-investment grants, investment and export credits, guarantees against political and non-commercial risks.

As far as the growing cost-consciousness, which may have raised the effectiveness of incentives, is concerned, Japanese firms in labour intensive industries such as textiles, clothing, electronics, etc., started as early as the sixties to establish production facilities in developing countries, especially in South Korea, Taiwan, Hongkong and other Southeast Asian countries, in order to overcome the rapidly rising unit costs of labour at home. No doubt, firms in these branches of other developed coun-

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1 This applies more in the case of small and medium size firms as they were harder hit by the rising costs of labour in Japan. The bigger firms were able to attract labour relatively easily because they could offer better working conditions (Marsh, 1983).
tries have also moved to the Third World. Some of the German firms, for example, have created production facilities in the neighbouring mediterranean countries even at the cost of existing capacities at home. But on the whole the share of labour intensive branches in Japanese FDI appears to be higher than in the German, British or the American FDI (Kojima, 1978) and to that extent investment incentives are likely to have been more effective in Japan. A similar corollary exists for FDI motivated by high environmental costs at home. Density of industrial plants in Japan is believed to be very high and it was one of the first, if not the first, industrial countries facing severe pollution problems resulting in costly anti-pollution regulations and thus forcing many industries to look for less regulated and thus less costly locations in the Third World.

In the field of natural resources Japan is more dependent on outside resources than any other industrialised country\(^1\). Consequently, it grants very generous incentives for FDI in this sector in order to get a safer access to input markets. The effectiveness of Japanese natural resource policies including the incentives for FDI is reflected in a comparatively high share of this sector in total FDI (Agarwal, 1979) and in undeterred economic growth of Japanese economy in spite the two oil crises in the seventies.

Thus, the Japanese incentives may have been more effective in promoting FDI than those of Germany, the UK and the USA. According to Ozawa (1979a) majority of Japanese firms are immature in size, technological sophistication and financial strength to undertake FDI on their own and have been able to do so as a result of financial and managerial support mobilised by the government as well as industry in favour of overseas production which

\(^1\) A very high share of Japan's need for coal (82%), oil (100%), natural gas (91%), iron ore (99%), lead (83%), zinc (69%), tin (98%), aluminium (100%), nickel (100%) and wood and lumber (68%), has to be met from imports (Marsh, 1983).
has emerged as an integral part of the strategy of economic growth and foreign economic diplomacy of Japan. Nevertheless, the discussion so far does not show why Japan commands a higher share of total FDI in the ASEAN countries which is the main point of discussion in this paper. Incentives in Japan, as anywhere else too, are available for FDI in all developing countries and not exclusively for ASEAN-countries. Therefore, it has to be examined whether these countries enjoy a privileged position in the implementation of incentive policies in Japan. However, this cannot be discovered from the Japanese incentive schemes, and empirical data on the regional distribution of financial subsidies, etc., which would enable to discover a regional bias, are not available. What we have, are statistics on regional distribution of Japanese economic aid. Aid can be - as shown in the following section - an important stimulator of FDI. In addition to that, its regional distribution may also reflect the geographical bias of a donor country in granting investment incentives because, firstly, the decision making authorities in both the cases may often be same and, secondly, some of the costs of investments incentives are included in economic aid. Therefore, the analysis of economic aid in the following section should enable not only to discover the relation between aid and FDI of donor countries but also to find out whether any particular region, viz. ASEAN, enjoys a privileged position in the implementation of incentives schemes by the home countries.

IV. Economic Aid and FDI

The hypothesis tested here envisages that economic aid stimulates FDI of the donor country into the aid receiving country. There are several factors which indicate a positive and not a negative relation between these two variables (Dudley and Montmarquette, 1976). Firstly, some of the constituents of bilateral aid (viz., grants for pre-investment studies, financing of some of the infra-structure required by the firms of donor countries in their host nations, subsidies involved in fiscal and financial
incentives and some of the institutional costs for promoting FDI in developing countries) are directly associated with FDI of donor countries. Secondly, bilateral aid is executed partly by private firms of donor countries and the economic relations emerging out of it between these firms and aid receiving countries may lead to FDI of these firms in such countries. Finally, grant of bilateral aid is mostly an indicator of good political relations between donor and recipient countries, which are necessary also for a smooth flow of private investments from the former into the latter. Aid has proved, besides other factors, an important determinant of FDI in some of the studies based on the data of recipient countries. Reuber (1973) came, for example, to the conclusion that there was a strong positive correlation between FDI and aid received by the countries included in his cross-sectional analysis. A very comprehensive treatment is given to this question is a recent study by Schneider and Frey (1985). Bilateral official aid of the Western countries is found by them to have a strong stimulating effect on FDI in host developing countries.

In order to test the above hypothesis FDI of the donor countries were simultaneously regressed on their net official bilateral aid to the host developing countries and on per capita income as well as population of these countries (Table 3). The focus of attention is on the relation between FDI and aid. But since the former are usually determined also by conditions prevailing in host countries, the latter two variables are included in the equation. They represent the demand side in the host countries and are expected to have a positive relation to FDI.

Except in the case of Japan, the aid hypothesis is rejected by the regression estimates (Table 3). For Japan the aid coefficient is positive and highly significant whereas for other three donor countries it is insignificant. Japan is famous for having used its aid for encouraging FDI (Marsh, 1983), especially in big projects in the field of natural resources such as Asahan project.
in Indonesia. The methods applied in this case have come to be known as Asahan formula according to which one or more of Japanese firms at first look for an investment opportunity in a country whose natural resources (Indonesia, Brazil) or location (Singapore) are of a great importance for them and Japan. The conceived project is usually very large so that its importance for the economy of the host country is quite obvious. Then the host government is approached to give it a national character, and request the Japanese government to give aid for financing the project. Meanwhile, the initiating Japanese firms try to seek cooperation of other firms in Japan for forming a big consortium representing various kinds of interests who may be able to make a noticeable impact on the Japanese government. If the Japanese aid is not forthcoming, the host government approaches some other country or countries for aid, and the Japanese firms then finally succeed in pressurising their government to support the project and not to let it go to other countries.

1 Initially this project was conceived as a private venture. It consisted of a large dam on Asahan river, a hydroelectric power station, an aluminium refinery and the related infrastructure encompassing port and land transport facilities. Later, the Indonesian government recognised its importance for its national economy and the Japanese government enlisted its financial support from bilateral aid funds. Ultimately the consortium of founding companies was converted into Nippon Asahan Aluminium Co. in which the Japanese OECF became a major partner holding half of the share capital. The 90 per cent share of Japan in the refinery was later to be diluted to 75 per cent in favour of the host country. Similarly the hydroelectric power station owned fully by Japan in the beginning was to be turned over completely to Indonesian government after thirty years of operation (Ozawa, 1980). This so-called Asahan formula has been used by Japanese investors also in other resource oriented projects (e.g., Amazon Project in Brazil and petrochemical venture in Singapore).

2 This is not to deny that other countries have also used their economic aid to support their private investments in the Third World. But the weight of such cases in German, British or American aid is not likely to be as heavy as in the Japanese aid.
Table 3 - Regression Equations (Least Squares Estimates) for Japan, West Germany, UK and USA

<table>
<thead>
<tr>
<th>Year</th>
<th>Equation</th>
<th>R²</th>
<th>DW</th>
<th>N</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982 (Japan)</td>
<td>[ FDI_{1982} = -280 + 1.55 X_1^* + 0.35 X_2^{**} - 0.77 X_3 ]</td>
<td>0.48</td>
<td>2.26</td>
<td>33</td>
<td>(F = 10.9)</td>
</tr>
<tr>
<td>1984 (Germany)</td>
<td>[ FDI_{1984} = 150 + 0.004 X_1 + 0.05 X_2 + 1.82 X_3 ]</td>
<td>0.02</td>
<td>1.88</td>
<td>65</td>
<td>(F = 1.34)</td>
</tr>
<tr>
<td>1983 (USA)</td>
<td>[ FDI_{1983} = 922 - 0.073 X_1 + 0.19 X_2 + 2.38 X_3 ]</td>
<td>0.005</td>
<td>1.48</td>
<td>32</td>
<td>(F = 0.44)</td>
</tr>
<tr>
<td>1981 (UK)</td>
<td>[ FDI_{1981} = 143 - 0.08 X_1 + 0.04 X_2 + 1.20 X_3 ]</td>
<td>0.02</td>
<td>2.39</td>
<td>35</td>
<td>(F = 1.30)</td>
</tr>
</tbody>
</table>

FDI = Foreign direct investment on cumulative basis
X₁ = ODA = Total net official bilateral development assistance on cumulative basis. For Japan data were cumulated from 1960 to 1983 (fiscal year 1982-83) and for the UK from 1960 to 1981. For both of them figures for 1968 are not included due to their unavailability. For West Germany data refer to 1950 to 1984 and for the USA from 1946 to 1983.
X₂ = Gross domestic product per head in 1982.
X₃ = Population in respective years.

Only those developing countries are included in the estimates which have total FDI and ODA of not less than US$ 10 Mill. in the case of Japan and the UK, DM 10 Mill. in West Germany and US$ 100 Mill. in the case of the USA.

One star denotes statistical significance at 1 per cent level and two stars at two per cent level; two-tailed test. The figures in brackets are t-values.

The analysis of the regional distribution of aid of the four donor countries, shows that ASEAN enjoys a very high regional priority in Japanese economic aid. In any case, it is far higher than the priority given to it by the other three donor countries. It receives about one third of total Japanese bilateral aid compared with its very low shares of about five per cent in the German, British and American aids (Table 4). Surprisingly, ASEAN has received nearly as much aid in terms of shares as FDI of Japan. As compared to this, Germany has given more aid to ASEAN than FDI there and the UK as well as the USA have invested in ASEAN more than what they have contributed to this region as bilateral economic aid. Within this region, Japanese aid and FDI are both concentrated in Indonesia. Germany has invested relatively more in Singapore than in other countries of this region but granted relatively more bilateral aid to Indonesia. The British FDI is concentrated in the Commonwealth member countries of Malaysia and Singapore, but the aid appears to be more equally distributed among all the countries.

On the basis of the assumption made earlier that governments in home countries are likely to follow similar regional preferences in granting investment incentives as in giving economic aid and the conclusion arrived on the relation between aid and investment, it may now be concluded that Japan has successfully promoted more of its FDI to ASEAN than the other countries.

Further it seems to be relevant to mention that FDI of every country shows some or the other regional concentration. The British investments in the Third World are mostly in Commonwealth countries, just like that of France in its former and existing colonies or overseas departments. The German and American FDI outside the developed world is concentrated in Latin America (Hiemenz, 1984). Many economic, geographical and political factors in home as well as host countries tend to determine in a complex way the regional distribution of overseas investments, and aid of home countries is only one of them. Decisions regard-
Table 4 - Shares of ASEAN-Countries in Total Gross Official Development Assistance (ODA) and Total FDI of Germany, Japan, UK and USA in LDCs in 1975 and 1980, per cent

<table>
<thead>
<tr>
<th>Country</th>
<th>Germany</th>
<th>Japan</th>
<th>United Kingdom</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>3.77</td>
<td>2.45</td>
<td>0.64</td>
<td>0.65</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.32</td>
<td>0.25</td>
<td>0.12</td>
<td>0.37</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.61</td>
<td>0.39</td>
<td>0.11</td>
<td>0.25</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.07</td>
<td>0.13</td>
<td>0.84</td>
<td>1.92</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.70</td>
<td>1.76</td>
<td>0.21</td>
<td>0.27</td>
</tr>
<tr>
<td>ASEAN-Total</td>
<td>5.47</td>
<td>5.00</td>
<td>2.12</td>
<td>3.47</td>
</tr>
</tbody>
</table>

Data on FDI of UK do not include investments in oil sector and are for 1974 and 1981 and of USA are for 1977 and 1980.

ing FDI are taken by private firms and those on aid by governments. Therefore they may not often match each other. However, greater the coordination between private and public decisions related with foreign activities, stronger would be the influence of aid of a country on the regional direction of its FDI. Japan is commonly known for its relatively strong and effective cooperation between government and industry in the field of foreign trade as well as investment (Roemer, 1975). Such cooperation is likely to increase also in other countries due to the emphasis on intergovernmental economic cooperation between developing and developed countries in order to help the industrialisation efforts of the former and due to the anxiety in the latter to reduce the balance-of-payments costs of aid as well as to raise its employment effect in their domestic economies. The British government is, for example, planning to double its financial support by 1988-89 for private business given under the Aid and Trade Provision (AIP) which is going to be supplemented by a new soft loan facility (The Financial Times, 16 January, 1986).

V. Conclusion

The central point of this paper has been the relatively very high share of Japan in FDI in ASEAN countries and the contribution of its investment incentives to this success. These incentives are defined for this purpose rather broadly and include besides fiscal, financial and institutional measures export subsidies and economic aid as far as they can be used by the investors for their foreign investment activities.

The comparison of these incentives of Japan, Germany, the UK and the USA showed that they all grant the same kinds of incentives to their investors and any quantitative differences among them cannot be determined, firstly, due to complex nature of fees or prices charged by these countries for the incentives and, secondly, for lack of data required for this purpose. What is quite conspicuous is that Japan has some institutions specialis-
ing in economic relations only with ASEAN countries and is planning to establish a few more such organisations to promote its FDI there, whereas the other investing countries rely more on their multiregional agencies.

Barring this last point, incentives of the home countries are on principle available for all overseas investments irrespective of their destinations so that from this point of view it is impossible to explain why Japan's FDI and not of Germany, UK and USA have gone more to ASEAN. In practice it is found that, firstly, investments of small and medium size firms are more amenable to incentives than those of big multinational corporations because the former do not have their own resources to collect reliable information about investment opportunities abroad and depend on logistic services of private as well as public institutions. Secondly, FDI of industries facing cost competition can be influenced by incentives more than that of industries characterised by monopolistic advantages which are often a result of high R&D expenditure, product differentiation and ownership concentration. Incentives tend to reduce risks and/or costs and both of these play a relatively greater role in investment decisions of smaller firms and in those industries where FDI is undertaken to avoid pressure on cost of production at home. This was the case during the seventies specially with labour intensive and environment pollutive industries. Both smaller firms and labour as well as pollution intensive industries appear to be more represented in Japanese FDI than in FDI of Germany, the UK or the USA. Therefore, the conclusion can be drawn that Japanese investors are likely to have taken a greater advantage of incentives than those from the other countries and this is taken as an evidence of a higher effectiveness of incentives in Japan. This is also confirmed by the data on ratio of insured or guaranteed investments in total FDI and those on preferential funding of long-term export credits, although enough figures for all the four investing countries were not always available for comparison. Thirdly, the analysis of FDI and aid showed that the latter has a statistically significant positive effect on geographical
distribution of FDI in the case of Japan and not in the other three countries. This is not surprising in view of the fact that resource oriented Japanese FDI has been supported strongly through government participation and aid in order to secure stable supplies of raw materials, and such investments are heavily represented in Japan's FDI in ASEAN, particularly in Indonesia, which is very rich in resources. Japan is planning to increase further the role of its aid in investment promotion to this region with a view to combat the declining share of ASEAN in its total FDI which has occurred lately due to rising investments of Japanese firms in Europe and the USA (The Japanese Economic Journal, 19 April, 1986).

The comparison of ASEAN's shares in aid of the donor countries confirmed that it is given by Japan a much higher priority than by any other of them. Since incentives and aid administering authorities are not quite independent of each other it is quite likely that ASEAN countries have received a preferential treatment in Japan in the grant of investment incentives also, and in so far as they may have been more effective in promoting FDI of Japan than is generally the case this preferential treatment could be one of the reasons for the higher Japanese share in total FDI in ASEAN as compared to FDI of Germany, the UK or the USA.

Finally, the question arises why Southeast Asian countries enjoy such a high priority in foreign economic policy of Japan. Certainly, Japanese government and businessmen were smart enough to perceive and use quickly the opportunities arising in this region due to its fast economic growth. But the lead which they could have gained through that cannot explain their continued domination of the market in this area. After all there were other countries specially in Latin America which were registering high growth rates during the seventies and Japan was not able to exploit them through exports or FDI except in Brazil and, on the other hand, economic growth of Southeast Asian countries has continued too long to be left unnoticed by the European or Ame-
rican businessmen and governments. The reason for western "negli-
gence" of Southeast Asian market is therefore to be found in
limited supply of private capital, government aid funds and mana-
gerial manpower in the home countries and in their alternative
investment opportunities. Each one of these four countries has
attempted to utilise its resources intensively in selected region
or regions to realise economies of scale. The German and American
FDI is thus concentrated in Latin America, the British and French
in their former colonies, and the Japanese FDI primarily in
Southeast Asian countries. All the locational choices have ex-
post not proved as successful as that of Japan. But these loca-
tional choices were not always made according to economic effi-
ciency criteria. They were instead determined also by historical
accidents whose consequences in terms of political ties are hard
to get rid of. Japan had to make reparation payments to Southeast
Asian countries occupied by it during the second World War and it
tried to make the best out it by directing these resources
through its industries which led to trade and investment of Japa-
nese firms in this region during the fifties and early sixties.\(^1\)
It is these early business relations which later proved helpful
in achieving a Japanese domination of the markets in this region.

However, there is already some shift of allocation of re-
sources of the Western countries towards Southeast Asia, which
has been caused by both long term growth prospects in this region
and worsening economic conditions in debt-ridden Latin American
economies. This is reflected in the rise of the shares of the EC
and the USA in total FDI in ASEAN. In order to raise these
shares further, it is tempting to draw a policy conclusion that
the role of economic aid in promoting FDI should be strengthened

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\(^1\) One of the first joint ventures in this connection was estab-
lished in the Philippines in December 1953 as Toledo Copper
Mine Company in partnership of six Japanese firms with the
Atlas consolidated Mining Development Company of Manila (Merz,
1982).
in these donor countries to match the Japanese efforts and success in this region. However, it should not be forgotten that economic aid is or at least ought to be given more to poorer countries whereas FDI tends to flow into better off countries having greater purchasing power. Therefore, attempts to promote FDI should be directed especially at improving the access of smaller and medium size firms to comprehensive and reliable information about investment opportunities in ASEAN and to capital markets in the home countries where they are likely to search at first for funds for financing their investment requirements abroad. Borrowing capability of firms for investments in a particular region depends also on creditworthiness of this region on the respective capital markets. Southeast Asian countries did not enjoy a high rating vis-à-vis the Latin American nations on the Western capital markets in the seventies. So it is not surprising that the former received a relatively smaller share of FDI of the Western firms. The standing of this region has, however, improved in the eighties. The main contribution for further improvement in this field has naturally to come from the Southeast Asian countries themselves. So far as the Western investing countries are concerned, they should liberalise their capital markets to enable also their small and medium size firms to secure funds at reasonable terms for their investments.
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Appendix A. Comparison of Investment and Export Incentives of Japan, UK, USA and West Germany

1. Fiscal Incentives

Taxes on income from FDI in home countries may act as an incentive or disincentive depending on the fact whether they are lower than those on domestic income of investors. In order to avoid any disincentive Japanese taxation laws give equal treatment to domestic and foreign income by crediting the taxes paid in host countries against the domestic tax liability. This is achieved by entering into double taxation agreements with host developing countries. The number of such agreements is smaller in Japan than in the other countries (Table A1) but it includes all the five ASEAN-members. Another fiscal incentive to FDI in developing countries is given by Japan through tax deferment scheme.

Germany has double taxation agreements with a larger number of developing countries (30) including ASEAN-members (except the Philippines) and allows for crediting of tax paid abroad against the local tax liability. Even in those cases where such an agreement does not exist investors can seek this relief under the German Foreign Taxation Act applicable to income on all FDI independent of the status of the host country. A distinguishing feature of German double taxation agreements is that they follow the principle of taxation in the source country with the result that tax holidays or exemptions granted by the host developing countries are not lost when the foreign income is transferred to Germany. In such cases tax credits equivalent to these incentives are allowed by German authorities on a fictitious basis. Further,  

1 Brunei as the sixth member of ASEAN has not been considered in this paper because of the absence of related data.
<table>
<thead>
<tr>
<th>A Fiscal incentives</th>
<th>Financial incentives</th>
<th>Institutional incentives</th>
<th>Export incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Double taxation agreements with 29 developing countries</td>
<td>1. Financial support is granted for pre-investment studies</td>
<td>1. Investment guarantee scheme</td>
<td>1. Export credit insurance through a government agency (EID of MITI)</td>
</tr>
<tr>
<td>2. A tax deferment scheme (Developing Country Tax Law) was applicable to FDI in LDCs up to 1981.</td>
<td>1. Financial participation in pre-investment costs of projects such as reconnaissance survey, feasibility studies and manpower training.</td>
<td>2. Bilateral investment protection agreements with host developing countries.</td>
<td>2. Export credits at preferential rates by EXIM of Japan.</td>
</tr>
<tr>
<td>3. Participation in equity capital through government agency (OECD).</td>
<td>1. Long-term loans to small and medium size firms (2.5 per cent for FDI in LLDCs and 3.5 per cent for FDI in LDCs) up to a maximum sum of DM 2.5 mill.</td>
<td>3. Loans in the form of convertible and profit participation notes but no direct equity participation by US government agency (OPIC).</td>
<td>3. Exchange risk insurance by EID.</td>
</tr>
<tr>
<td>1. Export credit insurance by a government agency (ECGD).</td>
<td>1. Subsidisation of pre-investment costs, e.g., feasibility studies.</td>
<td>1. Investment guarantee scheme.</td>
<td>1. Export credit insurance by Foreign Credit Insurance Association of about 50 insurance companies and by EXIM of USA.</td>
</tr>
<tr>
<td>1. Double taxation agreement with 78 countries</td>
<td>1. Economic aid is given to the British foreign investors in LDCs for infrastructure needed for their investment projects.</td>
<td>2. Bilateral investment protection agreements with host developing countries.</td>
<td>1. Export credit insurance through a government agency (ECID)</td>
</tr>
<tr>
<td>1. Tax crediting without any double taxation agreement on income transferred to the USA from the host country</td>
<td>1. &quot;Direct Investment Fund&quot; loans are granted to small US investors who are not able to raise private funds at appropriate terms.</td>
<td>2. Bilateral investment protection agreements with host developing countries.</td>
<td>1. Export credit insurance through a government agency (EID of MITI).</td>
</tr>
<tr>
<td>1. Double taxation agreement with 13 developing countries</td>
<td>1. Tax deferment on FDI in developing countries.</td>
<td>2. Subsidies for pre-investment costs such as feasibility studies and training of personnel for developing countries.</td>
<td>1. Export credit insurance through a government agency (EID of MITI).</td>
</tr>
<tr>
<td>1. Several government or semi-government institutions (Eximbank, OECD, JICA, JODC, Japan Petroleum Development Corporation, Metal Mining Agency of Japan, etc.) grant long-term soft loans for FDI in LDCs.</td>
<td>1. Double taxation agreement with 78 countries</td>
<td>2. Subsidies for pre-investment costs such as feasibility studies and training of personnel for developing countries.</td>
<td>1. Export credit insurance through a government agency (EID).</td>
</tr>
<tr>
<td>1. Export credit insurance by a government agency (ECGD).</td>
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<td>2. Financial participation in pre-investment costs of projects such as reconnaissance survey, feasibility studies and manpower training.</td>
<td>2. Official export credit financing by EXIM and the Private Export Funding Corporation (PEFCO).</td>
</tr>
<tr>
<td>1. &quot;Direct Investment Fund&quot; loans are granted to small US investors who are not able to raise private funds at appropriate terms.</td>
<td>1. Economic aid is given to the British foreign investors in LDCs for infrastructure needed for their investment projects.</td>
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</tr>
<tr>
<td>1. Several government or semi-government institutions (Eximbank, OECD, JICA, JODC, Japan Petroleum Development Corporation, Metal Mining Agency of Japan, etc.) grant long-term soft loans for FDI in LDCs.</td>
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<td>2. Subsidies for pre-investment costs such as feasibility studies and training of personnel for developing countries.</td>
<td>3. Exchange risk insurance by EID.</td>
</tr>
</tbody>
</table>

according to the special law of 1969 "Tax Measures for Foreign Investment of German Industry" investors can create profit reducing reserves or deduct losses on FDI from their domestic profits. This applies to FDI in developed as well as developing countries. The law allowing for tax deferment on FDI in developing countries (Entwicklungsländer-Steuergesetz) is applicable only to investments made upto the end of 1981.

The largest number of double taxation agreements (78) are held by the United Kingdom. However, in those cases where such agreements do not exist, investors can seek unilateral relief equivalent to taxes paid in the host countries. But if no tax has been paid in the host country on account of any tax holiday granted by it as a measure of investment promotion, a unilateral tax relief cannot be claimed under the British laws in the absence of double taxation agreement. Only under these agreements which include so-called "matching credit" provisions the home country is prevented from cashing the taxes foregone by developing countries under their investment promotion schemes.

The US taxation laws allow for crediting taxes paid in host countries against the tax liability in the USA. In other words, foreign taxes are treated as if they were paid in the USA. Liability for tax arises in the USA only on dividends repatriated to the American parent firms. American taxation laws do not distinguish between developing and developed countries for this purpose and there is no 'matching credit' for foreign tax incentives. Thus the American taxation system cannot be supposed to have an encouraging effect on outward FDI including those in developing countries.

2. Financial Incentives

As compared to investors from other countries, Japanese firms have access to a larger number of public and semi-public
institutions for financial support for their direct investments in other countries, specially in those of the Third World. However, most of these institutions have been established for other purposes and support for FDI is a subsidiary function for them.

Long-term loans are extended to Japanese direct investors in developing countries on soft terms by the Overseas Economic Cooperation Fund (OECF) which participates also in equity investments in developing countries. It also grants funds for preinvestment feasibility studies. Export-Import Bank of Japan (Exim) grants long-term loans for FDI in developed as well as in developing countries. The latter account for about half of the annual overseas investment credit given by the Exim and generally exceeds the flow of resources through OECF. If a Japanese firm fails to get financial support from any of these two agencies, it can seek funds from the Japanese Investment Cooperation Agency (JICA). It provides finance for investments in agriculture, forestry, mining and manufacturing. Support for the development of infrastructure related with the Japanese investment projects in the host countries is also given by it. For FDI in petroleum and other raw materials funds are granted also by the Japan Petroleum Development Cooperation and the Metal Mining Agency of Japan. Japan Overseas Development Corporation (JODC) grants finances to its national firms for establishing joint ventures with local partners in developing countries.

The German firms of small and medium size can get loans from the state agency Kreditanstalt für Wiederaufbau (KfW) on very low interest rates for FDI in developing countries. Such loans are, however, given up to a limited amount for a maximum period of 15 years and carry an annual interest rate of 2.5 per cent in the case of least developed countries (LLDCs) and 3.5 per cent for

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In terms of financial performance, OECF is the most important aid giving organisation in Japan. Three fifths of the Japanese official bilateral aid (1976-81) are disbursed by it. Share of loans to and equity investments in Japanese corporations amounted to 6.4 per cent of its total outstanding claims against the developing countries in 1981 (OECF, 1982).
other developing countries. The total amount of loans granted since 1979 is likely to be less than DM 200 mill. (Commerzbank, 1984). Earlier such loans were given from the funds accumulated under ERP-programm. Much more important for German firms are the financial and other supports given by the German financing agency for capital participation in developing countries (Deutsche Finanzierungsgesellschaft für Beteiligungen in Entwicklungsländern - DEG). It participates in equity capital of joint ventures established by German firms in developing countries and grants loans with equity features. At the end of 1984 it had equity participation in 219 projects in 65 developing countries involving DM 1069 mill. (DEG, 1985). Financial subsidies are given by the German agency for technical cooperation (GTZ) to national companies for education and training of personnel for employment in their plants in host developing countries. Finally, the German Ministry for Economic Cooperation (BMZ) provides its domestic firms with very low cost credits (1 per cent p.a. in the first five years and 2.5 per cent in the remaining ten years of the whole lifetime of loans) for direct investments using technologies adjusted to the needs of their host developing countries. Such loans are available only to small and medium size German firms and have the advantage that they are treated as equity capital in those cases where investment proves to be unprofitable (BMZ, 1982).

The counterpart of the German DEG in the UK is the Commonwealth Development Corporation (CDC), which not only participates in equity capital and grants loans to British foreign direct investors but also initiates projects wholly owned and managed by it. This is not done by similar corporations in the other three developed countries considered here. CDC has layed relatively more emphasis on investments in renewable natural resources. About half of its financial commitments are in this sector. Manufacturing sector accounts for about only one tenth of its all financial commitments (OECD, 1983b). Financial support for pre-investment studies is granted to British investors in developing countries by the Overseas Development Administration.
The most important institution in the USA for helping the private investors in undertaking direct investments in developing countries is the Overseas Private Investment Corporation (OPIC). It fulfills many other functions (e.g., management, insurance and guarantee) than giving financial support only. But unlike in other countries, it does not participate in equity capital of firms established by Americans in developing countries. But it does grant loans in the form of convertible and profit participation notes which support the equity capital of the firms in developing countries. OPIC participates financially in identification, assessment, survey and promotion of private investments in developing countries. Another organisation helping the private investor is the Bureau for Private Enterprise under the auspices of Agency for International Development (AID). However, it does not grant financial support to American investors directly but through various kinds of help to the developing countries in creating and fostering suitable conditions for business participation from the US. This is typical of many other AID activities amounting to financial assistance to local institutions in developing countries (OECD, 1983b).

3. Institutional Incentives

Most important among the institutional incentives given by the four investing countries are guarantees to FDI in developing countries against non-commercial risks. The USA have the longest experience in this field. The first American step was taken in this direction as early as 1948 by introducing an insurance against the risk of currency inconvertibility. The German scheme to protect the investors against political risks was introduced in 1960. Japan and the UK adopted similar schemes in 1970 and 1972 respectively. These schemes have been improved and extended subsequently to provide better risk coverage to investors, especially in the USA and Japan. Now these investment guarantee systems can be said to be in a mature stage and do not differ from each other very much.
Both equity participation and loans to subsidiaries or firms in which the investors have equity participation can be guaranteed. Japan extends the guarantee also to portfolio investments in companies engaged in the exploitation of mineral resources to be imported in Japan under long-term supply contracts. In such a case even non-political risks (bankruptcy) are covered under Japanese guarantee scheme. Portfolio investment can be insured also in the UK if the investor has an equity holding of not less than 10 per cent and £ 50 000. Retained earnings up to 180 per cent of the original investment are insurable in the USA and up to 200 per cent of the initial investment in the UK. In Germany reinvested earnings can be insured against political risks only up to 100 per cent of the original investment and earnings which are to be remitted but not transferred up to 8 per cent per annum of the investment for a maximum period of three years. In the petroleum sector Germany allows service contracts and production sharing agreements to be insured against political risks in host countries up to 70 per cent of the capital invested in exploration and development costs.

Risk coverage differs somewhat among the four countries. The principal is covered in Japan up to 100 per cent and in Germany up to 95 per cent. In the USA coverage is offered up to 100 per cent to institutional lenders and up to 90 per cent to other investors. The Guarantee is available for a maximum period of 20 years in Germany and the USA and for 15 years in Japan and the UK.

Also the fee payable for investment guarantees varies from country to country. It is lowest in Germany where in addition to an application fee (maximum DM 20 000) the investor has to pay 0.5 per cent of the guaranteed amount annually. In Japan the annual premium is 0.55 per cent of the guaranteed sum, but in the case of credit risks in portfolio investments in firms engaged in mineral resources it is as high as 1.3 per cent. In the UK it amounts to 1 per cent per annum of the amount currently insured.
plus a commitment fee of 0.25 per cent on any additional amount (e.g., earnings) to be insured in future. In the USA fees vary according to the risks covered. It is 0.3 per cent for transfer risks and 0.6 per cent for expropriation and war risks.

The investment guarantee schemes are hedged in these countries by signing investment protection agreements with the host countries. Sometimes these agreements are also called investment promotion agreements. Their main purpose is to seek a fair and prompt compensation in the case of nationalisation and to avoid discriminatory treatment vis-à-vis domestic as well as foreign investors from other countries (national/MFN treatment). These agreements usually contain provisions about free transferability of capital and returns as well as use of international arbitration procedures for settlement of legal disputes between host governments and foreign investors in the case of expropriation etc. These agreements are found by investors as useful contribution to good investment climate in host developing countries.

4. Export Incentives

Export credit financing in Japan is provided by Eximbank of Japan at preferential rates. Insurance of export credits against political and commercial risk is given by Export Insurance Division (EID) of the MITI. In Germany, most of the long-term export credit comes from the usual banking system. However, a private syndicate of more than 50 commercial banks AKA-Ausfuhrkredit GmbH and KfW provide subsidised export financing mainly for developing countries. Hermes and Treuarbeit provide insurance facilities against political and commercial risks to export credits. In Germany private companies also give insurance cover but only against commercial risks in trade with developed countries. Export credits in the UK are given by individual banks who are then granted interest rate subsidies by the British government to compensate for the difference between the interest rate charged
on export credits and the normal bank lending rate. This is managed by Export Credits Guarantee Department (ECGD) which is responsible also for insurance of export credits against political and commercial risks. Both of these functions are performed in the USA mainly by the Export-Import Bank as an independent government agency. In addition, there are two private organisations viz., Foreign Credit Insurance Association (FCIA) and Private Export Funding Corporation (PEFCO). FCIA was formed by private insurance companies and PEFCO by private banks, etc. The activities of these agencies in their respective fields are coordinated by the American Eximbank.

In addition to preferential export financing and export credit insurance, Japan and Germany provide facilities to their exporters to insure themselves against risks arising from exchange rate changes over periods which are not covered on forward exchange markets. Both of these countries and the UK have facilities for granting insurance against unfair calling of bid, advance payments or performance bonds. Such bonds are issued usually in construction, engineering and consultation contracts. In the UK, a cost escalation insurance is also available in the case of capital goods contracts having a manufacturing period of two years or more in order to protect the exporters against high inflation rates (usually over 7 per cent per annum). None of these kinds of insurance facilities are available to the American exporters.

Both coverage of risks and costs of insurance vary among the countries. In Japan premiums lie between 0.1 and 3.0 per cent per annum depending on the number of risks covered and creditworthiness of the buying country. Similarly risks can be covered from 80 to 95 per cent of the value insured. In the case of foreign exchange risk insurance it is limited to 20 per cent (OECD, 1982). In Germany a flat premium of 1.5 per cent is charged on guarantees on sales to private buyers in addition to a monthly charge of 0.1 per cent of the outstanding amount insured. For
guarantee on sales to public sector buyers the flat rate varies between 0.5 and 1 per cent and the monthly rate between 0.4 and 0.5 per thousand depending on the size of the contract. The premium for exchange risk insurance is charged at a rate of 0.6 per cent per annum for combined insurance and 0.7 per cent per annum for exclusive insurance. The risk coverage varies between 85 and 95 per cent of the insured value. Only in the case of exchange risk insurance it may go to 100 per cent of the amount covered if this insurance is combined with export credit guarantee. Otherwise, the liability of insurers in respect of exchange risk is limited to 50 per cent of the amount insured. In the United States the premiums vary depending on the agency issuing the insurance policy, life of the insurance and creditworthiness of the buyer. In the case of Eximbank the guarantee fee amounts to 0.5 per cent per annum on the outstanding amount of the loans plus a commitment fee of 0.125 per cent per annum on undisbursed balances. Eximbank assumes 90 per cent of all commercial and 100 per cent of political risks (OECD, 1982).
Table A2 - FDI of EC, Japan and USA in ASEAN, 1978 and 1982

<table>
<thead>
<tr>
<th>Country</th>
<th>1978 EC</th>
<th>1978 Japan</th>
<th>1978 USA</th>
<th>1978 Others (US$ Mill.)</th>
<th>1978 Total</th>
<th>1982 EC (shares in total, per cent)</th>
<th>1982 Japan (shares in total, per cent)</th>
<th>1982 USA (shares in total, per cent)</th>
<th>1982 Others (shares in total, per cent)</th>
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</thead>
<tbody>
<tr>
<td>Indonesia¹</td>
<td>1978</td>
<td>1982</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>575.4</td>
<td>781.6</td>
<td>2398.5</td>
<td>259.1</td>
<td>3087.9</td>
<td>6320.9</td>
<td>9.1</td>
<td>37.9</td>
<td>4.1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1978</td>
<td>1982</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>199.5</td>
<td>335.9</td>
<td>169.4</td>
<td>83.8</td>
<td>471.1</td>
<td>913.7</td>
<td>21.8</td>
<td>18.5</td>
<td>8.1</td>
</tr>
<tr>
<td>Philippines</td>
<td>1978</td>
<td>1982²</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>58.6</td>
<td>190.3</td>
<td>164.2</td>
<td>943.0</td>
<td>367.0</td>
<td>1779.6</td>
<td>10.7</td>
<td>15.7</td>
<td>53.0</td>
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<tr>
<td>Singapore</td>
<td>1978</td>
<td>1982</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>267.1</td>
<td>1560.9</td>
<td>364.7</td>
<td>1252.6</td>
<td>560.0</td>
<td>4023.5</td>
<td>38.8</td>
<td>16.2</td>
<td>31.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>1978</td>
<td>1981</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>28.2</td>
<td>45.1</td>
<td>79.5</td>
<td>68.1</td>
<td>1214.3</td>
<td>1711.8</td>
<td>17.9</td>
<td>28.2</td>
<td>16.8</td>
</tr>
<tr>
<td>Total</td>
<td>1978</td>
<td>1982</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>1128.8</td>
<td>2913.8</td>
<td>3176.3</td>
<td>2831.8</td>
<td>4157.4</td>
<td>9487.0</td>
<td>11.9</td>
<td>33.5</td>
<td>10.8</td>
</tr>
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</table>

¹ Excluding investment in the petroleum industry. ² June 1982.

Source: Lim (1985).
Table A3 - Share of EC, Japan and USA in Imports of ASEAN (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Thailand</th>
<th>ASEAN</th>
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<tr>
<td>EC</td>
<td>17.5</td>
<td>14.0</td>
<td>20.4</td>
<td>13.7</td>
<td>12.7</td>
<td>11.7</td>
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<tr>
<td>UK</td>
<td>3.8</td>
<td>2.2</td>
<td>9.8</td>
<td>3.5</td>
<td>4.3</td>
<td>2.3</td>
</tr>
<tr>
<td>FR Germany</td>
<td>7.2</td>
<td>4.5</td>
<td>5.3</td>
<td>4.9</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Japan</td>
<td>29.3</td>
<td>23.1</td>
<td>21.6</td>
<td>25.4</td>
<td>31.4</td>
<td>17.1</td>
</tr>
<tr>
<td>USA</td>
<td>18.8</td>
<td>15.4</td>
<td>8.2</td>
<td>15.6</td>
<td>28.3</td>
<td>23.3</td>
</tr>
</tbody>
</table>

Source: IMF, Direction of Trade Statistics Yearbook, New York (various years), own calculations.