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The Economic Impact of US Foreign Direct Investment in the Asia-Pacific Region

Abdur R. Chowdhury

FOREIGN direct investment (FDI) flows to the developing countries have increased at a rapid rate in recent years reaching an estimated US$38 billion in 1992, a four-fold increase since the mid-1980s (see Table 9.1). This reflects improved macroeconomic performance, a relaxed regulatory environment, and active privatisation and debt conversion programmes in many of these economies. The share of FDI going into developing countries increased from a low point of less than 12 per cent in 1987 to 22 per cent in 1991 (see Table 9.1). FDI now represents the dominant form of resource flows to the developing countries and the primary source of private capital for low-income countries.[1]

FDI flows into Asia and the Pacific region have been considerable, and have been particularly important for the export-oriented manufacturing sector of the economy (see Tables 9.2 and 9.3). For instance, in the Association of Southeast Asian (Asean) countries, foreign firms account for more than 50 per cent of manufactured exports. Between 1987 and 1992, FDI flows into Asia increased at an annual rate of 27 per cent. Over this period, total FDI in this region exceeded US$100 billion. It increased from US$9 billion in 1987 to US$28 billion in 1992. In recent years, FDI flows into this region have shifted from the manufacturing and extractive sectors to the services sector, particularly the new capital-intensive service industries including telecommunications, transportation, banking, and public utilities.

Table 9.1: FDI flows to developing countries

Year	FDI to developing countries (US$ billion)	Share of global FDI (percentage)
1971	2.7	23.0
1976	3.9	22.2
1981	12.9	22.8
1986	9.8	13.0
1991	35.9	22.1

Source: International Monetary Fund, *Balance of Payments Yearbook.*

Table 9.2: Major destinations of FDI to developing countries, 1991[a]

Countries	FDI (US$ billion)	Share of recipient GDP	Share of recipient GDI
All Developing Countries	35.895	1.1	4.5
Mexico	4.762	1.7	7.4
China	4.366	1.2	3.3
Brazil	3.600	0.4	2.0
Malaysia	3.455	7.4	20.5
Argentina	2.439	1.9	15.1
Thailand	2.014	2.2	5.6
Indonesia	1.482	1.3	3.6
Korea	1.116	0.4	1.0

Note: [a]/FDI based on net inflows, balance of payments basis.
Source: World Bank (1993, Table 3.2)

FDI has long been an important element in the economic relationship between the United States and the countries in the Asia-Pacific region. The US has been the largest single source of FDI for the five original members of Asean and this region has become an increasingly important destination of US FDI since the early 1980s. This essay analyses the trend as well as the policy implications of US foreign direct investment in the Asia-Pacific region. The essay is divided into several parts. The first part discusses the trends in FDI in the Asia-Pacific region, while the second part describes US FDI in this region. Concerns with FDI liberalisation are raised in the third part while the fourth part reports the impediments to FDI. The policies in the Asia and Pacific region regarding FDI are discussed in the final part. The essay ends with a series of policy recommendations.

Table 9.3: FDI in selected Asian countries (US$ million)[a]

Country	1981	1985	1989	1992	1993
Bangladesh	-	0.6	0.2	3.7	14.0
China	386.0	1030.0	2613.0	7156.0	23115.0
Indonesia	133.0	310.0	682.0	1774.0	2004.0
Korea	60.0	200.0	453.0	-497.0	540.0
Malaysia	1265.0	695.0	1668.0	5183.0	5206.0
Pakistan	108.0	139.0	167.0	346.0	348.0
Philippines	172.0	12.0	563.0	228.0	763.0
Singapore	1675.0	809.0	2004.0	5982.0	6062.0
Sri Lanka	49.3	24.8	17.7	121.0	187.6
Taiwan	91.0	261.0	-5347.0	-990.0	1534.0
Thailand	288.0	162.0	1726.0	1969.0	1496.0

Note: [a]Data are taken from the balance of payments statistics.
Source: ADB: *Asian Development Outlook*, 1994, Table 33.

FDI trends in the Asia-Pacific Region

Since the mid-1980s, the countries in the Asia-Pacific region have become the largest recipients of FDI amongst the developing countries.[2] The growing interest in this region as a host to FDI reveals the importance of certain factors influencing its attractiveness to foreign investors: economic growth, the size of the domestic market, the availability of natural resources, the growth of trade, the existence of adequate infrastructure, and the quality of labour and managerial skills. The relative importance of foreign direct investment to the domestic economies in the region can be gauged from the ratio of FDI flows to gross domestic capital formation (see Table 9.4). Table 9.4 indicates that the ratio differs between countries, often rising from initially low levels. With the notable exception of Singapore, Hong Kong, Indonesia and Papua New Guinea, where FDI accounted for more than 10 per cent of gross domestic capital formation during the period 1985-87, FDI remains a small but growing component of domestic capital.

Table 9.4: Share of FDI inflows in gross domestic capital formation, annual averages for selected years (in percentage)

Country	1980-82	1985-87
NIEs		
Hong Kong	7.1	15.2
Korea	0.5	1.4
Singapore	23.4	25.5
Taiwan	1.0	3.3
Southeast Asia		
Indonesia	11.1	14.4
Malaysia	8.2	8.7
Philippines	1.6	3.9
Thailand	2.6	2.7
South Asia		
Bangladesh	0. 2	0.4
India	0.1	0.2
Nepal	-	0.2
Pakistan	0.7	1.4
Sri Lanka	4.0 2.1	
Pacific Islands		
Fiji	9.9	3.1
Papua New Guinea	11.7	12.8
Other Asia		
China	-	2.2

Source: United Nations (1992, Table 6)

Despite the growing interest of foreign investors in the Asia-Pacific region, their activities have not been evenly distributed across countries. About 95 per cent of the total inflows to the region during 1980-89 have been confined to the following groups: (i) Newly Industrialised Economies (NIEs), consisting of Hong Kong, Korea, Singapore and Taiwan—all of which accounted for about 50 per cent of the region's inflows during the 1980s; (ii) the Association of Southeast Asian Nations (Asean), which accounted for about 26 per cent of the region's inflows during the 1980s (excluding Singapore which is included in the NIE group); and (iii) China, which accounted for about 19 per cent of the region's inflows during the 1980s.

Table 9.5: The distribution of FDI by home country, region, various years (in percentage)

		Share of FDI Stock from Developed Areas				Share of total FDI stock by All DCs[a]
Country	Year	America	Europe	Japan	Other DCs	
NIEs						
Hong Kong	1989	38.6	20.0	36.0	5.4	83.1
	1984	58.8	16.2	22.9	2.2	92.0
	1975	56.2	18.8	18.3	6.7	84.0
Korea	1988	29.9	13.8	56.1	0.2	92.8
	1980	21.9	10.7	67.3	0.1	89.9
	1976	23.3	7.3	69.4	-	88.6
Singapore	1989	35.1	32.4	32.5	-	94.6
	1980	33.4	47.7	18.9	-	88.5
	1975	24.2	56.0	14.5	5.3	64.9
Taiwan	1988	44.4	18.5	37.1	-	72.3
	1980	55.4	15.3	29.4	-	63.2
Southeast Asia						
Indonesia	1988	12.2	34.4	38.4	15.0	72.8
	1980	6.3	14.0	48.6	31.1	77.1
	1975	5.0	11.7	54.6	28.7	77.7
Malaysia	1987	12.4	46.1	33.9	7.6	59.2
	1981	11.5	49.4	30.0	9.2	58.6
Philippines	1987	65.0	17.2	14.7	3.1	90.6
	1980	63.7	13.71	8.3	4.4	92.0
	1975	58.7	13.0	24.2	4.1	97.2
Thailand	1988	31.7	19.9	47.5	0.9	77.3
	1980	40.5	22.5	36.2	0.8	80.2
	1975	48.7	17.5	32.8	0.9	82.9
South Asia						
Bangladesh	1987	18.7	72.6	8.1	0.7	86.6
	1980	4.6	83.5	5.7	6.1	97.9
	1977	7.1	96.0	0.6	-3.7	96.6
India	1980	25.9	73.7	0.5	-	95.5
	1975	26.8	72.8	0.5	-	95.5
	1970	20.6	79.0	0.4	-	96.3
Pakistan	1988	35.4	53.1	4.2	7.3	63.8
	1980	38.2	58.8	1.5	1.5	48.3
	1975	40.6	43.9	0.9	14.6	60.3

Sri Lanka	1987	22.5	57.1	19.6	0.8	50.9
	1980	32.8	51.5	0.5	0.5	54.8
Pacific Islands						
Papua New Guinea	1988	21.9	13.3	7.2	57.6	99.6
	1980	4.4	5.3	12.1	78.2	99.8
	1975	2.1	7.1	8.3	82.4	100.0
Other Asia						
China	1987	48.8	27.2	20.5	3.6	35.0
	1984	45.1	34.9	13.9	6.0	41.8
	1982	48.3	36.0	8.4	7.2	58.5
Vietnam	1989	0.6	72.7	17.9	8.8	80.5

Note: [a]/The figures in this column show the share of the developed countries in the total distribution of FDI stock in each country. The remaining proportion of the FDI stock is accounted for by all developing areas.
Source: United Nations (1992, Table 8).

Table 9.6: The sectoral distribution of foreign direct investment in the Asia-Pacific region, selected years (in percentage)

	Foreign Direct Investment Stock			
Country	Year	Primary	Secondary	Tertiary
NIEs				
Hong Kong	1989	25.9		
	1980	28.7		
	1975	60.4		
Korea	1988	0.9	61.5	37.6
	1980	1.0	66.8	32.2
	1976	1.0	79.9	19.0
Singapore	1989	0.2	42.4	57.4
	1980	0.2	54.6	45.2
	1975	0.2	42.4	57.4
Taiwan	1988	-	88.3	11.7
	1980	-	93.6	6.4
	1975	-	90.6	0.9
Southeast Asia				
Indonesia	1990	81.7	15.4	2.9
	1980	70.4	25.4	4.2
	1975	61.2	32.5	6.3
Malaysia	1988	28.3	41.2	30.5
	1980	31.3	30.1	38.6
	1975	39.3	30.6	30.1

Philippines	1988	28.6	48.3	23.1
	1980	18.8	50.4	30.7
	1975	9.2	44.9	45.9
Thailand	1989	9.2	42.8	48.0
	1980	13.5	31.7	54.7
	1975	15.1	29.9	55.0
South Asia				
Bangladesh	1988	25.1	34.3	40.7
	1980	38.7	51.1	10.1
	1977	43.0	47.5	9.2
India	1980	8.9	87.0	4.1
	1975	26.3	70.4	3.2
Nepal	1988	49.9	37.2	12.9
Pakistan	1988	11.5	38.7	49.8
	1980	7.9	53.6	38.5
	1975	6.9	48.1	45.0
Sri Lanka	1988	10.0	32.5	57.5
	1980	0.2	53.4	46.4
Pacific Islands				
Papua New Guinea	1989	60.3	10.9	28.9
	1980	73.7	16.4	9.8
	1975	81.4	10.5	8.1
Other Asia				
China	1988	8.2	49.7	42.2
	1985	15.0	36.2	48.8
	1983	66.9	20.4	12.7
Vietnam	1989	67.7	12.7	19.6

Source: United Nations (1992, Table 9)

At least two interesting characteristics emerge from Table 9.5 about the flow of FDI in this region. First, it shows a shift in the relative importance of developed countries as sources of FDI and, in particular, the emergence of Japan as a major source in the 1980s, accompanied by a decrease in the importance of Western Europe and North America as a source of FDI to the region. Although North America and Western Europe continue to account for a large share of FDI to the countries in the region, where historical affiliations are still strong, Japan has begun to emerge as a leading source of those investments. This can be attributed to the appreciation of the yen as well as Japan's need to retain cost competitiveness in order to compete effectively in the international market in the face of rising domestic production costs. Geographical proximity and historical affiliations also played a role in the choice of location of those investments.

Second, the table indicates a shift in the relative importance of developing countries as sources of FDI, and especially the growth in the level of intra-regional FDI and the increase in its share of FDI from developing countries.

The sectoral distribution of foreign direct investment in this region shows several shifts in its pattern (Table 9.6). First, there is a decline in the share of the primary sector during the 1970s and 1980s. Second, there has been an increase in the share of the secondary sector during the 1970s and, for selected countries, during the 1980s. A shift in the composition of FDI within the secondary sector through a movement of labour-intensive operations to South and Southeast Asia is also evident, thus leaving investment in the more technologically advanced industries in the NIEs. Third, the table shows a rise in the relative importance of the tertiary sector in the 1980s. Moreover, there is a shift in the composition of FDI within the tertiary sector, with a decline in the relative importance of finance and insurance in several countries and an increase in that of construction and other services, including tourism. This reflects the rapid rates of growth and the profitability of those investments due to growing demands.

As discussed above, the last two decades have seen considerable changes in the level and composition of FDI in this region. Significant changes have occurred in the overall importance and composition of sources of FDI to the region, as well as amongst Asia-Pacific countries as recipients of those investments. Changing conditions in the world economy have renewed the interest of the Asia-Pacific region in FDI as a source of capital, technological know-how and organisational and managerial skills. This shift in attitude has led to a gradual liberalisation of the regulatory framework for FDI in this region. Despite this overall trend towards a liberalisation of FDI policies, the degree of openness towards foreign investors varies across countries in the region. In general, policies and incentives relating to FDI have been more liberal in the NIEs and Southeast Asia than in South Asia or the Pacific region.

Overview of Trends in US FDI

During the period 1975-80, the United States accounted for about 43 per cent of world FDI outflows. Although the US still maintains its position as the largest source country for FDI, its share of FDI stock has declined sharply in recent years. For instance, the combined FDI position of the European Community countries is larger than that of the United States. Table 9.7 shows US direct investment in the Asia-Pacific region for selected years. In 1982, US investment in this region was about 6 per cent of total US FDI. The proportion remained the same in 1995. However, the countries in the NIEs and Asean experienced an increase in their share of US FDI from about 64 per cent in this region in 1982 to about 75 per cent in 1995. With the exception of electric and electronic equipment, petroleum and banking, US FDI in Asia and the Pacific is quite small. However, the margin of profit is higher in this region compared to US FDI in other regions.[3]

Concerns with FDI liberalisation

Over the last decade, countries in the Asia-Pacific region have been under heavy pressure from the US government as well as various international organisations such as the World Bank and the International Monetary Fund to liberalise tax laws and other regulations concerning FDI.[4] Ironically, this free market policy towards FDI is pushed at a time when neoclassical development theorists question the market-equilibrium assumptions necessary to sustain economy-wide liberalisation as an optimal approach.[5] Two major issues have been raised in the literature.[6] First, liberalisation of FDI, as suggested by *laissez-faire*, will be a sub-optimal policy prescription for any region when any of the equilibrium assumptions of perfect competition, perfect knowledge and zero transaction cost are replaced by:

1. Strategic competition or bargaining among economic agents;
2. Imperfect information and incomplete markets; or
3. Principal-agent problem, transaction costs, etc.

The resulting market outcome may shift the market structure against domestic agents, making the economy worse off. Another concern regarding the liberalisation of FDI arises from the notion of what actually drives economic growth. Capital and labour accumulation are no longer the main focus of attention. Instead, it is argued that growth and development are driven by economies of scale, learning by doing, external economies, entrepreneurial experience, etc. This shift can be seen in the appraisal of recent economic development in Korea and Taiwan.

Table 9.7: US FDI in selected Asian countries: Position at year-end (US$ million)

Country	1982	1985	1988	1990	1995
Total US FDI	207752	230250	335893	424086	450196
South and Southeast Asia	12142	15400	18528	22890	25180
DAEs	7809	8876	12940	16733	18832
Hong Kong	2854	3295	5240	6187	6430
Korea	690	743	1501	2178	2392
Malaysia	1221	1140	1135	1384	1440
Singapore	1720	1874	2311	3385	4313
Taiwan	544	750	1621	2014	2470
Thailand	780	1074	1132	1585	1787
Other Asia	4333	6524	5588	6157	6348
China	49	311	307	300	350
India	360	383	436	513	533
Indonesia	2295	4475	2921	3226	3458
Philippines	1315	1032	1513	1629	1672
Other[a]	314	323	411	489	335

Note: [a]/ This group includes countries not reported separately.
Source: US Department of Commerce: *Survey of Current Business* (1995).

Economy-wide liberalisation may be a blunt policy instrument with the potential to induce highly variable impacts in different sectors in the economy based on their specific market features and their role in the overall development process. It is not surprising that these measures can generate significant potential opposition from domestic economic agents likely to be hurt by the liberalisation measures. More important, this opposition may have different roots than the typically assumed 'rent-seeking motives'.[7]

Several countries in the Asia-Pacific region have tried to directly affect investment decisions by the multinational corporations (MNCs) by providing incentives such as tax relief, direct subsidies, tariff protection, credit assistance, etc. Countries have also tried to influence the economic impact of FDI through establishment of performance requirements such as local-content requirements, and export-performance requirements for local affiliates of MNCs. However, recent studies have shown that such policies usually lead to distortions of market-determined patterns of foreign trade. Special FDI incentives such as tax concessions, investment allowances, training subsidies and subsidised credits often prove unnecessary for attracting FDI and may make it more difficult for the country to achieve its other developmental targets. Moreover, certain tax incentives for FDI may simply result in a transfer of funds from the host country to the home country treasury without benefiting foreign investors.

Impediments to FDI

Recent studies by the United Nations, the World Bank and other international organisations have categorised the impediments to FDI in the Asia-Pacific region as follows:

1. *Legal:* FDI is likely to be facilitated by a legal framework that promotes open admission policies which do not violate national security; recommends equal treatment of foreign and domestic investors as a general principle; and provides for the free transfer of profits and repatriation of capital.
2. *Institutional:* Institutional problems are found in areas ranging from over-stringent bureaucracy to the presence of too many institutional bodies or to the absence of an agency facilitating investment.
3. *Regulatory constraints:* Inefficient regulatory structure, e.g., tax policy often results in a complex combination of incentive and disincentive elements that create a distortion in the economy without providing a concomitant attraction for investors.

Policies in the Asia-Pacific Region regarding FDI

During the last decade, a large number of Asian and Pacific Basin countries have changed policies and regulations affecting MNCs in an attempt to attract greater amounts of FDI. Studies by the World Bank have shown that in countries in this region that possess a large and growing internal market or substantial productive resources, and in countries that are in geographical proximity to a major developed country market, changes in policies and regulations can prove instrumental in helping to attract greater amounts of FDI. Support for this argument can be found in China, India and Korea.[8] In addition, some policy changes may be effective in certain economic conditions but not in others. At least three cases are worth noting.[9] First, many Asian countries have long had policies to regulate the entry and operations of MNCs. These regulations include keeping certain sectors of the economy closed to foreign participation, limiting foreign ownership of domestic corporations, provisions requiring foreign owners to withdraw their ownership interest, and limitations on the reinvestment of profits. However, many of these policies have been modified in recent years. These modifications have helped to improve the climate of FDI in several countries in this region, for example, China and Korea.

Second, the growing use of non-equity arrangements by MNCs involves an 'unbundling' of the components of foreign direct investment. When production is undertaken by wholly-owned affiliates of multinational corporations, the corporation puts forward the capital, technology and management, bears the risk and receives the returns. On the other hand, with non-equity arrangements, the MNC and its host country partners both put forward inputs and share the risks and returns. In general, MNCs will seek to retain control over those elements of production where the ownership-derived rents are greatest.[10]

The growth of non-equity arrangements is partly due to MNCs seeking to reduce their international exposure as well as risks. Regulations in countries that restrict asset ownership by US MNCs have also led to a greater interest in non-equity arrangements. For the countries in this region, such arrangements can be beneficial, as institutions in the host country are more closely involved with production. They also distribute more of the risk to the host country, require more capital to be raised in the host country, and may result in a reduction in technology transfer. The growing flexibility shown by the multinational corporations in choosing the mechanism by which they engage in international production suggest that developing countries also need to be flexible and consider a variety of alternative approaches to the regulation of MNCs.

Third, the increasingly important role being played by technology in economic growth has been accompanied by increasing attention to the transfer of technology by developing countries. In the past, countries like Korea have been successful in importing technology while at the same time restricting the inflows of FDI.[11] An important issue is whether the Asian and Pacific Basin countries have the capacity to absorb and apply the new technological and organisational methods. In this regard, Japan and Korea represent cases where the transfer and resulting transformation of production technology was supported by the relatively high level of education and skills available in the importing country, and the existence of both private and public sector institutions capable of providing the necessary training.

Policy Recommendations

In order for US FDI to have a positive impact on the process of economic development of the Asia-Pacific region, each of the players involved in the process must play an important role. Based on the research conducted by various international agencies and institutions, the following policy recommendations can be made.

Role of the Asian and Pacific Basin countries. If it is accepted that FDI, like trade, can increase international competitiveness, then the main policy task of both the United States and the Asian and Pacific Basin countries would be to establish a legal, foreign exchange regulatory and institutional framework, and an administrative and commercial environment that promote openness to FDI. For instance, there has been discussion in various multilateral forums of the desirability of a code of conduct on the transfer of technology and for environmental safeguards. An additional task for the Asia-Pacific region countries is to adopt sound policy, for example, outward trade orientation, if they are to reap the benefits of FDI.

The policy of the host country has an important bearing on the amount and character of FDI received. Consistent and stable macroeconomic policies are essential in establishing a private sector that is conducive to investment. Also vital is a foreign-exchange regime that provides ready access to foreign exchange for imported inputs and freedom to remit dividends and profits and to repatriate capital. Choosing policies necessarily involves a careful weighing of alternatives. However, to judge when interventions are effective in meeting host country objectives, and to assess how effective they are in practice is difficult. With regard to incentives, the countries in the Asia-Pacific region can find themselves in competition with other developing countries as potential locations for FDI and feel they must offer incentives to remain competitive. MNCs may stand to benefit from these incentives without changing their locational decisions.[12]

In certain cases, an investment promotion programme can be an alternative to the granting of investment incentives by the countries in this region. A number of developing countries have had success in this area. In many cases, investment promotion has been more cost effective than tax incentives, such as tax holidays. These programmes tend to be most effective when used by countries that have the necessary resource base to support export industries, but have not attracted significant FDI. This fits the description of several countries in this region.

While countries in the Asia-Pacific region can embark upon investment promotion programmes in the United States, there is the risk that such efforts will result in greater competition amongst the countries in this region without necessarily leading to greater foreign investment flows. Promotion efforts could be aimed at small- and medium-sized US corporations, many of which have not previously been foreign investors. Moreover, these countries can try to develop promotional programmes jointly with US agencies which have separate programmes designed to support the foreign production of their MNCs. Moreover, promotional activities could also assist MNCs to establish links with host country partners and suppliers, and perhaps even to develop possibilities for financing.

When undertaking FDI or engaging in non-equity investments in this region, the MNC must deal with host country administrative arrangements. A number of countries in this region have taken steps to simplify the entire process whereby investments are approved. This can lower costs for both host countries and MNCs, as well as reduce uncertainty for potential investors. Examples include the creation of a single office which can take care of all necessary approvals for foreign investment, or adoption of a 'negative list' whereby all industries of a host economy are open to FDI except those explicitly listed. Such simplifications can also reduce the scope for corruption by improving the transparency of the administrative process. Also the host countries in this region can improve their articulation of the approval structure, develop materials that describe what the requirements are for potential investors and distribute these materials widely amongst US MNCs that are potential investors. It needs to be pointed out that host countries are also concerned with minimising the negative effects that may be associated with the activities undertaken by the MNCs. Thus, these countries frequently establish extensive monitoring operations to assess the impact MNCs are having on the localities in which they operate and also ensure that domestic regulations are followed.[13]

Role of the United States. The United States also has a role to play. Amongst macroeconomic policy measures, import policy (i.e. open trade) appears to have the most effective impact on FDI flows because export-oriented FDI strategies are critically dependent on fair and stable access to the market in the United States and other developed countries. Other macroeconomic policies, particularly fiscal, monetary, import and foreign exchange policies in the United States, will have a significant impact on the outward volume of FDI.

In addition, the United States can also initiate a number of micro-specific steps in order to increase the flow of FDI in the Asia-Pacific region. Such measures include, but are not limited to, the signing of double taxation treaties, tax-sparing and bilateral investment agreements, and improvement in promotional programmes and institutions dealing with FDI in the Asia-Pacific region.

Postscript: The 1997 Currency Crisis in Southeast Asia

The currency turmoil that erupted in mid-1997 in Southeast Asia shows little sign of abating amid forecasts that the region's financial crisis will persist in 1998. For more than a decade, Southeast Asian economies grew rapidly. Not everyone benefited equally, but the boom was quite widespread. There was a natural flow of foreign direct investment to regions with cheap labour, inexpensive land, and governments willing to build the infrastructure needed to produce goods. But gradually some weaknesses of these economies were exposed—the biggest being the misuse of capital. Corruption, greed and government interference diverted capital to areas that were unproductive and wasteful, such as property development and securities speculation.

The economies of many of these countries were surging in the last decade, in part because they could borrow money at low interest rates abroad in foreign currency, than in the domestic market in local currency. Expecting strong economic growth, foreign lenders invested heavily in these countries. With ever greater amounts of foreign money at their disposal, banks and finance companies lent generously. Given the stable exchange rates in the last decade, some customers borrowed heavily in foreign currency, while others squandered the loans on commercial and residential real estate.

In early 1997, attention was drawn to the rapidly deteriorating investment condition in these countries as many companies threatened to default on foreign loans. Persistent economic problems such as huge amounts of foreign borrowing, current-account deficits and a weak banking sector riddled by default loans aggravated the situation. Many foreign investors and local companies rushed to convert their local currency to the US dollar anticipating that the increased selling of local currencies in the foreign-exchange market would depreciate their value. The resulting currency crisis has cast a limelight on the source and nature of foreign direct investment in this region. Once this crisis is resolved, attention needs to be focused on the role that foreign investments played in precipitating this crisis, and lessons that can be learned in order to avert a similar situation in the future.

ENDNOTES

1 According to World Bank estimates, foreign direct investment now accounts for more than 25 per cent of aggregate net flows to the developing countries and exceeds total long-term debt flows; *World Bank Annual Report*, 1993.

2 About half of all foreign direct investment to the developing countries now flow to the Asia-Pacific region. See, United Nations, *World Investment Directory*, New York: United Nations Centre on Transnational Corporation, 1992, vol 1.

3 In fact, Asia's share of worldwide US FDI income is large relative to its share of US FDI stocks. This indicates a relatively high return on FDI in this region. For more evidence on this issue, see E.D. Ramstetter, "US Direct Investment in Developing Asia and Structural Adjustment in the US Manufacturing Industry," in E.D. Ramstetter (ed.), *Direct Foreign Investment in Asia's Developing Economies and Structural Change in the Asia-Pacific Region*, Boulder: Westview Press.

4 There has been a push for liberalisation of various rules restricting FDI. It has been suggested that this would reduce macroeconomic constraints, transform the structural deficiencies of previous development models, and begin the process of economic recovery. This point has been made in B.L. Barham, "FDI in a Strategically Competitive Environment: Coca-Cola, Belize and the International Citrus Industry," *World Development*, vol 20, 1992, pp 841-857.

5 For a more detailed discussion on this issue, see, P. Bardhan, "Alternative Approaches to Development Economics," in H. Chenery and T. Srinivasan (eds.), *Handbook of Development Economics*, New York: Elseviers Science Publishers, 1988, vol 1, and A. Fishlow, "The Latin American State," *Journal of Economic Perspectives*, vol 4, Summer 1990, pp 61-74.

6 See B.L. Barham, "FDI in a Strategically Competitive Environment," op. cit.

7 It is in this sense that Barham has suggested that liberalisation policies pursued for the entire economy may both reduce the economic gains associated with liberalisation efforts as well as lower the likelihood of achieving implementation in areas where it may be an optimal policy. See B.L. Barham, "FDI in a Strategically Competitive Environment," op. cit.

8 Experiences with policy changes in several countries, including India, have shown that a blanket liberalisation policy may be less effective than changing specific regulations or policies towards the multinational corporations. Such policy experiences have been detailed in *United Nations, Foreign Direct Investment and Technology Transfer in India*, 1991.

9 These three cases have been elaborated in *United Nations, Foreign Direct Investment and Technology Transfer in India.*

10 Consequently, multinational corporations are more likely to enter into non-equity agreements when they are certain to gain substantial returns

from a proprietary technology. This has been pointed out by J. Dunning, *Explaining International Production*, London: Unwin Hyman, 1988.

11 In recent years, however, Korea has formulated policies to encourage greater inflows of FDI. See S.H. Kim and Y.K. Song, "US Private Investment in Korea," *Columbia Journal of World Business*, vol 22, Winter 1987, pp 61-66.

12 In such a situation, MNCs may benefit from the incentives without changing their locational decisions. Hence countries in this region can seek greater cooperation amongst themselves in harmonising laws and regulations regarding MNCs. This would help to avoid situations where neighbouring countries bid against one another for FDI. World Bank, *Annual Report*, 1993.

13 In *United Nations, Foreign Direct Investment and Technology Transfer in India*, suggestions have been made to streamline those activities in order to reduce the monitoring costs.