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Abstract

Foreign Direct Investment (FDI) has grown steadily in volume and is a major source of development finance. Recognizing that FDI can contribute to economic development, all governments want to attract it. However, the experience has been mixed. The paper examines the different forms of capital, role of FDI in economic development, the global and regional trends in FDI flows, the determinants of FDI, and selected country experiences in Asia. The experiences of China, India, Indonesia, Malaysia, Philippines, Singapore, and Thailand have been examined. Finally, the policy implications of the determinants of FDI flows are discussed. It is evident that economic determinants will remain key, but local advantages and created assets (e.g. brand name) on a country or subregional basis are also important in attracting FDI and will determine future flows.

JEL Code**:** F-21; F-24; G-15; O-11; O-16; O-20; O-23; O-53; P-45.
Key Words: foreign direct investment; foreign aid; international financial markets; economic development; official development assistance; remittances

* This paper was written by Nihal Amerasinghe, Ph.D. and Justin Modesto III, M.A. of the Center for Development Management of the Asian Institute of Management. A paper with a similar title was published in August 2006. The purpose of this paper is to update the information and capture any new insights on FDI in Asia. The views expressed are those of the authors, and do not necessarily reflect the views of the Asian Institute of Management. Comments and suggestions could be directed to the corresponding author (namerasinghe@aim.edu).

I. INTRODUCTION

A country's development depends on domestic and external financing. Developing countries have many developmental needs, and they often have a savings or trade gap. In an economy in equilibrium, it is an accepted identity that savings equals investment ($S = I$). However, economies are seldom in equilibrium, and in a developing economy, a shortfall normally exists between savings and the desired level of investment, which countries seek to fill by capital inflows. As such, external financing is important for economic and social development.

Since the Bretton Woods Institutions and the United Nations system were established, official development assistance (ODA) has grown steadily and played a lead role as a source of external capital for economic growth and development of less developed countries around the world (Amerasinghe & Espejo 2006). However, since the early 1980s, private capital flows, particularly foreign direct investment (FDI), have grown at a phenomenal rate. FDI has become an important source of private external finance for developing countries. It is different from other major types of external private flows in that it is motivated largely by investors' long-term prospects of making profits from production activities that they control. Foreign bank lending and portfolio investment, in contrast, are invested in activities which are often motivated by short-term profit considerations. These investments can be influenced by a variety of factors (e.g. interest rates), and they are prone to herd behavior.

What determines the selectivity of FDI, and has it changed in recent years? In particular, how are countries in Asia dealing with this source of external financing? This paper reviews the sources of capital and postulates a framework for the determinants of FDI, examines trends and lessons of experience for seven countries in Asia, and discusses the policy implications for the developing countries of Asia.

II. DIFFERENT FORMS OF CAPITAL

When the trend in the international financial scene veered toward openness and deregulation through the 1970s and 1980s, few foresaw how explosive private capital growth would become. Tempted by the prospect of higher returns on investment, private capital rushed toward emerging economies in the 1990s and became a far-reaching economic development trigger of the late twentieth century.

Sixty six years since the establishment of the Bretton Woods Institutions, private capital[1] now accounts for about 60 percent of total capital going to developing economies. Since the start of the 1990s, private capital flows, particularly foreign direct investment, have been growing rapidly, while ODA has more or less remained stagnant. Among the three types of private capital (FDI, portfolio equity, and private debt), FDI is largely motivated by long-term prospects of profit-making from production activities in developing countries.

Government Financing

In economic terms, development has traditionally meant the capacity of a national economy to generate and sustain an increase in its gross domestic product (GDP). Economic development is often expressed as a combination of the following factors: consumption, investment (which includes government financing), and net exports. Based on this equation, the purpose of government financing is to increase investment, thereby creating infrastructure and employment for the developing economy.

In an optimally planned economy, the actual level of investment is equal to the desired level of investment, and therefore savings equals the desired level of investment ($S = I$). However, most developing countries grapple with a savings gap. Domestic savings are low, which means that government financing is not enough to spur economic development in order to achieve an optimally planned economy. For instance, in 2009, least developed countries (LDCs) in the world had a gross domestic savings rate of only 14.6 percent of GDP, whereas the world average was at 19.1 percent. Developing countries in Sub-Saharan Africa had gross domestic

[1] Private capital includes foreign direct investment (FDI), portfolio or equity investment, and other private investments that include private debt of banks and private institutions (bond holders).

savings of 15.5 percent, which was also below the world average. This is not true for all developing countries, however. Some countries in Asia continue to enjoy surplus savings. China and Lao PDR have gross domestic savings of 52.0 and 51.4 percent respectively, while countries such as Cambodia and the Philippines still have low savings, at 18.3 and 15.5 percent, respectively (Table 1).

Table 1. Gross Domestic Savings in Asia
(As a Percentage of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009
Bangladesh	18.4	17.6	18.7	18.1	18.4	17.5	15.8	17.2
Cambodia	9.3	10.1	8.9	9.8	13.1	13.6	16.4	18.3
China	40.4	43.4	45.8	47.6	50.7	50.5	51.8	52.0
Hong Kong	31.1	31.2	30.7	33.0	33.1	31.8	30.7	28.8
India	24.2	25.5	31.1	31.9	32.6	34.1	29.1	32.0
Indonesia	27.7	32.9	28.7	29.2	30.8	29.0	28.9	33.8
Lao PDR	19.3	21.1	16.4	13.4	28.9	38.3	47.5	51.4
Malaysia	42.0	42.5	43.4	42.8	43.1	42.1	42.3	36.0
Philippines	15.5	15.4	16.1	15.9	16.2	17.2	16.8	15.5
Singapore	41.2	44.0	47.4	49.4	50.8	53.3	51.1	50.0
Thailand	30.5	31.8	31.6	30.3	31.8	34.8	31.7	31.8
Vietnam	28.0	27.1	27.9	31.4	31.7	28.2	24.5	27.8

Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

For developing countries with low savings, how have their governments responded to the crisis after 2008? Bangladesh, for instance, only had gross domestic savings of 17.2 percent in 2009. In response to the crisis, the government scaled up pre-existing food distribution programs in order to provide subsidized rice for workers, and it increased short-term spending in tax breaks and cash subsidies (Food and Agriculture Organization of the United Nations [FAO] 2009). Furthermore, its central bank made it easier to lend to businesses, while withdrawing from risky investments.

Government financing should be managed, as increased spending could lead to higher rates of inflation. As such, rather than increasing spending, governments have been turning to external sources of capital for development finance.

External Financing

From an economic perspective, external assistance is assumed to facilitate and accelerate the process of development by generating additional domestic savings as a result of the higher growth rates that it is presumed to induce. With the trend in openness and deregulation throughout the 1970s and 1980s, private capital has been rushing towards emerging economies in the 1990s and is an important source of development finance.

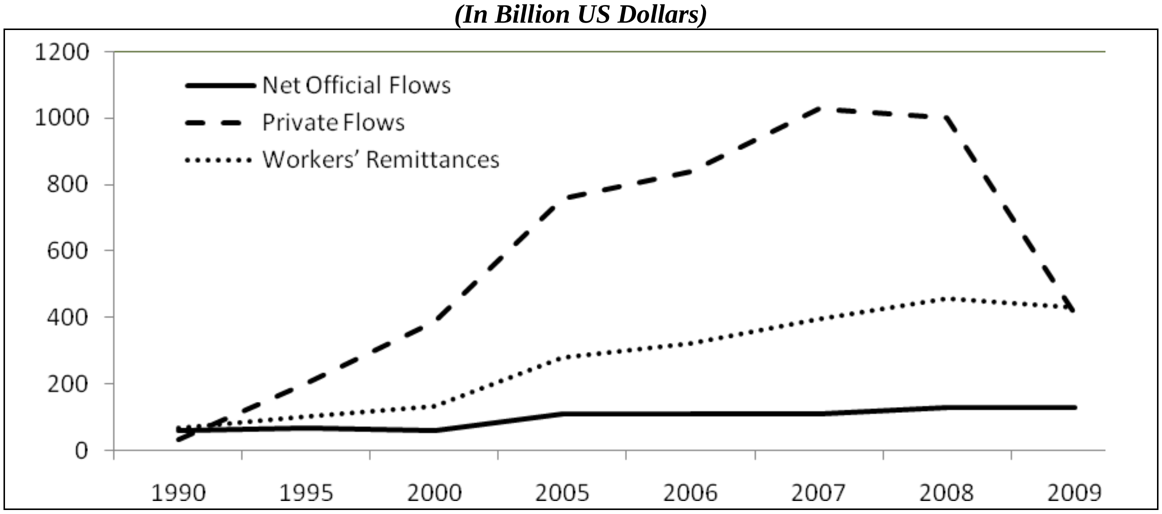
Since 1990, private flows have increased by almost tenfold in 2007, whereas official flows have more or less remained static (Figure 1). The growth spurt was continuous, until the Asian and Latin American crises in 1997 and 2001, where private capital to developing countries started to slow down. Investors and equity, debt, and bond holders liquidated their holdings, resulting in a huge capital outflow. But as developing economies started to recover, private flow increased again, until 2008, when the U.S. and European crises had investors withdrawing from developing countries.

Meanwhile, remittances of overseas workers continue to increase. Remittances help develop human capital through education and improved health and, to a lesser extent, physical investment in farms and housing (OECD 2011). Page and Plaza (2005) have identified possible policies of promoting the use of remittances for development purposes, including:

- Creation of tax regimes for remittances.
- Promotion of competition of money transfer firms to reduce transaction costs and removing regulatory restrictions on money transfers.
- Creation of innovative financial products to encourage savings and increasing access to banking services.
- Promotion of financial literacy for receiving households.
- Enhancement of the institutional capacity of credit unions and microfinance institutions.
- Establishment of business networks to mobilize investment in home countries and creation of incentives to set up a business.
- Promotion of Home Town Associations as a means of channeling remittances towards community projects.
- Offering of bonds to workers to raise money for investment in their home countries.

These mechanisms for utilizing remittances as development finance are not new and have shown several success stories. Latin America has the best developed money transfer systems, and these are also improving for North Africa. Home Town Associations are well-developed in Mexico, El Salvador, and Haiti. In Asia, India has been offering bonds to migrant workers, while Armenia and Lebanon have created active private business networks for their migrant workers.

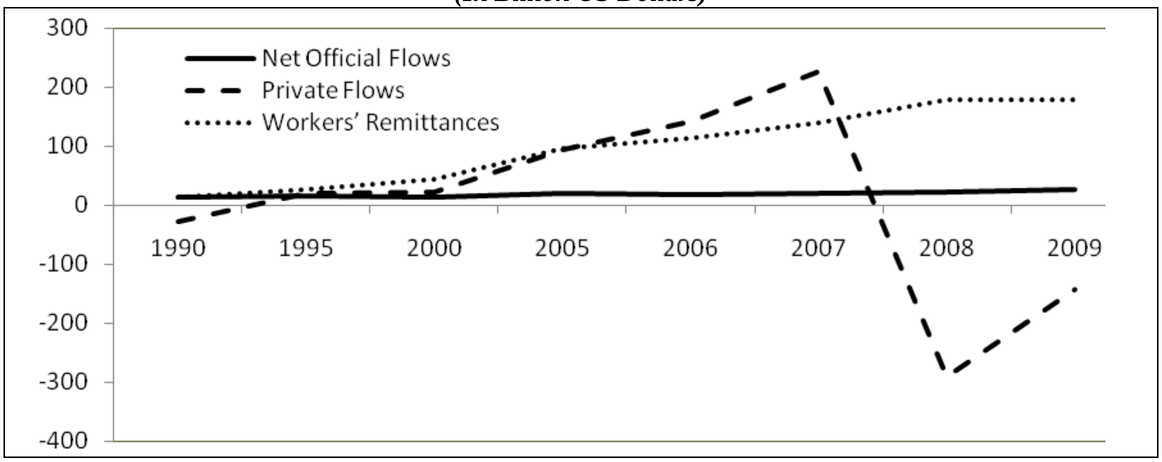
Figure 1. Sources of External Financing in the World
(In Billion US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

For Asia, the pattern of external finance flows is similar (Figure 2). Private capital had increased from the 1990s (with the exception of the slump in the 1997 crisis) until 2007, where investments turned negative, signifying withdrawal of investors as an effect of the 2008 global crisis. Official flows are consistent and have not wavered for Asia, although they remain at a very low level. Remittances have been increasing since the 90s, and majority of these funds are going to India, Bangladesh, and the Philippines.

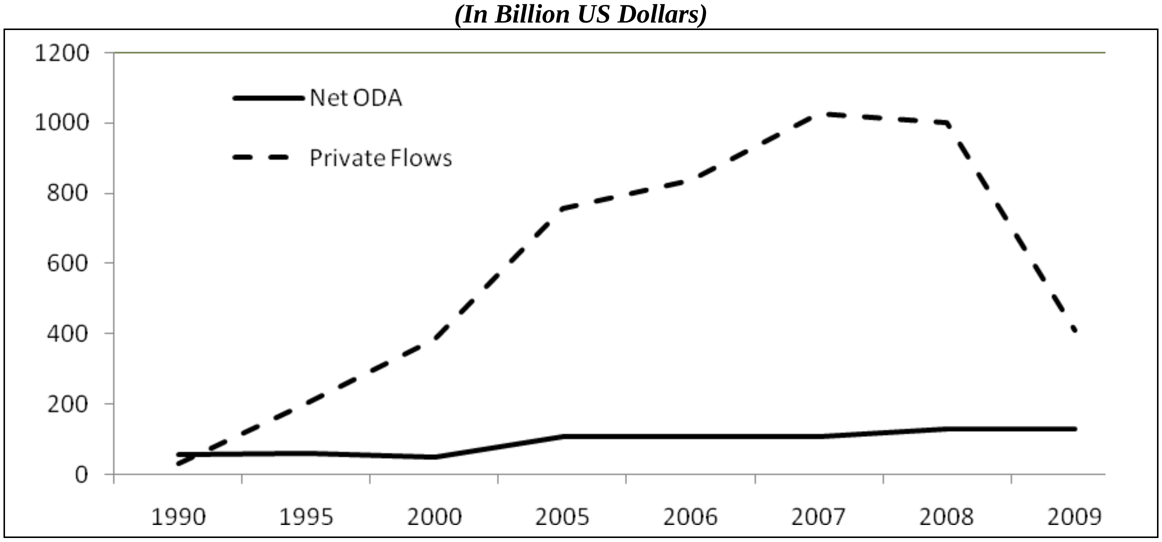
Figure 2. Sources of External Financing in Asia
(In Billion US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

Whereas private flow has been volatile, official development assistance (ODA) has remained consistent in the past 20 years (Figure 3). Any decline in official flows would be a result of increasing debt burdens of developing countries, allegations of corruption and misuse of donor aid, and donor fatigue. The introduction of performance-based lending, however, has encouraged improvements in policies and institutions of aid recipients, and this plays an important complementary role in the increase in private flow.

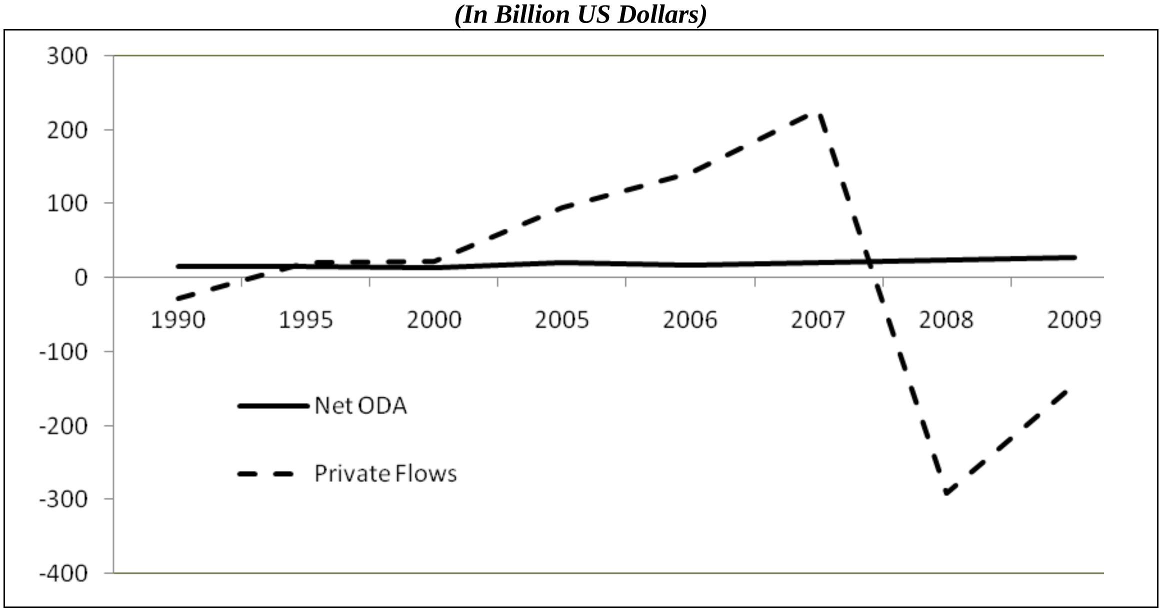
Figure 3. Private Flows versus Net ODA in the World
(In Billion US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

For Asia in 2008, countries experienced outflows of private capital, but this trend is slowly recovering as of 2009 (Figure 4). These inflows can be attributed to increased FDI in India and China, as well as Vietnam.

Figure 4. Private Flows versus Net ODA in Asia
(In Billion US Dollars)



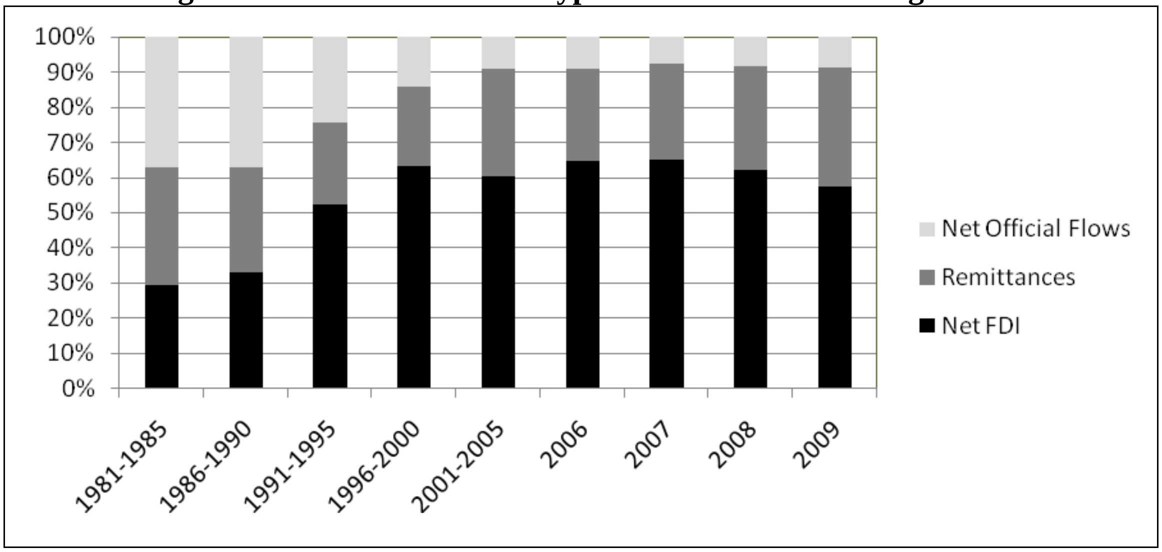
Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

When the financial crisis hit Asia in 1997, the current account balance of all developing countries was negative at US$83.7 billion. As the crisis dragged on, private creditors became reluctant to lend, and portfolio equity flow veered away from these developing countries in Asia. These economies then found respite in increased aid, grants and loans from the international financial institutions (World Bank, Asian Development Bank, and the International Monetary Fund), and the steady flow of workers' remittances in the late 90s.

The flipside of private debt is that it has far shorter maturities and less favorable terms over other sources of private capital, such as FDI. On the other hand, FDI will not flow to economies in financial or political turmoil. It is not surprising then, that developing countries turn to official flows at times of crisis, when it becomes risky for foreign investors to bring in private capital.

In spite of this, it can be seen that the share of FDI has increased over the decades (Figure 5). It now occupies around 60 percent of external financing flows. Remittances have also been an increasing source of capital – through bonds, business networks, financial products, and so on.

Figure 5. Share of Different Types of External Financing Flows

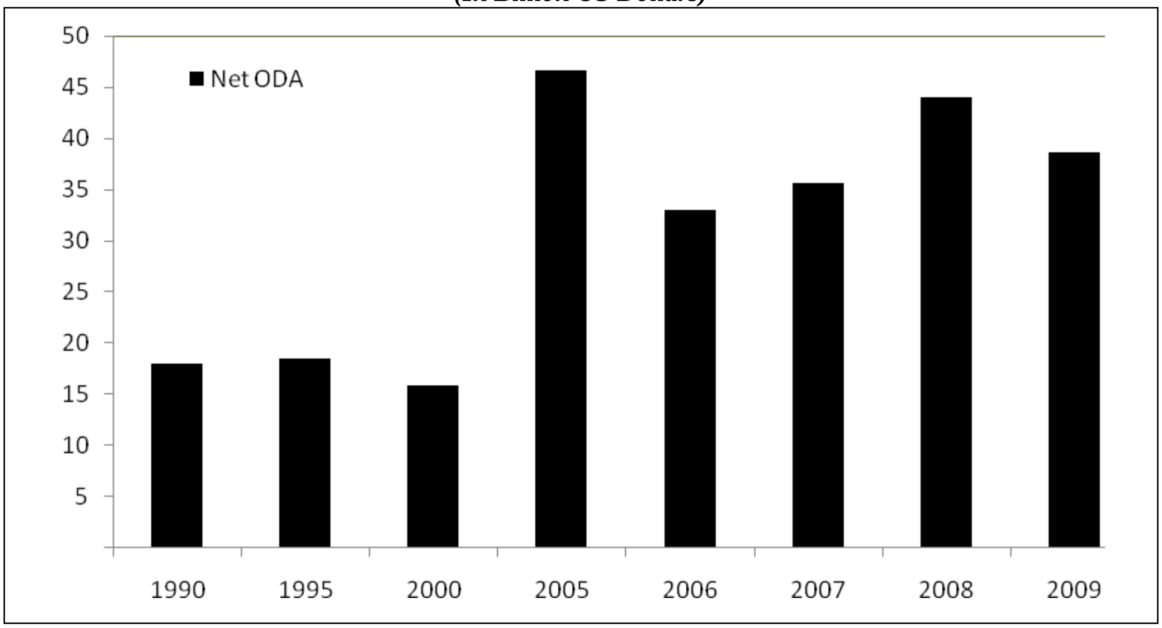


Source: "FDI Statistics," accessed November 2011, http://www.unctad.org.

Official Development Assistance

While private capital's role as a source of financing for developing countries has been gaining more ground in recent years, net official development assistance (ODA) share in total external financing has been declining. The dwindling share is due to growth of private capital, and not because of a drop in disbursements of aid. In fact, net ODA to Asia has been increasing over the past 20 years in nominal terms (Figure 6).

Figure 6. Net ODA to Asia
(In Billion US Dollars)



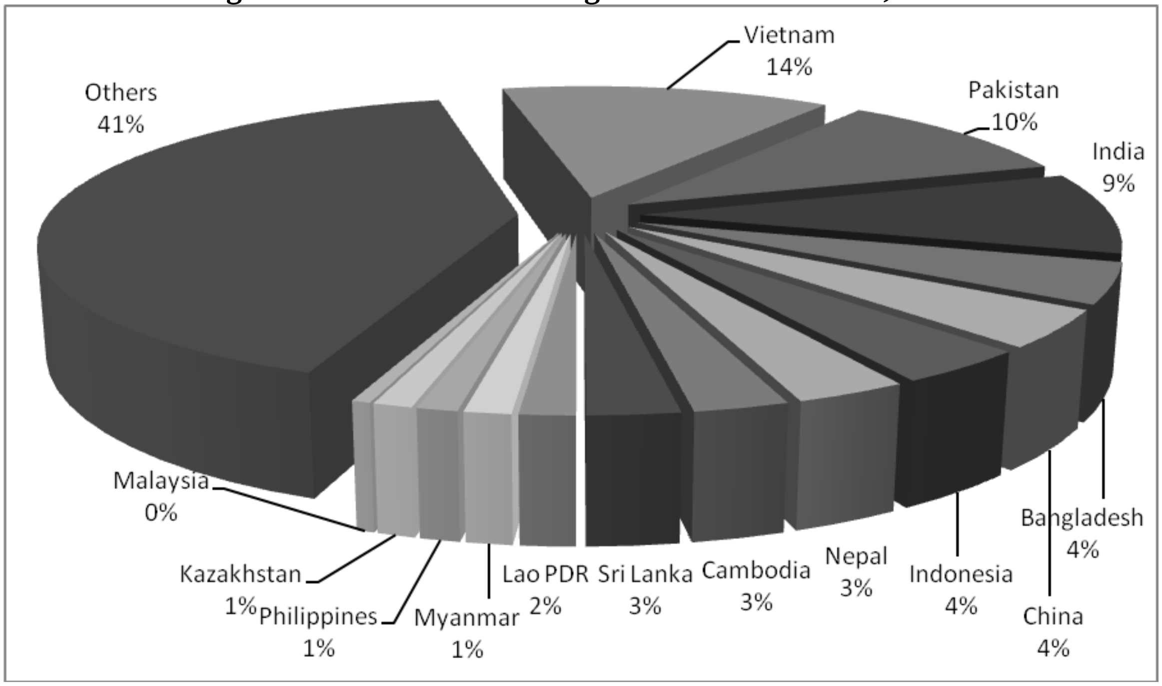
Source: "Development Database on Aid," accessed November 2011, http://www.oecd.org/.

From US$59 billion in 2001, ODA to all developing countries has increased US$140 billion in 2009 (Appendix 1). Bilateral ODA still accounts for around 70 percent of total ODA to developing countries. Meanwhile, total official flows to Asia have increased threefold in 2009 since 2001 (Appendix 2). Half goes to South and Central Asia while around a quarter goes to East Asia.

For Asia, historically, China has been the biggest recipient of official assistance. Recently, however, large market economies such as Pakistan and Bangladesh (apart from India) have also been receiving huge amounts of ODA (Appendix 3).

In 2009, Vietnam became the largest recipient of ODA, from various sources (Figure 7). For instance, China has been investing in specific Vietnamese industries such as the heavy industry sector (iron and steel, timber, fertilizer, and mining), the energy sector (hydroelectricity and thermo-electricity), and infrastructure development (houses, railways, and telecommunications) (Van and Sam 2009). In these cases, Chinese ODA to Vietnam was ultimately concerned with prioritizing economic gains between the two countries, rather than addressing development and social problems such as poverty.

Figure 7. Net ODA Percentage Breakdown in Asia, 2009



Source: "Development Database on Aid," accessed November 2011, http://www.oecd.org/.

In terms of multilateral organizations, EU institutions have become a huge source of multilateral ODA, as well as regional development banks (Appendix 4). Disbursements from the IDA (World Bank) have also increased significantly in the past decade. In spite of these nominal increases, ODA remains to be a small percentage (only around 35 percent) of total external financing for Asia.

Private Capital

Beginning in the 1980s, private capital has become the major source of external financing for developing countries. There are three forms of private capital: foreign direct investment (FDI), portfolio equity, and private debt. Private capital was mostly driven by the robust growth in FDI.

(1) *Foreign direct investment* – In the year 1990, net FDI flowing to developing countries stood at US$23.7 billion, but by 1996 FDI ballooned to US$128.6 billion, far outpacing any other type of private capital flow. The surge in FDI was mostly due to the series of mergers and acquisitions (M&As) that were encouraged by the wave of privatization in the developing countries at the wake of the Asian financial crisis. Although FDI has been on a general rise since 2003, the current global financial crisis

of 2008 has once again slowed down direct investment in the past two years. As a result of withdrawal and low investor confidence, in 2008, 2009, and 2010, the world experienced FDI outflows of US$196.8 billion, US$22.3 billion, and US$49.7 billion, respectively. For Asia in particular, the experience was not as severe, though net FDI flows decreased from US$133 billion in 2006 to only US$30 billion in 2008.

(2) *Portfolio equity* – Historically, portfolio investments are more volatile compared to FDI, and they are more prone to react quickly to adverse changes in the economic climate relative to other forms of private capital. This susceptibility to changes in market sentiment accounts for the fluctuations in net portfolio flows toward the developing and transition economies in the past few years. For instance, before the Asian financial crisis struck, portfolio investments to developing countries were generally upward. After the Asian crisis, however, portfolio investments to developing countries in Asia dwindled. Furthermore, the recent global crisis also caused a decrease in portfolio investments. From US$154 billion in 2006, net portfolio equity to Asia decreased to negative US$121 billion in 2007 and US$99 billion in 2008, a manifestation of the volatility of these short-term investments.

(3) *Private debt* – More than any other form of private capital, private debt has suffered the most due to the financial crises that rocked the global financial markets in Asia, Latin America, and most recently, Europe and the United States. Banks and bondholders do not want to expose themselves in emerging economies. The series of financial crises has severely reduced developing countries' access to the international capital markets. In a similar pattern to portfolio equity, from US$176 billion in 2006, net flows to Asia dwindled to US$71 billion in 2008.

The advantages of private capital can be summarized as follows:

- FDI promotes advanced technology transfer to developing and emerging market economies. Multinational corporations (MNCs) are amongst the most technologically advanced firms, accounting for a substantial part of the world's research and development investments.

- FDI encourages more efficient business practices, new styles of management, and ways of doing business that would enhance the overall business environment.
- Portfolio investments and international bank loans provide domestic firms with a valuable and cheaper alternative for financing business expansion.
- If managed properly, an inflow of private capital would lead to increased domestic investment which would in turn enhance economic growth.

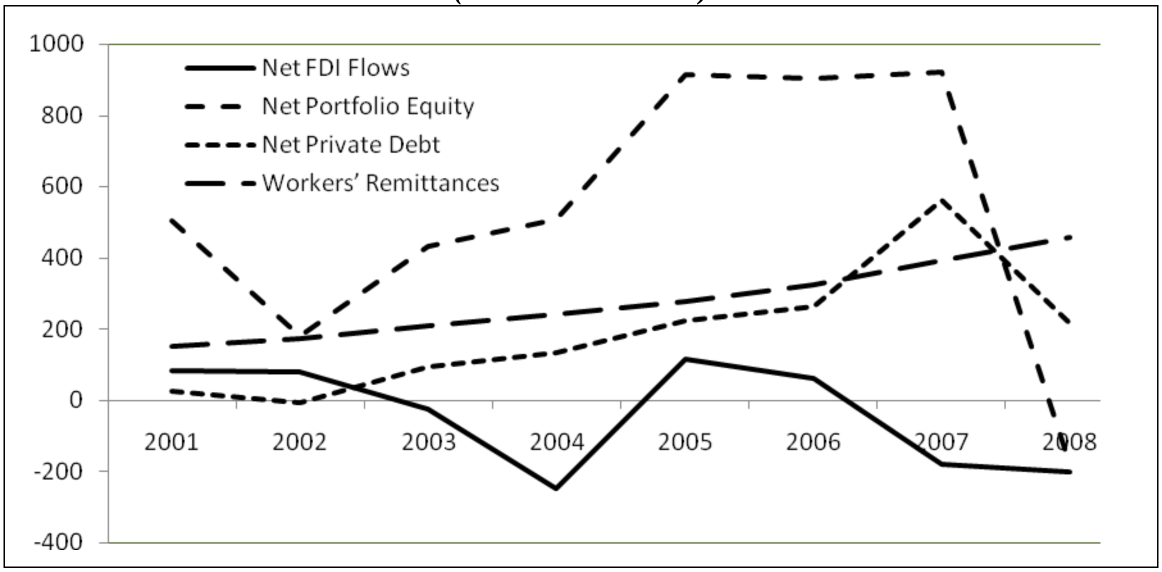
On the other hand, there are inherent risks that can adversely affect the emerging economy:

- Crises can lead private capital flows, especially of the portfolio and private debt kind, to flee affected economies. This is one thing that the different financial crises (Asia, Latin America, and currently North America and Europe) have taught the emerging economies.
- Sectoral growth will be uneven, as private capital may go to certain industries such as manufacturing and service, while neglecting the agriculture sector of developing countries. Private capital investors are first and foremost businessmen who put their money where they think they are most likely to earn the best returns for their investments.
- A surge in private capital flow may slow down domestic investment growth (crowding out of domestic investment).

What are the forces driving private capital flows? First of all, the trend in both industrial and developing countries toward capital market liberalization and trade globalization encourages cross-border transactions. The arrival of supporting infrastructure, such as telecommunications and information technology, and the international standards on banking supervision and accounting have made business processes more accessible and integrated. Furthermore, regulatory changes have made it possible for companies of developed countries to invest abroad, especially in perceived new, high-yield investment opportunities in emerging market economies.

In the past decade, private capital flows have greatly fluctuated as a result of financial crises (Figure 8). In 2008, as expected from volatile short-term investments, portfolio equity and private debt took a huge dive, while FDI only decreased slightly.

Figure 8. Breakdown of Private Capital Flows and Remittances to the World
(In Billion US Dollars)

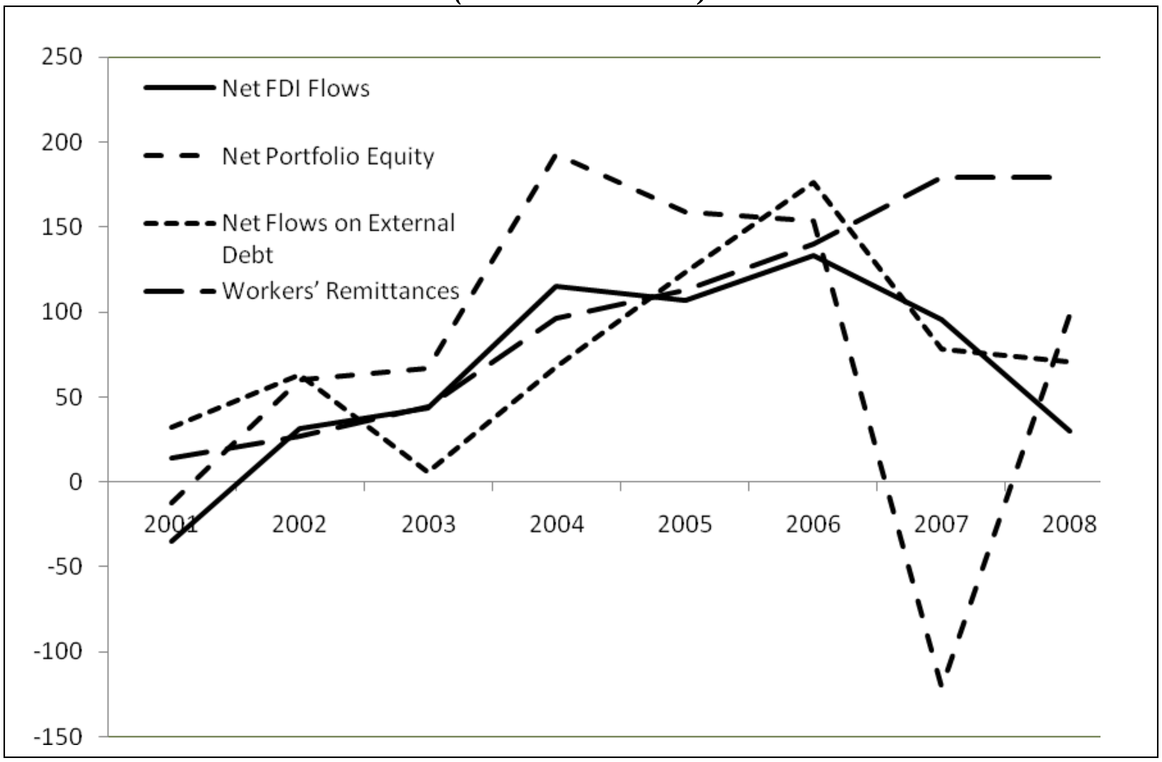


Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

FDI plays an important role in developing countries, and this importance has grown over the past decade, as evidenced by the expanding (e.g. doubled) presence of the largest transnational corporations (TNCs), such as the Fortune 500 companies, in the past decade (UNCTAD 2011). For Asia, FDI has been on a general increase, up to 2007, when investors have been withdrawing from developing countries (Figure 9). Portfolio equity has the sharpest movements, turning negative in 2007, while private debt flow has also decreased, but remains positive.

Among the Asian countries, China is still the largest recipient of FDI in 2009, at US$70 billion, followed by India at a distant US$19 billion (Appendix 5). Portfolio equity to China, India, and the Republic of Korea are all above US$20 billion (Appendix 6), while China has the largest private debt inflow, at US$42 billion (Appendix 7).

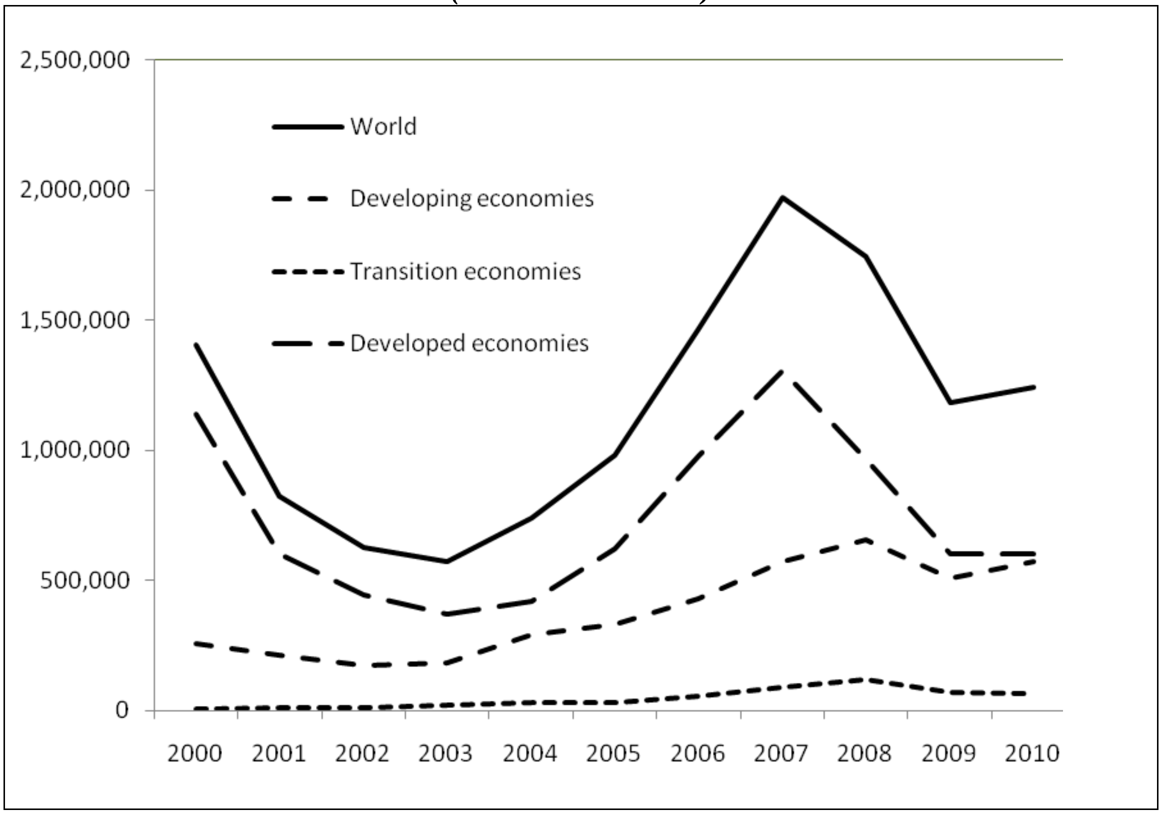
Figure 9. Breakdown of Private Capital Flows and Remittances to Asia
(In Billion US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

World FDI inflows grew rapidly and faster than world GDP and world exports during the period 1981-2000. In particular, world FDI inflows over the period 1990-2000 increased 4.8 fold as compared to the previous ten year period, and they have surpassed the 4.5 fold increase attained between the 1970s and 1980s. So far, the major share of FDI has gone to the developed world, but this is slowly merging with developing economies in 2010 (Figure 10). This trend has been reversing as Asia has emerged as an attractive destination for world FDI. Europe and North America have also been major destinations of FDI, although this may be shifting due to the crisis of 2008.

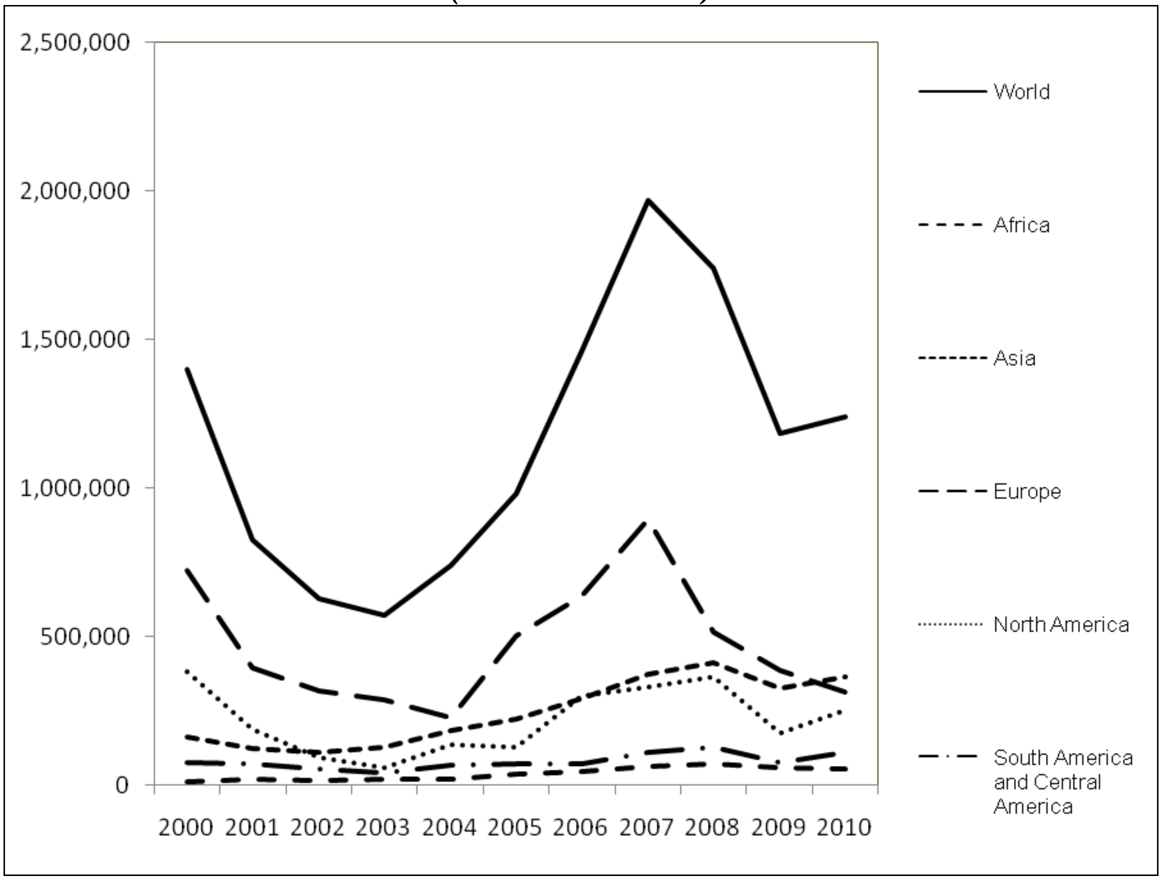
Figure 10. FDI to the World
(In Million US Dollars)



Source: "FDI Statistics," accessed November 2011, http://www.unctad.org.

In terms of regional distribution, Asia has overtaken Europe and North America and is now the largest destination of FDI (Figure 11). Traditionally, Europe and North America have been the largest recipients of FDI, but lately, China has emerged as the most favored destination. Europe has slumped because of the crisis, peaking in 2007. North America, a developed region wherein a lot of the multinational corporations (MNCs) are based, remains to be a big destination of FDI, while Africa, where the majority of developing countries are, receives the least FDI. South America and Central America also receive little FDI compared to Asia.

Figure 11. Regional Distribution of FDI
(In Million US Dollars)



Source: "FDI Statistics," accessed November 2011, http://www.unctad.org.

Several reasons explain the concentration of FDI in certain regions: buoyed market sentiment, the existence of suitable infrastructure, sound institutions including a reliable legal framework, a sound and consistent policy framework, and high potential for future growth. In Asia, historically, aside from China (largely due to its accession to the World Trade Organization), other preferred destinations are the Republic of Korea and Singapore, being among the fastest growing and most resilient economies in the region (Table 2). Thailand and Vietnam have also been huge recipients over the years. Cambodia and Lao PDR are still struggling to attract foreign direct investment.

Table 2. FDI Trends in Asia

(In Million US Dollars)

	1990	1995	2000	2005	2006	2007	2008	2009
Cambodia		151	142	375	475	866	795	511
China	2,657	33,849	37,483	105,903	102,922	143,057	121,677	70,316
Hong Kong			2,572	6,417	75	-6,754	9,065	-11,599
India		2,026	3,075	4,629	5,992	8,202	24,150	19,669
Indonesia	1,093	3,743	-4,550	5,271	2,188	2,253	3,419	2,628
Lao PDR	6	95	34	28	187	324	228	319
Malaysia	2,332	4,178	1,762	994	53	-2,744	-7,828	-6,626
Philippines	530	1,079	2,115	1,665	2,818	-620	1,285	1,604
Republic of Korea	-263	-1,776	4,802	-58	-7,588	-17,935	-16,941	-14,948
Singapore	3,541	4,748	10,569	4,241	10,539	4,331	8,845	-3,185
Thailand	2,303	1,182	3,389	7,554	8,479	8,309	4,442	862
Vietnam			1,298	1,889	2,315	6,516	9,279	6,900

Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

III. FOREIGN DIRECT INVESTMENT

Advantages of FDI over Other Forms of Capital

Foreign direct investment is different from other types of external private flows in that it is motivated largely by investors' long-term prospects of making profits from production activities that they control. On the other hand, foreign bank lending and portfolio equity are invested in activities which are often motivated by short-term profit considerations. These considerations are influenced by a variety of factors (e.g. interest rates) that are prone to herd behavior. The success of attracting FDI by Asian economies has been markedly different. There are particular conditions or determinants which make these countries attractive to foreign investors.

Role of Foreign Direct Investment

While FDI represents investment in production facilities, its significance for developing countries is much greater. Not only can FDI add to investible resources and capital formation, but, perhaps more importantly, it is also a means of transferring production technology, skills, innovative capacity, and organizational and managerial practices between locations, as well as accessing international marketing networks. The first to benefit are enterprises that are part of transnational systems (consisting of parent firms and affiliates) or that are directly linked to such systems through non-equity arrangements, but these assets can also be transferred to domestic firms and wider economies of host countries if the environment is conducive. The greater the supply and distribution links between foreign affiliates and domestic firms, and the stronger the capabilities of domestic firms to capture spillovers (indirect effects) from the presence of and competition from foreign firms, the more likely it is that the attributes of FDI that enhance productivity and competitiveness will spread (Mallampally & Sauvant 1999).

Furthermore, domestic market-oriented FDI brings new products and services to market. It would also add to the exchequer through taxes, boost exports, and encourage competitiveness in local industries. Despite these opportunities, the large literature on host economy impacts concludes that the benefits are uneven.

In terms of poverty reduction, the development of infrastructure has positive impacts, on two levels (Van and Sam 2009). First, the poor living in remote areas have access to transport services, which would enable them to go to work or participate in trading centers (e.g. markets). Second, the actual process of building the infrastructure creates a large volume of jobs for many people in the host country.

In relation to the type of investing countries, some studies find a distinction between FDI from developed countries versus FDI from so-called emerging countries (e.g. China, India) (Van der Lugt et al. 2011). FDI inflow from emerging countries assumes considerable importance for host developing countries. Because of greater familiarity with the technology and business practices of developing countries, emerging country foreign affiliates may be able to interact more effectively with domestic firms in host developing countries than the affiliates of transnational corporations (TNCs) from developed countries. As such, the impact of spillovers from emerging country TNCs on economic growth and poverty reduction can be higher.

Why FDI Moves

A large number of factors determine the inflow of FDI into a host country. These can broadly be classified as factors endogenous and exogenous to the host country. The national government of the host country has total control over the endogenous factors; the exogenous factors are beyond its control. Given the potential role FDI can play in accelerating growth and economic transformation, developing countries are strongly interested in attracting it. They are taking steps to improve the principal determinants influencing the locational choices of foreign direct investors. These determinants are given in Table 3.

Developing countries have during the past two decades liberalized their national policies to establish a hospitable regulatory framework for FDI by relaxing rules regarding market entry and foreign ownership improving the standards of treatment accorded to foreign firms, and improving the functioning of markets (Mallampally & Sauvant 1999). These core policies are imperative because FDI will simply not take place where it is excluded or strongly impeded. Changes in policies have an asymmetric effect on the location of FDI: changes in the direction of greater openness allow firms to establish themselves in a particular location, but do not guarantee that they will do so. In contrast, changes in the direction of less openness (e.g., nationalization) will ensure a reduction in FDI.

Table 3. Determinants of FDI

Host country determinants	Type of FDI classified by motives of firms	Principal economic determinants for MNCs
Policy Framework for FDI • **Economic, political, and social stability** • **Rules regarding entry and operations** • **Standards of treatment of foreign affiliates** • **Policies on functioning and structure of markets (especially competition, mergers and acquisitions)** • **International agreements on FDI** • **Privatization policy** • **Trade policy (tariffs and non-tariff barriers) and coherence of FDI and trade policies** • **Tax policy**	**Market-seeking**	• Market size and per capita income • Market growth • Access to regional and global markets • Country-specific consumer preferences • Structure of markets
Economic determinants **(see table on the right)**	**Resource/asset-seeking**	• Raw materials • Low-cost unskilled labor • Skilled labor • Technological, innovative, and other created assets (e.g. brand names) including as embodied in individuals, firms, and clusters • Physical infrastructure (ports, roads, power, telecommunications)
Business facilitation • **Investment promotion (including image-building, investment-generating activities, and investment-facilitation services)** • **Investment incentives** • **Hassle costs (related to corruption and administrative efficiency)** • **Social amenities (e.g. bilingual schools, quality of life)** • **After-investment services**	**Efficiency-seeking**	• Cost of resources and assets, adjusted for labor productivity • Other input costs, such as transport and communication costs to/from and within host economy and other intermediate products • Membership of a regional integration agreement conducive to the establishment of regional corporate networks

Source: UNCTAD, “Trends and Determinants,” *World Investment Report 1998*.

The most important determinants of FDI are economic considerations, which come into full play once an enabling FDI policy framework is in place (Table 3). They may be divided into three groups: those related to the availability of location-bound resources or assets, those related to the size of markets for goods and services, and those related to the cost advantages in production. Although many of the factors that attract investments to particular locations such as abundant natural resources, large host country markets, or low cost, flexible labor remain important, their relative importance is changing as transnational corporations within the context of a globalizing and liberalizing world economy are increasingly pursuing new strategies to enhance their competitiveness (Sachs & Bajpai 2000) .

An important factor under the market-seeking determinant is political motivation (Rajan 2008). Lower political risk is an important consideration in selecting host countries for FDI. For instance, political instability in Thailand in 2008 resulted in a huge drop in FDI inflow, with effects being felt in 2009. Previous or intended political ties may also play a role; for instance, former colonies are likely to be selected as destinations of FDI due to cultural ties and familiarity.

Under the efficiency-seeking determinant, there is another factor which may play a role in selecting FDI flow to developing countries. One possible determinant of FDI would be the geographical distance between donor and recipient countries (Rajan 2008). As in the case of international trade, a larger geographical distance stands out as an important determinant deterring bilateral FDI flow. Higher exports appear to stimulate future FDI flow, as firms desire to increase regional integration. There is then a role for government policy to reduce transactional and informational distance and to somehow reduce trade and transport costs. While this factor can be considered "natural," exogenous, and cannot be shaped by policy, governments in Asia still need to focus greater attention on reducing communication and transaction costs and informational barriers that may hinder intra-regional FDI flow.

An analysis of the experiences of seven countries in Asia – China, India, Indonesia, Malaysia, Philippines, Singapore, and Thailand – was undertaken to glean lessons of experience which would provide a framework for countries aspiring to attract future FDI. An initial comparative assessment of factors attractive to FDI can be found in Table 4.

Table 4. Business Climate and Competitiveness in Selected Asian Countries, 2009

	China	India	Indonesia	Philippines	Malaysia	Singapore	Thailand
Number of procedures required to start a business	14	13	9	15	9	3	7
Number of days required to start a business	37	30	60	52	11	3	32
Cost of setting up (% of income per capita)	4.9	66.1	26.0	28.2	11.9	0.7	6.3
Difficulty of Hiring Index	11	0	61	56	0	0	33
Rigidity of Hours Index	33	20	0	0	0	0	0
Rigidity of Employment Index	31	30	40	29	10	0	11
Redundancy costs (weeks of salary)	91	56	108	91	75	4	54
Time to close down (years)	1.7	7.0	5.5	5.7	2.3	0.8	2.7
Global Competitiveness Index (rank)	27	51	44	85	26	3	38

Source: *World Economic Forum Global Competitiveness Report 2010-2011*.

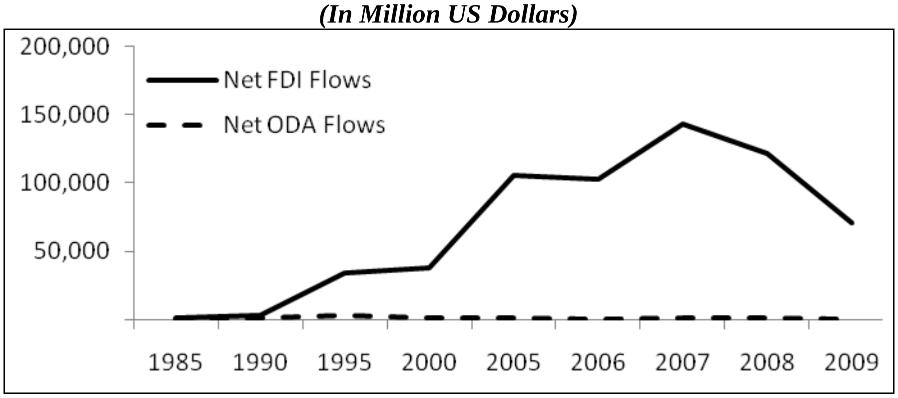
The Global Competitiveness Index (GCI) is composed of three "pillars," all of which are widely accepted as being critical to economic growth: the quality of the macroeconomic environment, the state of a country's public institutions, and, given the increasing importance of technology in the development process, a country's technological readiness. The GCI for Singapore is way ahead compared to other Asian countries, as it is very easy and quick to set up a business in this country. Singapore is followed by Malaysia then China (Table 4). The cost of setting up a business in China is very low at 4.9 percent, which may explain the high inflow of FDI. Meanwhile, labor is an issue for countries such as Indonesia and the Philippines, where there are high redundancy costs, difficult hiring, and rigid employment requirements.

IV. COUNTRY EXPERIENCES

China

China has by far attracted the largest amount of FDI amounting to currently about US$70 billion in 2009 (Figure 12). China embarked on its economic transformation in the late 1970s. The approach can be best described as incremental and experimental with considerable responsibility assumed by local governments. The economic reforms were in three waves. The Agricultural and Rural Reform (1978-1984) took place following the upheavals of the Great Leap Forward and the Cultural Revolution.

Figure 12. FDI in China
(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

Key measures included the leasing of land to farmers under the household responsibility system, higher procurement prices for key crops, and introduction of the two-track price system. The reforms led to a surge in agricultural production and productivity, contributing to higher savings and investment, and the release of large amounts of labor for employment in emerging rural industries, notably town and village enterprises. Most notably, open economic zones were established in coastal regions to attract foreign investment and promote exports. Tentative steps were taken to scale back the planning system for industrial state enterprises, and experiments were initiated to establish tighter links between wages and productivity (International Monetary Fund [IMF] 2007).

The second wave entailed a Broadening of Reforms (1984-1991), which led most notably to state industrial enterprises in urban areas, and the gradual dismantling of the central planning system. Important measures included granting state enterprises more autonomy in production and employment decisions (the contract responsibility system) and the extension of the two-track system to industrial prices. In addition, other types of enterprises such as urban collectives began to gain importance. In the financial sector, the monobank system was dismantled, and the People's Bank was established as the central bank. In 1984, fiscal reforms allowed enterprises to retain a larger share of profits, and an enterprise tax system was introduced to replace profit transfers to the budget.

Next was a Deepening of Reforms (since 1992) which took place following Deng Xiaoping's 1992 tour of the Southern Provinces and his call for the country to accelerate reforms. A key focus of the strategy was to strengthen the institutions and infrastructure for macroeconomic control and increase the market orientation of the economy through wide-ranging reforms in central banking and the financial sector, the fiscal system, and the exchange rate and trade system, and corporatization of the State Owned Enterprises (SOEs).

China's admission into the World Trade Organization in late 2001 has served to accelerate the country's growth. The World Bank estimates that exports represent a quarter of China's GDP, five times the level of 1978. And it is not just exports that are booming. China is consuming and importing at a phenomenal rate. China's economic transformation has created a large middle class. Wages have risen, but remain well below the rest of the industrialized world – a fact that has kept Chinese goods competitively priced and allowed China to make major inroads into markets where they were formerly small players (CBC News 2005).

Factors that have been most influential in determining attractiveness of China as an FDI destination are as follows: market size, abundant supply of cheap labor, infrastructure, scale effect and crowding in effect, tax concessions, special privileges and special economic zones, and open coastal cities, large Chinese diaspora, and political commitment and stability.

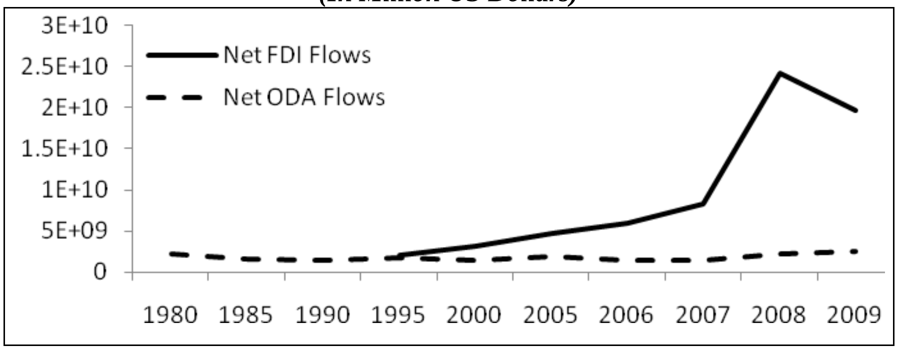
India

India's economic growth performance during the first three decades since it achieved independence in 1947 was dubbed the "Hindu" rate of growth.[2] The term connoted a disappointing but not disastrous outcome and the acquiescence that the Hindu religion supposedly inspires, because of its greater emphasis on the "life after." FDI in India sharply

[2] The "Hindu" rate of growth was a term coined by the late Professor Raj Krishna of the Delhi School of Economics.

increased after 2005 to around US$24 billion in 2008. The global crisis caused only a small decrease, while ODA increased to US$2.5 billion (Figure 14).

Figure 14. FDI in India
(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/

India's development strategy since the second plan (1956-1961) has come to be known as the Nehru-Mahalanobis strategy. This strategy accorded primacy to the capital goods sector and advocated a socialist framework for India in which the public sector would play a dominant role. In line with the mainstream thinking, planners subscribed to the supply-side view of the growth process in which capital accumulation was key. Since 1980, India's per capita economic growth rate has more than doubled, rising from 1.7 percent in 1950-80 to 3.8 percent in 1980-2000.

Some rethinking on economic policy had begun in the early 1980s, by then the limitations of the earlier strategy based upon import substitution, public sector dominance and extensive government control over private sector activity had become evident. However, the policy response was limited, and was confined only to liberalizing particular aspects of the control system. A wave of reforms swept the country in 1991, which brought in liberalization, globalization, and privatization. After three decades of sluggish growth of about 3.5 percent per annum in the post independence period, the Indian economy attained an impressive growth of about 5.6 percent in the last two decades. Furthermore, during the mid-nineties, the economy grew by more than 7 percent per annum. Since India's economic reforms were launched in 1991, the Indian economy has sustained an annual average growth rate of over 6 percent. India's foreign exchange reserves have crossed the US$100 billion mark. And the current account deficit has turned into a surplus. This was achieved through non-debt creating capital flows, so that India's external debt has remained virtually static in nominal terms. The debt servicing and debt ratios have fallen sharply. In fact, India is now repaying its foreign debt ahead of schedule.

Taking advantage of its pool of high-quality scientific talent, international corporations have established large R&D centers in India.

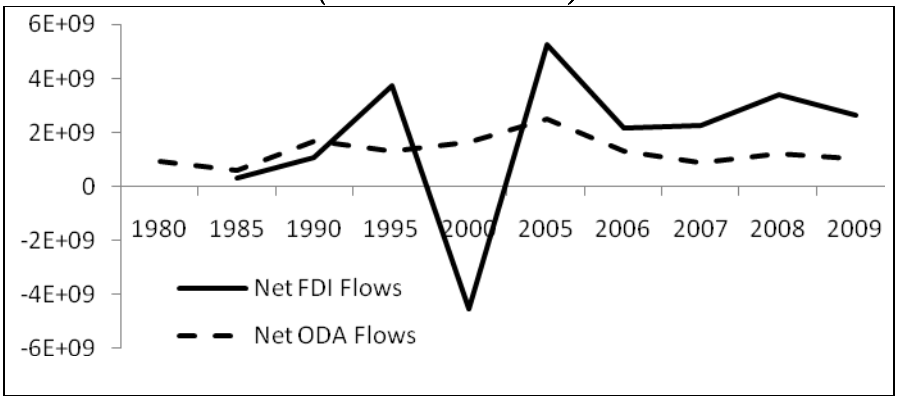
The most important factors which have attracted FDI into India are not FDI-specific policies but, rather, broader economic policies including corporate taxes, trade openness, and other business climate issues, such as regulatory quality and burden. India has made considerable progress in liberalizing its FDI regime, which is a necessary but not sufficient condition to attract significant FDI inflows. The differences across Indian states in attracting FDI further underscore the importance of business climate in determining FDI rather than FDI-specific incentives. Labor market flexibility also appears to be an important factor in determining FDI, and India has a relatively inflexible labor market. Protection against dismissal is stringent in India making it difficult for businesses to fire workers. Correlation between the labor flexibility and FDI across countries suggests that countries with inflexible labor markets receive less FDI (Javorick & Spatareanu 2005).

India's human capital and R&D base has pockets of international excellence, most notably in information technology and in some defense-related industries. Until recently, and in contrast to much of East Asia, its educational priorities resulted in centers of international quality alongside high levels of illiteracy. Furthermore, its inward-looking strategy meant that it was unable to exploit its human capital strengths in the global economy. In contrast to China, however, its major intrusion into the international information technology industry has been via services rather than manufacturing. Its commercial environment is broadly predictable, and the legal system cumbersome but independent. It also has the highest level of decentralized economic policy making among the seven countries. A large diaspora facilitates its connection to the international economy. It is evident that, the 1991 reforms and their aftermath have begun to transform the commercial environment.

Indonesia

As it was the most affected country, FDI in Indonesia took a huge slump after the 1997 crisis then rose up to an average of US$2.5 billion per year (Figure 15). On the other hand, the global crisis of 2008 had not affected the flow of FDI as much, with FDI even increasing in 2008. The levels of ODA have a similar trend as those of other Asian countries.

Figure 15. FDI in Indonesia
(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

From independence and through the period of the Sukarno presidency, increasing reliance was placed on fiscal stimulus financed by money creation. This policy mix gave rise to accelerated inflation, a collapse in confidence and economic stagnation. Inflation peaked at 1,500 percent in 1965, accompanied by food shortages and high employment. The coming to power of Suharto in 1965 saw a sharp change in economic policy settings, with the introduction of multiyear economic plans to guide development. To encourage foreign direct investment in the country, the Indonesian government introduced the Foreign Investment Law No. 1/1967 in the year 1967. However, this legislation excluded oil and gas, banking, insurance, and leasing sectors. This law provided a number of incentives to foreign investors such as tax exemptions and some guarantees. Though in the beginning, the Indonesian government adopted an open door policy, in later years they changed their strategy. In the year 1970, some of the sectors were closed for foreign direct investment. Oil revenues permitted government to play a major role in driving economic development while maintaining relatively conservative fiscal and monetary policies.

In response to the pressures of the early 1980s, economic policy became more market-oriented, with private sector investment assuming the role of the principal driver of economic growth. These policy changes stimulated FDI inflow and made it a major contribution to restoring economic growth. In the late 1980s and early 1990s, economic growth returned to the levels of the 1970s. This period of strong growth ended in 1997 with the onset of the Asian crisis. Although all the affected countries suffered massive short-term capital outflows during the crisis, Indonesia was unique among the crisis-affected economies, since it suffered substantial and sustained negative FDI inflow in the wake of the crisis.

The Indonesian economy finally began to recover in 2000, posting growth of 4.8 percent, and it seemed to weather the global slowdown evident in 2001 with an economic growth of 3.3 percent. With the fourth quarter showing an even bleaker picture, with GDP only 1.6 percent above its level of the fourth quarter of 2000, growth is generally forecast to be a little over 3 percent in 2002.

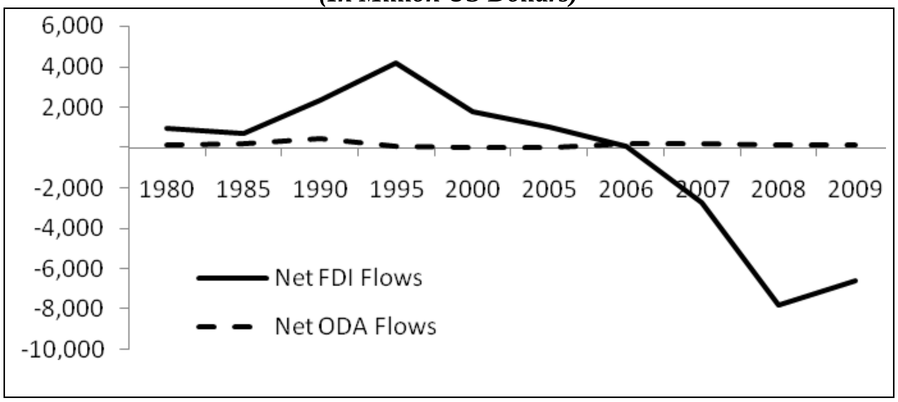
The Asian Development Bank (ADB) (2002) observed in its outlook for Indonesia:

Spurred by rising exports, increased investment was one of the factors that helped to pull the economy out of recession in 2000 and early 2001. However, FDI inflow faded as the global markets weakened in 2001. More important to longer-term prospects, there has been a widespread perception that the policy for investment in Indonesia has turned harsh and unsupportive. In the first ten months of 2001, only US$6 billion of FDI projects was approved, roughly equal to one third of the total approved during the comparable period in 2000. Because the fall in investment predates the September 2001 attacks on the U.S., it would seem to be part of the broader, longer-term problem of capital flight seen in Indonesia since the financial crisis. Continuing problems of financial governance, lack of credibility of the legal and judicial system, and political uncertainty have all discouraged investors from making longer-term commitments.(ADB 2002)

Malaysia

Malaysia has been suffering an outflow of FDI over the past five years. Net ODA has also been very low, but remains at a constant level (Figure 16). Since independence in 1957, Malaysia has fully capitalized on its tangible assets – such as rich natural resources, abundant and cheap labor, and its sizeable domestic market – as well as its intangible assets, namely its preferential trade status under the Generalized System of Preferences (GSP), macroeconomic stability, liberal trade regime and an efficient legal infrastructure to attract FDI (Rajenthran n.d.). Broadly speaking, FDI in the context of Malaysia has been relatively successful. The government of Malaysia's principal policy is to harness FDI as part of the economic development strategy in order to obtain foreign technology, capital, and skills.

Figure 16. FDI in Malaysia
(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

To this end, the predominantly import substitution-based economy of the 1960s was to a large extent replaced by a vigorous and diversified export-oriented economy. This was followed by an unprecedented real GDP growth rate averaging 8.9 percent per annum from 1988 to 1996, particularly buoyed by FDI in the manufacturing sector. However, since the onset of the 1997 Asian financial crisis, FDI inflow has declined significantly in Malaysia vis-à-vis Southeast Asia as a whole. This may be attributed to "shifting technological/trade patterns, the lure of China, the liberalization of other emerging economies, and the dampening effect of the Asian crisis". (ADB 2004)

The Malaysian government encourages FDI, particularly in export-oriented manufacturing and high-tech industries, but retains considerable discretionary authority in approving individual investment projects. The government permits 100 percent foreign ownership in the manufacturing sector. However, in keeping with long-standing public policies designed to increase Bhumiputra (i.e. ethnic Malay) participation in the economy, the Malaysian government encourages or requires joint ventures between Malaysian and foreign companies and in many cases limits foreign equity and employment.

In 1998, the Malaysian government relaxed existing restrictions on foreign equity in new manufacturing projects. Foreigners may now hold 100 percent equity in any new manufacturing project, whether export-oriented or not, for which MIDA approves a license.

The Malaysian government promotes the acquisition of economic assets by Bhumiputra to encourage a more even distribution of wealth among the different ethnic groups. The government often requires foreign and domestic non-manufacturing firms to take on Bhumiputra partners (usually 30 percent of share capital) and to maintain a workforce that proportionately reflects Malaysia's ethnic composition.

In an effort to insulate the Malaysian economy from risks posed by volatile short-term capital flows, and to eliminate offshore trading of the Ringgit, the government imposed selective capital controls on September 1, 1998, including a fixed exchange rate.

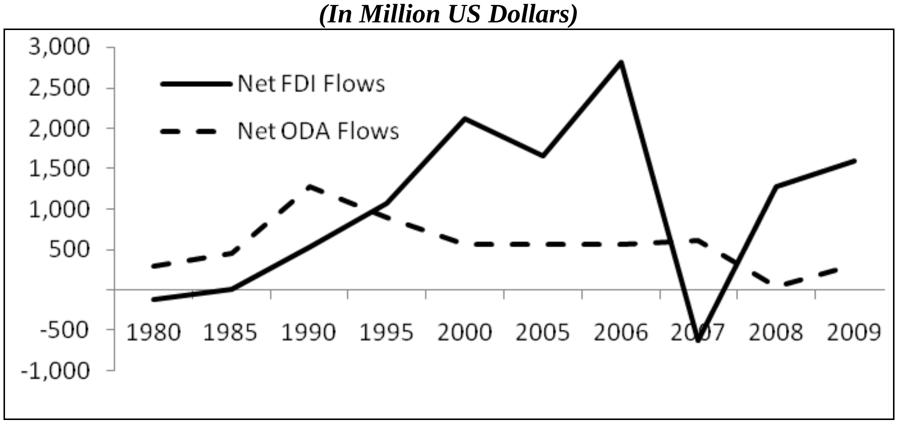
Thus Malaysia emerges as a country with comparatively high institutional quality, very good infrastructure, consistent commercial policy, exchange rate stability, and a good human resources base. However, there are concerns that the independence of its legal system may have weakened in the past two decades (ADB 2004).

Philippines

FDI in the Philippines has not lived up to expectations. It has been volatile, peaking at almost US$3 billion in 2006 and slumping in 2007 (Figure 17). FDI is slowly increasing in the past years in spite of the crisis. ODA, however, is just starting to pick up from low levels.

Figure 17. FDI in Philippines

(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

The Foreign Investment Act (FIA) of 1991 opened most areas of the Philippine economy to foreign investments. An amendment to FIA allowed almost 100 percent foreign ownership in enterprises serving the domestic market and removed foreign equity restrictions in enterprises exporting at least 60 percent of their total product. While foreigners are not allowed to own land, leasing terms are liberal, with the passage in July 1993 of RA 7652, which extended the maximum allowable lease to foreign companies from 25 years to 50 years, renewable once for 25 years. Liberal terms were also provided by the 1995 Mining Act (RA 7942), which gave foreign investors 100 percent control over a maximum of 81,000 hectares of mineral lands for 25 years, with the possibility of renewal for another 25 years (Bello 1999).

What went wrong? According to some analysts, the problem does not lie in foreign investors' perception of an inhospitable climate in the Philippines. Nor does it lie in non-competitive wages: average wages in many countries receiving more investment than the Philippines, like Singapore, Malaysia, Thailand, and Korea, are much higher than those in the Philippines. The problem lies in the changing priorities of investors and where those priorities place the Philippines. Since the mid-eighties, foreign investors have no longer been principally interested in using investment sites as cheap-labor platforms from which to export cheap manufactures to the rich markets of the North. The main objective of foreign investors has shifted to focus on setting up facilities to exploit expanding domestic markets dominated by a growing middle class, and many investors are willing to put up with restrictive investment rules in countries to gain access to this middle class.

In this light, it is not its investment regime but its economic policies and management that have disadvantaged the Philippines. The mess created by crony capitalism under the Marcos regime was followed by six more years of IMF-imposed structural adjustment under the Aquino administration, where the nation's top economic priority was paying off the foreign debt. This starved the economy of much-needed investment. At the same time, redistribution of assets and income via effective land reform was postponed indefinitely. The result of these growth-unfriendly policies was not surprising: zero average growth between 1983 and 1993, resulting in 54.0 percent of Filipino families living under the poverty line by 1991, a rate higher than 52.0 percent in 1985.

Foreign investors surveying the dismal scene would not be attracted by the market opportunities in the Philippines. Moreover, this income distribution situation worsened in 1991 relative to 1985, with the share of income going to the top 10 percent rising from 36.4 percent to 38.6 percent.

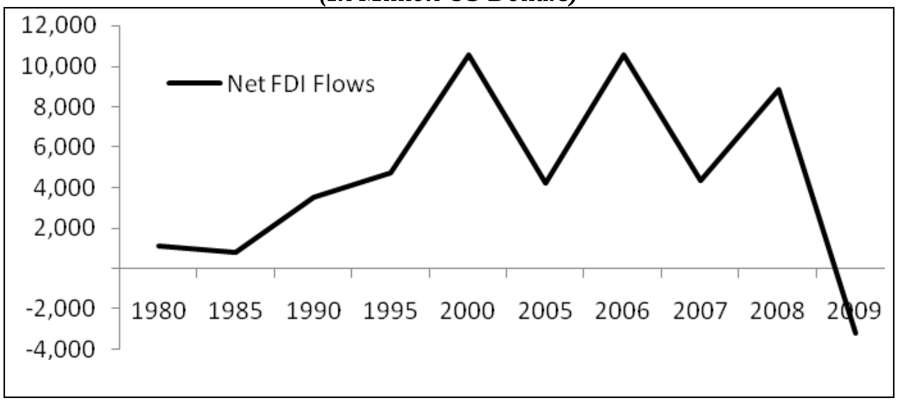
In the early 1990s, the Ramos administration provided political stability, but the attempt to attract foreign investors was nullified by the priority placed on macroeconomic stabilization instead of expansion. Official statistics indicated that the poverty rate had dropped to 32 percent by the end of the Ramos administration, but that was attributed largely to methodological changes in measuring poverty introduced by the government's statistical agencies.

The Asian Development Bank urged the Philippines to strengthen its efforts to tear down the barriers that sour investors' interests in the country (Asian Economic News 2004). The call was made in the wake of a recent study that indicated the Philippines had lagged behind for two or three decades due to the poor investment climate brought about by macroeconomic instability, poor infrastructure, excessive regulation, and corruption – a classic situation of government failure in comparison to other East Asian governments. Apart from macroeconomic instability, investors are also concerned about poor governance and institutions including massive corruption, power outages, inefficient telecommunication systems, inefficient water supply, tax rates, economic uncertainty, crime and labor regulations. Other constraints include red tape in obtaining government licenses or permits, informal payments or gift-giving to government officials to secure permits, active labor unions and high labor costs compared with its Asian neighbors. Clearly, much more needs to be done to improve the business environment before FDI can be achieved in substantial amounts in the Philippines.

Singapore

FDI to Singapore has fluctuated over the past decade, with flows ranging from US$4 to US$10 billion. The recent global crisis of 2008 resulted in an outflow of US$3 billion in 2009 (Figure 13).

Figure 13. FDI in Singapore
(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

Singapore maintains an open investment regime with few exceptions (e.g. limits on foreign ownership in domestic banking and media). Foreign investment combined with government directed investments through state-owned companies provided the basis for the transformation of Singapore into a modern industrial economy.

According to the 2001 Singapore Investment Climate Report by the U.S. Department of State (2001), the Singaporean government is presently pursuing a strategy to upgrade Singapore into a technology and innovation-driven knowledge-based economy, in response to stiffer competition from lower income countries for exports and investment and increased economic globalization. Singapore aspires to become a world-class player in the electronics, chemicals, life sciences, engineering communications and media, logistics, education and healthcare industries, as well as a key Asia-Pacific financial center and an "infocom" hub.

Singapore's economy is dominated by foreign multinational corporations (MNCs) and corporations owned entirely or partially by the Singapore government (i.e., "government-linked companies" or GLCs). GLCs straddle all major sectors of the economy, while MNCs are mainly concentrated in the manufacturing sector. Foreign banks and financial institutions, and legal and accounting firms are an integral part of the financial and business services sectors.

Attracting foreign investment into the country – initially to spearhead industrialization and subsequently climb the technological and value-added ladders – has been a key economic strategy of the government since independence in 1965. Singapore has evolved into a base for MNCs to engage in high-end manufacturing and product development, and coordinate regional procurement, production, marketing, and distribution operations. Today, Singapore actively woos MNCs to invest in knowledge-intensive manufacturing and service activities. This has complemented lower-end assembly operations located in other Southeast Asian countries where production and business costs are lower.

Consequently, the country's legal framework and public policies have always been foreign investor-friendly. Foreign investors are not required to enter into joint ventures or cede management control to local interests, and local and foreign investors are subject to the same basic laws. Apart from regulatory requirements in some sectors (financial and telecom services), the government screens investment proposals only to determine eligibility for various incentive regimes. Singapore places no restrictions on reinvestment or repatriation of earnings or capital. FDI flow has increased steadily since 1975 to around US$6 billion per year.

The Singaporean government promotes its regulatory environment as business-friendly, with transparent and clear regulations. Both on the Global Competitive Index and Business Competitive Index, Singapore is far ahead compared to any other Asian country. With some important exceptions, Singapore does not have a system whereby proposed regulations are published for public comment in a government gazette. However, prior to implementing any law or regulation, the government usually consults relevant bodies and agencies, companies and the public. Tax, labor, banking and finance, industrial health and safety, arbitration, wage and training rules and regulations are formulated and reviewed with the interests of foreign investors and local enterprises in mind, and the Government is usually open to comments from interested businesses. Local laws give regulatory bodies wide discretion to modify regulations and impose new conditions, thereby enabling government agencies to have flexibility in adapting incentives or other services to foreign companies on a case-by-case basis (Heritage Foundation, Index of Economic Freedom 2004).

Policies in Singapore facilitate free flow of financial resources. Credit is allocated on market terms, and foreign investors can access credit in the local market, in denominations of U.S. dollars, Singapore dollars, or other foreign currency. Singapore's financial markets are sophisticated and world class. The legal, regulatory, and accounting systems are transparent and match international norms and best practices.

Singapore is regarded by most observers and businesses as having clean, corruption-free government. It has been ranked as Asia's least corrupt country by Transparency International. Singapore has and enforces anti-corruption laws. The Prevention of Corruption Act and the

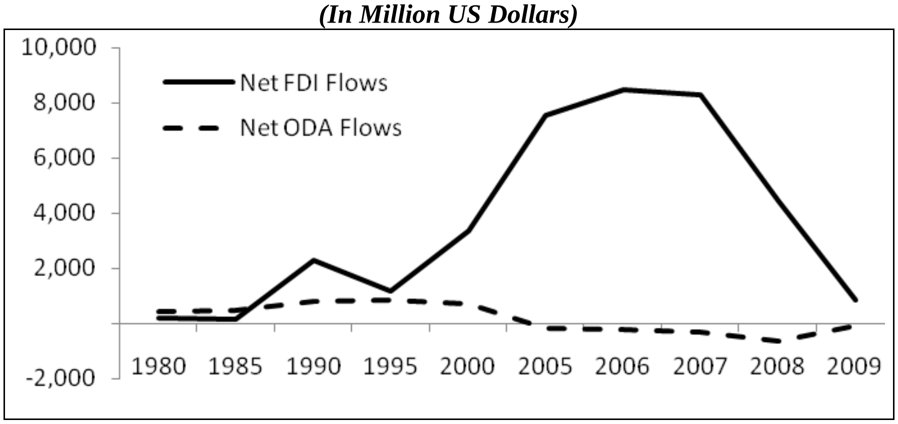
Corruption Act (Confiscation of Benefits) provide the legal basis for government action by the Corrupt Practices Investigation Bureau (a division of the Prime Minister's Office). These laws cover acts of corruption both within Singapore as well as those committed by Singaporeans abroad. When cases of corruption are uncovered, the government deals with them swiftly and publicly, as they do in cases where public officials are involved in dishonest and illegal behavior (U.S. Department of State, Singapore Investment Climate Report 2001).

Thailand

Thailand has been an attractive destination for FDI. It has increased over the past decade before slumping as a result of the global crisis (Figure 18). In the 1960s, the government followed a traditional import substitution strategy, imposing tariffs on imports, particularly on finished products. The role of state enterprises was greatly reduced from the 1950s and investment in infrastructure was raised. Attention was given to nurturing the institutional framework necessary for industrial development.

Figure 18. FDI in Thailand

(In Million US Dollars)



Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

By the late 1960s and the early 1970s, the import substitution policy had led to balance of payments problems since most components, raw materials, and machinery to support the production of finished products had to be imported. A major policy shift towards export promotion was inevitable.

The late 1970s and early 1980s saw continued interest in export industries, small-scale industries, resource-based and labor-intensive industries, and the promotion of regional industries. In particular, a new Investment Promotion Law was passed in 1977 which provided the Board of Investment (BOI) with more power to provide incentives to priority areas and remove obstacles faced by private investors. Regional inequalities also became a key concern and the BOI steadily shifted its emphasis from promoting export activities to promoting regional development.

By the early 1980s, policy makers had become aware of the inefficiencies fostered by high protection. In the late 1980s and early 1990s, the government started to promote openness and competitiveness. However, the strategy of opening up was rather ad hoc, based on short-term assessments of industrial weaknesses rather than on long-term strategy.

Before the financial crisis in 1997, Thailand's economic development was considered a success with an average economic growth rate of about 8 percent per year from 1960-1996. Despite the world recession of the mid 1980s, Thailand's economy grew at double digit rates during 1988-1990 and by over 8 percent per year from 1991-1995. The rapid growth, driven largely by growing FDI inflows and exports, was accompanied by a shift towards manufacturing, with the manufacturing share of total GDP reaching 29.9 percent by 1995, up from 11.6 percent in 1960. The key challenge of Thailand-based producers, by the mid 1990s was to enhance production capabilities and move up the value-added ladder as competition from lower wage countries like China, India, Indonesia, and Indochina intensified (Brimble 2002).

The Thai government has taken a very favorable approach towards FDI. Although there have been laws and regulations which limit foreign ownership in certain activities, they have been progressively liberalized over the past decade, with an acceleration of this trend in the period since the crisis.

The Alien Business Law, which was enacted in 1972 and restricted majority foreign ownership in certain activities, was amended in 1999. The new law relaxes limits on foreign participation in several professions. It also reduces previous limits on foreign ownership of firms manufacturing certain products such as cement, pharmaceuticals, alcohol, textiles, garments and footwear. Previously, the BOI restricted the majority foreign ownership in promoted projects that were resource-based and manufacturing mainly for the domestic market. But it has gradually relaxed this condition over the past decade. The legal infrastructure has also been strengthened. The Bankruptcy Law was significantly amended in March 1999 to provide improved security for new leaders among other measures designed to facilitate corporate rehabilitation and debt restructuring.

FDI inflow into Thailand increased substantially in the second half of the 1980s after the Plaza Accord, which resulted in currency appreciation in Japan and NIEs such as Taiwan, Hong Kong, and Korea. From 1986 to 1989, Thailand attracted an average of US$0.9 billion per annum of net FDI flow, accounting for around seven percent of private investment. FDI flow has reached US$7.0 billion by 1997, prior to the financial crisis. The manufacturing sector has consistently been a large recipient of FDI with an increasing share in net FDI flow. The sector share increased from an average of 37 percent during 1970-1995 to 57 percent in 2001. Sources of FDI in Thailand have generally been quite diversified, including Japan, the United States, Europe, Taiwan, Hong Kong, and Singapore.

Thailand scores well on most measures of economic and social development with the principal exception of human capital. Until recently, while achieving almost universal primary enrollment, its retention of students through secondary school was low. Consequently, during the 1990s, as real wages began to rise quickly in the wake of rapid economic growth, it experienced difficulty in managing the transition out of labor-intensive activities. It has become progressively more open in its trade and FDI policies. Historically, its legal and commercial “rules of the game” were widely understood and observed. The physical infrastructure is generally good (ADB 2004).

V. CONCLUSION

Policy Implications

From the Asian country experiences discussed, the following lessons are summarized:

(i) Political and economic stability and continuity and predictability of policy are fundamental in attracting FDI to a country. General development conditions are more important than specific FDI focused policies.

(ii) All countries cannot follow a uniform policy to attract FDI. It is necessary to understand the determinants of FDI in the context of each country. The attractiveness of countries keep changing with global economic conditions and economic and industrial structures in individual countries. Countries must determine their requirements and formulate appropriate policy to attract investments. Thailand will continue to dominate the Southeast Asian countries as a destination for FDI because of its investor-friendly policies. It is therefore important for countries to undertake an in-depth analysis of their actual and potential competitiveness on the basis of which national development plans could then be formulated.

(iii) FDI could spur economic development, but economic development itself is a major determinant of FDI. Once economies gain development momentum, FDI can be more easily attracted, thereby further boosting economic development and attracting even larger inflows of FDI. The result is an accelerating pace of development in which FDI has a potentially important role to play. For less developed countries where such momentum has not yet been reached, FDI is not yet a viable policy tool to boost development, unless the country has exceptionally attractive characteristics favorable to inward FDI. The best choices for countries in the initial stages of development are usually to attract resource-based and labor-intensive export-oriented FDI, even if the domestic market size is large. As countries move towards a higher development level, domestic market-oriented FDI can be encouraged to expand consumer choice and spur competition. Incentives and a legal framework should be created that are conducive to the kind of FDI that is to be attracted to a specific country.

(iv) Market-seeking FDI is often constrained by the small markets of developing countries, not only in terms of the size of the population, but also in terms of purchasing power. China and India with their huge populations clearly are magnets for market-seeking FDI. Smaller countries have less scope to attract market-seeking FDI. However, if they integrate markets with neighboring countries, they can attract market-seeking FDI.

(v) Apart from the infrastructure and institutional framework, the legal framework in most developing countries and economies in transition remain underdeveloped. As strong legal framework, consisting of required laws relating to business, contracts, finance, bankruptcy, and investment are fundamental. Governments should pay priority attention to the swift formulation, adoption, and enactment of these laws followed by the swift adoption of implementation regulations. In addition to the above, laws and regulations are required in relation to foreign exchange, repatriation of profits and the hiring of expatriate and local labor.

(vi) Exogenous factors could influence FDI inflow. It is very important for the host country to have a surveillance of these factors so that corrective measures may be taken at the earliest to remain attractive.

(vii) A large number of social policies also indirectly affect FDI. If a country wants to attract FDI, mere focus on the economic policies may not be sufficient. A wide range of government policies affect advantages in industry. Policies relating to education, health care, anti-trust regulation, environment, fiscal and monetary, and others are important.

(viii) Countries should be careful with the choice of financial incentives. Incentives may attract undesirable investments and impose a burden on the government budget.

(ix) As foreigners are often prevented from owning land in most developing countries, this restriction should be reviewed. It should be noted that countries where foreign investors can own land or have long-term leases, are more successful in attracting FDI.

FDI has grown steadily in volume over the past two decades and is a major source of development finance. Recognizing that FDI can contribute to economic development, all governments want to attract it. Indeed, the world market for such investment is highly competitive, and developing countries, in particular, seek such investment to accelerate their development efforts. With liberal policy framework becoming commonplace and losing some of their traditional power to attract FDI, governments are paying more attention to measures that actively facilitate it. The economic determinants are imperative. The principal economic determinants are: market size and per capita income, access to regional and global markets, market growth, raw materials, skilled labor, physical infrastructure, and technology. The country experiences also indicate that it is not the FDI-specific policies that are important but the broader economic policies including corporate taxes, trade openness and other business climate issues such as regulations. However, it is likely that in the future, local advantages and specially created assets (e.g. brand names) that a country or region can offer potential investors would emerge as major determinants of FDI.

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Appendix 1. Official Development Finance to Developing Countries

(In US Billion Dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Official Development Finance	**115.9**	**80.7**	**136.2**	**175.4**	**319.9**	**325.9**	**453.6**	**293.7**	**393.1**
1. Official Development Assistance	59.3	67.0	79.7	91.8	120.4	119.7	120.2	143.2	139.9
Bilateral	41.3	48.9	59.3	65.6	94.2	91.0	88.4	107.0	102.1
Multilateral	18.0	18.1	20.3	26.2	26.2	28.7	31.8	36.2	37.8
2. Other Official Flows	-1.5	1.1	0.9	-2.7	4.1	-8.0	-0.8	3.0	10.0
Bilateral	-0.7	3.5	0.4	-2.4	5.0	-7.8	-1.3	2.2	7.4
Multilateral	-0.8	-2.4	0.5	-0.3	-0.8	-0.2	0.5	0.8	2.5
3. Private Flows	51.3	6.7	48.3	77.6	182.9	203.1	319.4	130.6	226.0
Bilateral	55.4	9.8	47.2	82.3	182.8	200.3	329.1	140.6	207.2
Multilateral	-4.1	-3.1	1.1	-4.7	<0.1	2.8	-9.7	-10.0	18.8
4. Net Private Grants	7.3	8.8	10.3	11.4	14.9	14.8	18.4	23.9	22.2

Source: “Development Database on Aid,” accessed November 2011, http://www.oecd.org/.

Appendix 2. Net Official Flows from All Sources to Asia

(In US Billion Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total Asia	**14.1**	**18.0**	**13.3**	**9.9**	**18.6**	**53.1**	**39.9**	**38.8**	**49.7**	**47.6**
Far East Asia	5.7	7.0	0.4	-2.8	1.3	7.4	6.2	7.3	7.9	10.9
Cambodia	*0.4*	*0.4*	*0.5*	*0.5*	*0.5*	*0.6*	*0.5*	*0.7*	*0.8*	*0.7*
China	*1.2*	*2.9*	*<0.1*	*-1.9*	*2.1*	*2.1*	*2.3*	*2.4*	*3.0*	*1.4*
Indonesia	*2.3*	*1.0*	*<0.1*	*0.9*	*-1.4*	*0.8*	*1.4*	*-0.4*	*0.6*	*1.0*
Lao PDR	*0.3*	*0.2*	*0.3*	*0.3*	*0.3*	*0.4*	*0.4*	*0.5*	*0.5*	*0.4*
Malaysia	*-0.1*	*0.5*	*0.4*	*0.2*	*0.2*	*-0.5*	*-0.2*	*-0.7*	*<0.1*	*0.4*
Philippines	*0.4*	*0.5*	*0.2*	*0.2*	*-0.5*	*-0.2*	*-0.2*	*2.3*	*<0.1*	*1.1*
Thailand	*-1.2*	*-0.6*	*-2.9*	*-5.9*	*-2.5*	*1.3*	*-0.6*	*-0.8*	*-0.9*	*0.1*
Vietnam	*1.6*	*1.4*	*1.3*	*2.1*	*1.9*	*2.0*	*1.9*	*2.5*	*3.0*	*4.9*
Others	*1.0*	*0.6*	*0.7*	*0.8*	*0.7*	*1.0*	*0.6*	*0.8*	*1.0*	*0.9*
South & Central Asia	6.0	7.6	8.4	5.1	8.1	12.7	13.7	17.3	20.4	24.0
Afghanistan	*0.1*	*0.4*	*1.3*	*1.6*	*2.3*	*2.9*	*3.0*	*4.0*	*4.9*	*6.3*
Bangladesh	*1.2*	*1.0*	*0.9*	*1.4*	*1.5*	*1.5*	*1.3*	*1.6*	*2.2*	*1.9*
India	*1.2*	*1.5*	*1.1*	*-3.3*	*0.3*	*3.0*	*3.3*	*4.4*	*4.9*	*5.7*
Myanmar	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.2*	*0.5*	*0.3*
Nepal	*0.4*	*0.4*	*0.3*	*0.5*	*0.4*	*0.4*	*0.5*	*0.6*	*0.7*	*0.8*
Pakistan	*0.8*	*1.9*	*2.1*	*0.8*	*<0.1*	*1.7*	*2.5*	*2.6*	*2.4*	*3.1*
Others	*2.3*	*2.4*	*2.6*	*4.1*	*3.4*	*3.2*	*3.1*	*3.9*	*4.9*	*5.8*
Middle East	2.1	3.0	3.3	7.4	9.0	31.9	19.1	13.2	20.0	11.4
Regional Asia	0.2	0.3	1.2	0.3	0.3	1.1	0.9	1.0	1.4	1.4

Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

Appendix 3. Net Official Development Assistance to Asia

(In US Billion Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total Asia	**15.8**	**16.7**	**18.9**	**20.1**	**23.1**	**46.6**	**32.9**	**35.6**	**44.0**	**38.6**
Far East Asia	7.6	6.5	6.5	6.3	6.0	8.4	6.5	7.3	7.0	8.3
Cambodia	*0.4*	*0.4*	*0.5*	*0.5*	*0.5*	*0.5*	*0.5*	*0.7*	*0.7*	*0.7*
China	*1.7*	*1.5*	*1.5*	*1.4*	*1.7*	*1.8*	*1.2*	*1.5*	*1.4*	*1.1*
Indonesia	*1.7*	*1.5*	*1.3*	*1.8*	*0.1*	*2.5*	*1.3*	*0.9*	*1.2*	*1.0*
Lao PDR	*0.3*	*0.2*	*0.3*	*0.3*	*0.3*	*0.3*	*0.4*	*0.4*	*0.5*	*0.4*
Malaysia	*<0.1*	*<0.1*	*0.1*	*0.1*	*0.3*	*<0.1*	*0.2*	*0.2*	*0.2*	*0.1*
Philippines	*0.6*	*0.6*	*0.6*	*0.7*	*0.4*	*0.6*	*0.6*	*0.6*	*<0.1*	*0.3*
Thailand	*0.7*	*0.3*	*0.3*	*-0.9*	*<0.1*	*-0.2*	*-0.2*	*-0.3*	*-0.6*	*-0.1*
Vietnam	*1.7*	*1.4*	*1.3*	*1.8*	*1.8*	*1.9*	*1.8*	*2.5*	*2.6*	*3.7*
Others	*0.6*	*0.6*	*0.7*	*0.7*	*0.8*	*0.9*	*0.6*	*0.8*	*0.9*	*0.8*
South & Central Asia	5.6	7.6	8.8	8.1	9.3	11.6	11.4	13.1	15.9	18.5
Afghanistan	*0.1*	*0.4*	*1.3*	*1.6*	*2.3*	*2.8*	*3.0*	*4.0*	*4.9*	*6.2*
Bangladesh	*1.2*	*1.0*	*0.9*	*1.4*	*1.4*	*1.3*	*1.2*	*1.5*	*2.1*	*1.2*
India	*1.4*	*1.7*	*1.8*	*0.7*	*0.8*	*1.9*	*1.4*	*1.4*	*2.1*	*2.5*
Myanmar	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.2*	*0.5*	*0.4*
Nepal	*0.4*	*0.4*	*0.3*	*0.5*	*0.4*	*0.4*	*0.5*	*0.6*	*0.7*	*0.9*
Pakistan	*0.7*	*1.9*	*2.1*	*1.1*	*1.4*	*1.6*	*2.1*	*2.2*	*1.5*	*2.8*
Others	*1.8*	*1.9*	*2.3*	*2.7*	*2.8*	*3.4*	*3.0*	*3.1*	*4.1*	*4.5*
Middle East	2.3	2.3	2.4	5.5	7.5	25.5	14.1	14.3	19.8	10.8
Regional Asia	0.2	0.3	1.2	0.3	0.3	1.1	0.9	1.0	1.3	1.1

Source: "World dataBank," accessed November 2011, http://databank.worldbank.org/.

Appendix 4. Net Disbursements of Donors to Multilateral Organizations

(In US Billion Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Net Disbursements	**17.8**	**17.4**	**17.6**	**19.5**	**25.2**	**24.9**	**27.5**	**30.8**	**35.1**	**36.1**
UN Agencies	5.3	5.4	4.8	4.9	5.2	5.5	5.3	5.9	5.9	6.2
EU Institutions	4.9	4.9	5.7	6.9	8.9	9.2	9.9	11.7	13.	13.8
IDA	3.7	3.6	3.3	3.1	5.7	4.9	6.8	5.7	8.2	7.2
Other World Bank (IBRD, IFC, MIGA)	0.1	0.4	0.5	0.4	0.6	0.4	0.4	0.5	0.4	0.4
Regional Development Banks	2.2	1.5	1.8	1.8	2.3	2.2	2.5	2.4	3.2	3.1
Global Environment Facility	0.3	0.4	0.2	0.7	0.5	0.5	0.4	0.7	0.5	0.5
Montreal Protocol	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Agencies	1.1	1.1	1.3	1.5	1.9	2.1	2.2	3.9	3.8	4.8

Source: "Development Database on Aid," accessed January 2012, http://www.oecd.org/.

Appendix 5. Foreign Direct Investment in Asia

(In US Million Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Armenia	104	70	111	121	246	233	450	701	925	725
Azerbaijan	129	227	1,067	2,352	2,351	459	-1,289	-5,035	-541	147
Bangladesh	280	79	50	266	445	811	697	653	1,010	713
Brunei		61	230	124	72	175	70	258	222	326
Cambodia	142	142	139	74	121	375	475	866	795	511
China	37,483	37,357	46,790	47,229	53,131	105,903	102,922	143,057	121,677	70,316
Cyprus	683	696	555	318	407	614	975	1,032	-135	590
Fiji	-2	39	29	36	247	145	412	344	318	53
Hong Kong	2,572	12,431	-7,781	8,132	-11,683	6,417	75	-6,754	9,065	-11,599
India	3,075	4,074	3,948	2,444	3,592	4,629	5,992	8,202	24,150	19,669
Indonesia	-4,550	-2,977	145	-597	-1,512	5,271	2,188	2,253	3,419	2,628
Japan	-23,307	-32,306	-22,930	-22,528	-23,151	-42,224	-56,954	-51,308	-106,266	-62,790
Kazakhstan	1,278	2,861	2,164	2,213	5,436	2,117	6,663	7,966	13,118	10,653
Kyrgyz Rep	-7	-1	5	46	132	43	182	208	377	190
Lao PDR	34	24	4	19	17	28	187	324	228	319
Macao			346	519	849	1,706	2,131	5,033	3,156	2,505
Malaysia	1,762	287	1,299	1,104	2,563	994	53	-2,744	-7,828	-6,626
Maldives	22	21	25	32	53	53	64	91	135	112
Mongolia	54	43	78	132	93	185	344	360	838	570
Myanmar	258	210	152	251	214	237	279			
Nepal			-6	15		2	-7	6	1	38
Pakistan	297	352	795	515	1,062	2,157	4,164	5,492	5,389	2,267
Papua N.G.	96	63	18	109	30	32	12	95	-31	419
Philippines	2,115	335	1,477	188	109	1,665	2,818	-620	1,285	1,604
Rep of Korea	4,802	1,332	-632	-610	3,595	-58	-7,588	-17,935	-16,941	-14,948
Samoa					2	-5	21	7	33	3
Singapore	10,569	-4,878	4,073	9,247	10,224	4,241	10,539	4,331	8,845	-3,185
Solomon Is.	13	-10	-2	-2	6	17	29	52	91	115
Sri Lanka	173	172	185	201	227	234	450	548	691	384
Tajikistan			36	32	272	54	339	360	376	16
Thailand	3,389	4,639	3,171	4,609	5,784	7,554	8,479	8,309	4,442	862
Tonga				3	5	7	10	28	4	
Turkey	112	2,854	939	1,222	2,005	8,967	19,261	19,941	16,955	6,856
Vanuatu	20	18	14	17	19	12	43	34		
Vietnam	1,298	1,300	1,400	1,450	1,610	1,889	2,315	6,516	9,279	6,900

Source: “World dataBank,” accessed November 2011, http://databank.worldbank.org/.

Appendix 6. Net Portfolio Equity Flows to Asia

(In US Million Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Bangladesh	1	-3	-1	2	4	20	31	153	-48	-153
China	6,912	849	2,249	7,729	10,923	20,346	42,861	18,510	8,721	28,161
Cyprus	29	89	-4		-14	13	46	1	-70	24
Hong Kong	46,976	-855	1,391	5,771	1,979	9,961	14,480	43,625	17,423	9,492
India	2,481	2,950	1,063	8,216	9,054	12,151	9,509	32,863	-15,030	21,112
Indonesia	-1,021	442	877	1,130	2,043	-165	1,898	3,559	322	787
Japan	-1,286	39,101	-16,690	87,775	98,280	131,315	71,437	45,455	-69,692	12,432
Kazakhstan	19	55	39	64	-13	150	2,789	828	-1,280	38
Kyrgyz Rep.			-10	5				1	6	1
Malaysia			-55	1,339	4,509	-1,200	2,355	-669	-10,716	-449
Pakistan	35	-130	79	-26	49	451	1,152	1,276	-270	-37
Philippines	-202	125	227	500	518	1,465	2,525	3,178	-1,289	-1,096
Rep. of Korea	13,094	10,266	395	14,419	9,469	3,282	-8,391	-28,728	-33,623	24,856
Singapore	-1,169	-90	-442	2,785	2,383	4,895	10,142	18,306	-11,697	-324
Sri Lanka		-35	-53	-143	-100	-216	-304	-322	-488	-382
Thailand	900	352	539	1,786	1,319	5,121	5,242	4,268	-3,802	1,334
Turkey	489	-79	-16	905	1,427	5,669	1,939	5,138	716	2,827
Vietnam						115	1,313	6,243	-578	128

Source: “World dataBank,” accessed November 2011, http://databank.worldbank.org/.

Appendix 7. Net Flows on External Debt to Asia

(In US Million Dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Afghanistan							143	201	131	126
Armenia	42	61	249	231	56	-38	104	831	497	1,462
Azerbaijan	309	-1	105	103	139	300	587	899	673	318
Bangladesh	368	354	322	534	702	370	1,235	532	1,826	817
Bhutan	30	73	94	91	81	85	47	-8	5	51
Cambodia	128	85	101	156	172	154	138	165	430	116
China	-5,247	41,360	3,724	17,966	35,569	40,878	33,514	45,870	-3,465	41,948
Fiji	-10	-6	2	6	58	-47	166	-9	25	56
India	3,358	-1,800	-1,755	714	3,889	1,949	36,295	43,355	21,628	11,179
Indonesia	-1,969	-7,710	-10,689	-4,563	-3,101	-8,602	-5,042	4,984	9,821	10,606
Kazakhstan	1,057	2,543	2,026	4,643	9,381	9,996	28,466	21,434	11,057	3,389
Kyrgyz Rep.	152	-64	22	35	-8	63	261	95	-82	422
Lao PDR	47	64	198	77	204	386	357	923	492	529
Malaysia	337	5,217	3,437	-1,516	3,491	601	396	8,516	-1,378	-1,560
Maldives	-4	37	20	9	47	58	84	122	93	59
Mongolia	45	53	72	89	-7	-73	82	160	108	322
Myanmar	33	-55	352	90	41	-36	102	203	-142	-83
Nepal	69	70	-20	42	61	118	113	36	-21	-29
Pakistan	-343	298	529	-1,058	-843	1,090	2,039	3,084	4,034	5,080
Papua N.G.	30	94	-153	32	-125	214	-68	-408	-64	115
Philippines	2,551	2,114	-757	681	-818	1,472	-2,414	4,611	-3,128	370
Samoa	2		-1	1	1	6	2	13	20	28
Solomon Is.	-4	14	5	-4	-9	-2	1	12	-10	6
Sri Lanka	-22	115	339	613	267	1,160	251	1,934	808	1,544
Tajikistan	-4	77	-46	31	59	80	135	132	317	133
Thailand	-13,649	-10,016	-9,952	-7,462	-314	4,098	2,690	1,484	393	1,797
Tonga	2	1	3	9	-2	1		1	5	15
Turkey	18,023	-4,402	14,727	23,983	17,553	12,055	23,010	34,079	33,145	-12,277
Turkmenistan	-2	-123	-413	-290	-267	-280	-201	-185	-155	-90
Uzbekistan	-223	412	-379	-79	-167	-308	-317	-170	-93	61
Vanuatu	14	2	12		20	-28	-1	11	24	3
Vietnam	472	320	22	1,583	2,084	1,917	636	3,502	757	3,995

Source: “World dataBank,” accessed November 2011, http://databank.worldbank.org/.

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