

JAPANESE FOREIGN DIRECT INVESTMENT AND THE RESTORATION OF EAST ASIA'S ECONOMIC DYNAMISM

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Abstract

The recovery of the crisis-hit East Asian economies will depend importantly on an increase in net exports and the inflow of foreign capital. Because of their unstable financial systems and the existence of large deflationary gaps, they cannot count on portfolio investment and an increase in foreign borrowings, at least from the private sector, to help restore their economies. Moreover, there is doubt about whether a large inflow of bank loans and portfolio investments is necessary for developing economies. Capital inflow other than FDI appears to contribute relatively little to investment and economic growth in developing economies because of their limited capacity to absorb portfolio investment and foreign borrowing, particularly short-term. Thus, it is essential for the crisis-stricken economies of East Asia to maintain FDI, particularly export-oriented FDI, in order to increase exports to fill the short-run demand gap. In the longer run, these developing economies must attract larger amounts of FDI in order to facilitate technology and management transfer.

It is particularly important for economies in the region to continue to attract Japanese FDI. FDI from Japan accounts for about 20 percent of the total received by the region and it is technology-intensive. Moreover, Japanese companies are also supporting the development of 'cooperative business networks' within the region. In this respect, it is a grave matter that Japanese FDI declined precipitously in East Asia in 1998.

The first part of this paper examines, with a focus on the ASEAN economies, the role of Japanese FDI in the restoration of East Asia's economic dynamism, the historical pattern of Japanese FDI in East Asia, the factors that drive Japanese FDI in East Asia, the impact of the East Asian economic crisis, and the future outlook and agenda for Japanese FDI in East Asia.. The paper highlights the key demand and supply-side factors that influence Japanese FDI and finds that export-oriented FDI is least affected while market-oriented FDI is severely hit by the crisis. The paper discusses what ASEAN and other East Asian economies, should do to attract Japanese FDI in the future, especially to the export-oriented sector.

The second part of the paper consists of case studies of Japanese FDI in two industries: the export-oriented electronics industry and the domestic market-oriented automobile industry.

The Asian crisis had a comparatively small effect on Japanese FDI in the electronics industry in ASEAN. Survey data indicate that Japanese producers have not curtailed operations at their bases in ASEAN as the currency depreciation should improve the price competitiveness of the sector in its largely export market. Also, Japanese electronics companies are making new investments to cope with the formation of AFTA (ASEAN Free Trade Area) which is scheduled for the early years of the next century. Because of regional industrial integration and balanced domestic demand and export competitiveness, the region will become the target for reinvestment and renewed direct investments. To attract investment and transfer of technology, governments should implement measures to foster supporting industries for the electronics sector.

Japanese investment in the automobile industry in ASEAN expanded dramatically in 1996 and 1997 but fell off with the outbreak of the financial and economic crisis. The crisis affected the industry severely because of the stagnation of domestic automobile demand and increases in the prices of imported parts and materials. Given the small size of the combined automobile market

of the ASEAN-4, intra-regional cooperation through the AICO and CEPT schemes is essential.