Foreign direct investment in East Asian newly industrializing economies

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Introduction

In the second half of the twentieth century a small number of underdeveloped countries experienced high economic growth rates. Income per capita in these countries jumped from an average of $800 in the 1950s to $15.000 in the 1990s. These countries were located in the East Asia and their incredible performance initiated a discussion about the economic development models. Neoclassical economists argued that these countries were successful because they rely on market and adopted free trade policies and encouraged MNCs operations. On the other hand institutionalists and Marxist economists emphasized the significant role of state intervention in the development process.

This study examines political economy of MNCs in NIEs rather than revealing the contribution of MNCs in these countries by relying on statistical data. It focuses on the relationship between MNCs and the states in these countries. This study argues that MNCs played important role in the industrialization of some of these countries. But there are countries such as South Korea which did not depend on FDI. Therefore it would be wrong to generalize the argument.

Newly Industrializing Economies (NIEs)

FDI has recently gained further importance as many developing countries suffered by the debt crisis of 1980s. These countries have begun to seek this

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investment as an alternative source of external finance. However, FDI also played an important role in the development process of some developing countries (especially in Latin America and East Asia) between 1950 and 1980. As the income gap between some of the East Asian countries and industrialized countries converged during the 1970s and 1980s the role of the MNCs in this successful process appeared.

Some of these successful economies are Hong Kong, Singapore, Taiwan, South Korea, and Thailand. They enjoyed high growth rates from the early years of 1960s. They have commonly been treated as a single group of successful NIEs. Their common success was in export expansion and industrial development. Hong Kong and Singapore are much smaller than Taiwan and especially South Korea in population and economic output[2]. Their limited domestic market makes an inward looking strategy of import substitution much less feasible. They are much more reliant on external sources of capital, technology and consumer demand to offset the limitations in their domestic resource base. Especially Hong Kong and Singapore are highly attractive for MNC location because of their considerable human capital, developed physical infrastructure, and strategic geographic location[3].

Hong Kong is generally perceived to represent the neoclassical vision of political economy. The British administration in Hong Kong refrained from economic intervention. The government adopted laissez faire policies. There are numerous small and medium size firms in Hong Kong and they are dynamic export sector and they tend to be owned and operated as family enterprises with relatively low capitalization.

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[2] Cal Clark and Steve Chan "NCs and Developmentalism: Domestic Structures as an Explanation for East Asian Dynamism"in Foreign Direct Investment in a Changing Global Political Economy ed. Steve Chan London:1995 p.86.

[3] Ibid. P.87.

South Korea represents the polar opposite to Hong Kong in the sense that its political economy is based on a strong developmentalist state. Owing to its much larger domestic market, South Korea pursued industrial deepening. There are large conglomerates (the cheabol), there is a heavy reliance on foreign loans (as opposed to fdi) which gives government bureaucrats a powerful role. They seek to gain experience and modify plans on the basis of learning by doing. U.S. was primarily motivated to support and defend South Korea, Taiwan and Thailand for political and strategic reasons during the C old War.

Table.1 MNCs access and NIEs

Case	Culture	Power	MNC Access	Growth
Hong Kong	Japanese	Society	High	high
Singapore	American	State	high	high
Taiwan	Japanese	balance	medium	high
South Korea	Japanese	state	low	high

Source: Clark and Chan p.91.

Table.1 shows that political economy culture and state-society relations can affect MNCs access and economic growth. According to Fajnzylber, there are two contrasting policy styles when political-economy culture is considered: American and Japanese models of development. In the first model; US firms have traditionally been inward looking, being concerned primarily with production for a large domestic market. There is a belief about no need a big government and to put emphasis on individual freedom, consumerism and the equality of opportunity. Public policy as well as mass culture encourages consumption at the expense of savings.

In contrast to US model, in Japan model there has always been a much higher level of popular support for government intervention in the marketplace. The state is seen as the guardian of common welfare. Moreover, Japanese firms have always been outward looking. Being poor in natural resources manufactures with high added value are the Island's chief exports. Plus, cultural norms emphasize the virtues of group conformity, collective responsibility and social integration at the expense of personal liberty. They also encourage saving and distributive justice.[4]

In South Korea, Taiwan and Hong Kong, the Japanese model of development has prevailed. This model emphasizes an outward looking industrial strategy focused on the export of manufactures, fiscal conservatism by public and private sectors, austere consumption patterns and highly saving rates and social integration over individual liberty.[5]

South Korea has imposed the most stringent conditions on MNC access. It has the lowest net FDI to total investment ratio. It has preferred to rely on foreign debt over FDI as a source of external finance. Of course this is strongly related with the historical context. In the 1950s and 1960s the small size of the markets, their lack of psychical resources and security concerns about the communist threat across their borders deterred the MNCs from investing in Taiwan and South Korea. This interval provided a crucial "breathing space" whereby the Taiwanese and Korean state enterprises were able to block the more strategic sectors such as steel, energy, banking, and transportation from subsequent MNC activities. In the 1980s Korea tends to be a harder bargain. Its policies have aimed at building up "national

[4] F. Fajnzylber "The United States and Japan as Models of Industrialization" in ed. G. Gereffi and D. Wyman Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia Princeton: 1990.

[5] S. Chan and C. Clark "Do MNCs Matter for National Development? Contrasting East Asia and Latin America in ed. Foreign Direct Investment in a Changing Global Political Economy ed. Steve Chan London:1995 p.171.

champions" among the chaebol first by forcing MNCs into joint ventures with them and then by forcing the foreign corporations to divest once the Korean enterprises learned the business and technology[6].

In Singapore, FDI plays a much larger role than in any other cases. Its popular welfare, human-capital development and physical infrastructure attract MNCs. After separation from Malaysia in 1965, the Singapore government aggressively sought to attract foreign capital to Singapore itself. As a free port and trading center, the city, full of merchants, had not developed a class of indigenous entrepreneurs who could lead its industrialization efforts, or who would press the government for protection for imports[7]. Most of the new investments were in 100 % foreign owned enterprises with initially limited local linkages. As industrialization proceeded more local entrepreneurs were attracted into manufacturing but mostly as suppliers to multinational subsidiaries.

With its open door policy towards foreign investment and the greater competitiveness of foreign firms in export markets Singapore, today has probably the most heavily foreign dominated manufacturing sector in the world[8]. Since 1965 Singapore's policy towards foreign investment has been liberal and non interventionist with few excluded industries and few restrictions and government enacted Tax incentives for the MNCs[9]. However, on the other hand, local business feels crowded out by both state enterprises and large multinational companies.

Taiwan constitutes an intermediary case. During Taiwan's colonization by Japan in the early years of the twentieth century, Japanese colonial policy encouraged

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[6] Ibid. P.175.
[7] L. Lim and P.E. Fong, Foreign Direct Investment and Industrialization Paris:1991. p.51.
[8] Ibid. P.52.
[9] L. T. Wells, N.J. Allen, J. Morisset and N. Pirnia Using Tax Incentives to Compete for Foreign Investment Washington:2001.

and favored investment by Japanese companies. After the War and decolonization in the 1950s foreign capital inflow was mainly in the form of official aid mostly from the US. Foreign investment became significant only with the shift to labor intensive export manufacturing in the 1960s.

In Taiwan both foreign capital and local capital have been aided by strict government control[10]. Entry barriers for MNCs have been higher in South Korea. The Taiwan government encourages FDI projects that are strategic or vital to its economic development. Private capital is also strong in Taiwan. The state has exercised cautious oversight of the MNCs. These firms were strongly regulated and channeled into those export sectors most particularly electronics where Taiwan's firms did not have the expertise to operate.

In Hong Kong the government does not treat local and foreign investors by different standards.

State and MNCs access

Neoclassical modernization theory would lead us to expect that society dominated systems should have higher MNC access such as in Hong Kong, on the other hand, statist theory would lead us to expect that state dominated political economies should have lower MNC access which can be observed in South Korean case. However, between these two extremes there is Singapore with a combination strong state and high MNC access. Therefore it can be argued that depending on its development agenda, and ideology, a strong state may discourage or encourage MNC

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[10] [10] L. Lim and P.E. Fong, Foreign Direct Investment and Industrialization Paris:1991. p. 64.

participation in its domestic economy[11]. A strong state, however, is a necessary condition for excluding and dislodging MNCs from the domestic economy. In other words, this policy is not likely to be successfully implemented in the absence of a strong state.

Although both Hong Kong and Singapore welcome MNCs the state plays a much more active and direct role in recruiting these companies in the latter[12]. In Singapore the state's long-term development strategy is to continue relying on foreign investment and on skilled and unskilled foreign labor, while providing more support for local business and adding high value exportable services to the emphasis on high tech industry. While it plans to divest its equity shares in government-linked companies and to enlarge the role of the private sector in economic development, the government has said it will invest in new ventures where private sector will not risk its resources or does not have the capacity to enter. In short, the state will continue to play a major and catalytic role in shaping Singapore's comparative advantage in existing and new activities[13].

Taiwan shares Hong Kong's tendency for commercial opportunism and its emphasis on family enterprises and flexible manufacturing. The Island's export sector is likewise dominated by small and medium size firms. However, in contrast to Hong Kong Taiwan also has large state enterprises that control various strategic industries such as steel, energy and chemicals. In 1949 when the Nationalist party took it over,

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[11] S. Chan and C. Clark "Do MNCs Matter for National Development? Contrasting East Asia and Latin America in ed. Foreign Direct Investment in a Changing Global Political Economy ed. Steve Chan London:1995 p.98.
[12] Ibid. P.88.
[13] L. Lim and P.E. Fong, Foreign Direct Investment and Industrialization Paris:1991.p.27

Taiwan was a relatively backward agricultural island province of China. From the early 1950s to the early 1960s the new government adopted Import Substitution Industrialization development strategy and promoted agricultural growth. These were facilitated by the infrastructure which was established during Japanese colonial era and heavy US aid in the 1950s and 1960s[14]. Taiwan adopted export led growth in the 1960s. Private sector rapidly expanded. The economy came to be dominated by small firms whose competitive advantage is raid and flexible response to market conditions.

The Role of Japanese FDI

The role of Japan in the development process of these countries was in two ways. First, most of NIEs were used to be Japanese colonies in the first half of the twentieth century. This enabled the establishment of infrastructures in these countries by Japan. Second, the flow of Japanese FDI played a significant role. In the 1970s Kojima argued that unlike US firms, Japanese firms were operating in the Third World countries and again unlike US firms, Japanese firms were concentrating in the labor intensive sectors[15]. In addition, while US firms were operating in the host country for domestic markets, Japanese firms were concentrating in the export oriented sectors. The analysis of Kojima, the Japanese pattern of FDI was not familiar before. Japanese firms especially until 1980s operated in East Asian countries in export oriented sectors and this strengthened the NIEs to become competitive export oriented economies.

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[14] Ibid. P.27.

[15] K.Kojima, "Japanese-Style Direct Foreign Investment", *Japanese Economic Studies.* (Spring, 1986). P.70.

Japanese FDI is central to accelerating regional economic integration. Three features of regionalism in Europe, North America and East Asia. Japan was forced from East Asia in defeat in 1945. FDI began to increase significantly in the second half of the 1960s. In 1968 Japan's cumulative FDI of $2 billion increased four times during 1969-1973. In 1977 it was $22.2 billion; it reached to $310 billion in 1990.[16]

Increases in Japanese FDI have been driven by both domestic and international factors such as labor shortages, rising wages, and increasing land prices in Japan. These have motivated firms to establish overseas operations to diminish costs since 1960.

After 1970 Japanese FDI increased in manufacturing in North America. For instance, from 1984, FDI increased around five and a half times in both North America and Europe but only about one and two thirds times in Asia. (For instance 44 % is in North America, 20 % is in Europe and in Asia it is 16 %). However, the biggest number of Japanese overseas manufacturing companies is in Asia (% 55).[17]

The Contribution of MNCs

Whether MNCs facilitate or hinder economic growth is a principal focus of debate between the neoclassical modernization theorists and the dependency scholars. Especially in the 1970s, as the volume of FDI activities increased, scholars began to question the contribution of FDI to the host economies. The former argues that MNCs contribute to growth because they provide the critical missing capital, technology,

[16] S. Tokunaga "Japan's FDI-Promoting Systems and Intra-asia Networks: New Investment and Trade Systems Created by the Borderless Economy" in ed. S. Tokunaga Japan's Foreign Investment and Asian Economic Interdependence. Tokyo: 1992. P.43
[17] Ibid. P.44.

management expertise, and foreign markets[18]. Dependency scholars disagree with this and emphasize that MNCs damage the host economy due to their tendency to engage in transfer pricing, adopt inappropriate technology, and support authoritian regimes.[19] Especially in Latin American countries some scholars argued that MNCs transferred more than they bring in[20].

Actually, in five cases, there are examples of high MNC access being associated with both rapid growth rates in Hong Kong, and Singapore. However, the negative impact of MNCs did not take place in the East Asian countries as it took place in Latin American countries. East Asian countries were successful directing the MNCs. We thus turn to a country's political economy culture (patterns of production, consumption, and distribution). These norms underlie and shape official policies, enterpreneual decisions. The question of why different than Latin America? can be explained by the quotation "the past influences, determines the present (path dependence)". Plus, existing domestic and foreign patterns of interaction shape a country's political agenda[21].

Conclusion

The success of NIEs does not depend on common facts. Each country has a different background, institutional framework and governmental organization. While in one of them government may rely on free market idea, the other may act as

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[18] P. Krugman and Edward M. Graham. "Economic İmpact", *Foreign Direct Investment in the United States*. Second Edition. Washington DC: Institute for International Economics, 1989. pp.28-29.

[19] Theodore H. Moran,, "Multinational Corporations and Dependency: A Dialogue for Dependentistas and Non Dependentistas" *International Organization* 32, no.1 (Winter 1978) pp. 80-94.

[20] Theotonio Dos Santos, "The Structure of Dependence", *American Economic Review* (May, 1970), p.231.

[21] S. Chan and C. Clark "Do MNCs Matter for National Development? Contrasting East Asia and Latin America in ed. Foreign Direct Investment in a Changing Global Political Economy ed. Steve Chan London:1995 p.170.

interventionist. However, except South Korea all of them encouraged MNCs in the domestic economy. Unlike some Latin American countries MNCs in NIEs contributed to the economic growth and increased the competitiveness of the export oriented sectors in these countries.

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