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FDI Environments and Policy Competitiveness of Asia Pacific Economies

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This study provides an assessment of FDI regimes on selected Asia-Pacific economies before the financial crisis, and then follows the changes of FDI policies after the crisis. For this purpose, this paper uses survey results on FDI environment for Asia Pacific economies and Individual Action Plans for FDI policies presented to APEC by member economies. There are wide differences in the inducement of FDI among different economies and regions. Different FDI regimes and policies seem to explain, at least to some extent, different performances of FDI Indices. Economies with high FDI index reflect highly liberalized FDI regimes. Economies, which have not made any necessary measures, showed significant decrease in their indices. This study examines the details of policy measures undertaken by Asia-Pacific countries. While many countries have taken various measures to improve their FDI environment, most of their actions are not directed to problematic areas of their FDI regimes which are identified in the survey. Countries have made numerous policy measures but they seem to have missed the target.

Keywords: FDI, FDI Index, APEC, FDI Regime

1. INTRODUCTION

FDI contributes to the growth of host economies through various channels. These channels with an addition to physical capital formation, include technology transfer, human capital development, transfers of managerial skills and the promotion of foreign trade. But host economies cannot take the full advantage of FDI if it has either excessive restrictions on foreign investment or a heavily distorted economic environment. FDI can benefit host economies in various ways: increase in production capabilities via adding to capital formation, enhancement of productivity, technology advancement through transfer, employment, and expansion of trade.

First, an immediate effect of FDI is found in the increase of production capabilities in host economies. It helps with the formation of capital and adds to investment expenditure. For developing economies, FDI plays a crucial role in the early stage of economic development by contributing to capital formation. Second, foreign-owned firms may stimulate local productivity, mostly through backward links to domestic industries. Foreign investors serve as a model of management practices and techniques, which enhance the whole economy's productivity. Third, foreign affiliates of transnational corporations can directly upgrade the technology level of host economies through R&D expenditures and higher factor productivity. Depending on their domestic sourcing strategies and practices, domestic suppliers may improve their technology level a learning-by-doing process with foreign investors. Fourth, there is the employment effect. In many developing economies employing foreign investment as an important development strategy, the employment share of foreign firms is relatively large. Fifth, FDI contributes to trade expansion; a foreign firm's local purchases from local suppliers and sales to customers in the host market are analogous

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to exports and imports. Though there are controversies over whether investment outflow and exports are complementary or substitutes, many empirical evidences show that they are complementary. Especially in developing countries of Southeast Asia, a large portion of exports are attributed to foreign affiliates of Japanese transnational corporations.

Foreign direct investment can be broadly classified into four categories, accordingly to investment motivations: (1) market access (2) trade expansion or import barrier circumventing (3) market- and technology-accessing and (4) round-tripping.

FDI for market access is a typical objective of investments by multinational firms. Investment aimed at accessing host markets is common among developed countries. For example, Japanese companies have been building marketing networks and facilities in the United States through investment in distribution service sectors. Investment with the purpose of accessing local markets has also become important in the developing economies. The rapid economic growth of Asia's developing countries has made Asia more attractive as a market for final products. More investment projects focused on local markets are being undertaken despite higher production costs than alternative sites in the region. It is believed that these costs can be justified more by savings in tariffs and by the prospects of rising demand. As a result, the location of such projects may not be consistent with the level of economic development of receiving countries. Typical examples include Japanese investment in the automobile industry in the ASEAN countries and in higher-end consumer electronics products in China.

FDI for outsourcing has been by far the most important objective of companies from advanced countries investing in Asia's developing countries. This type of investment commonly involves the relocation of production processes from developed economies to the developing ones. The pattern of investment flows associated with outsourcing objectives, and the dynamic changes in the pattern of trade accompanying it, has come to be known as the "flying-geese" pattern, which is a catching-up process that refers to the typical development pattern of modern industries in Japan. A similar pattern is being observed in the Asian economies. For example, Asian NIEs seem to have acquired competitiveness comparable to Japan in many consumer products. Leading countries of ASEAN and China are "catching-up" with ANIEs. Taiwan and Korea are advancing beyond the level of developing countries and are establishing their own Official Development Assistance (ODA). Thailand and Malaysia are described as 'quasi-NIEs' and rely on less ODA. As NIEs like Korea move into more technologically sophisticated industries, they compete with Japanese and US industries in several technology-based sectors. Moreover, the quasi-NIEs not only accelerated their exports of labor-intensive goods and processed materials, but have also become legitimate competitors of NIEs for more skill-intensive products. However, a basic difference exists between ANIEs and ASEAN countries in the "catching up" processes. That is, Korea and Taiwan are attaining competitiveness through their own firms' vigorous capital borrowings and technology imports. Therefore these countries have been less open to FDI than other Asian countries. Meanwhile, ASEAN countries are catching up with ANIEs based on their reliance on foreign subsidiaries established mostly by Japanese FDI. This way of catching up has undoubtedly contributed to the sustained dynamism of the Asian Pacific economy.

However, the Asian financial crisis pushed the affected economies to take active measures to induce FDI for sustained economic stability and development. According to the World Investment Report (2001), a total of 414 FDI regulatory changes had been made worldwide to improve FDI environment. APEC also provides a compendium of FDI related policy regimes and changes. It seems that economies are competing against each other with

FDI policy measures. However, there are wide differences in the inducement of FDI among economies and regions. While there are many explanations for the differences, it is no doubt that the difference in competitiveness of FDI policies is one of the explanations. An exact menu of policies that corrects the most restrictive aspects of FDI regimes is necessary to effectively promote FDI inflows.

In this context, this study attempts to provide an assessment of FDI regimes of selected Asia Pacific economies before the financial crisis, and then follows changes of FDI policies after the crisis. For this purpose, this paper uses the survey results of the FDI environment for Asia Pacific economies (Han 1998) and Individual Action Plans for FDI policies presented to APEC by member economies. Through an appropriate summary and analysis of those responses from foreign investors before the crisis, we hope to produce a proper assessment of how economies responded to the foreign investors' demands.

2. MEASURING FDI ENVIRONMENT OF SELECTED ASIA PACIFIC ECONOMIES

2.1. Measuring the FDI environment

For this study, a survey was taken to assess the FDI environment of Asia-Pacific economies. The survey has a total of 104 questions and distributed to foreign investors in 14 Asia Pacific economies. The survey questions were classified into the following 5 sections: 1) Investment Decisions and Motivations, 2) Procedures of Investment Admission, 3) Discrimination, 4) Forms of Investment and Ownership and 5) Other Restrictions. Each section includes several related questions. The first section is designed not only to investigate the factors behind investment decisions, but also to evaluate the investment environment of host economies in general. Questions in the other 4 sections are intended to evaluate difficulties (between scale 1 to 5) related to admission, ownership, operation and other activities of investing firms.

Section I. *Investment Decisions and Motivations for Investing*. Section I is about investment decisions, motivations for investing and the general investment environment. As discussed in the previous chapter, motivations for FDI can be broadly classified into market access, trade expansion, resource or technology assessment and incentives. Questions in the survey are designed to show such motivations to identify important factors for investment decisions. Each section is also divided into several groups, which contain related questions. Also, this section is designed to evaluate the investment environment of host economies in general.

Section II. *Procedures for Investment Admission*. Questions in section II seeks to find the level of progressiveness an economy has in terms of investment admission procedures and measures. Admission procedures of investment can be classified into the following: 'Notification' and 'Authorization'. Investors are asked to indicate the degree of difficulty associated with various investment impediments and environments.

Section III. *Discrimination*. Questions in section III are designed to acquire information of the level of discrimination that foreign investors receive in foreign investment regimes of recipient economies. Discrimination can be broadly classified into 'MFN(Most Favored Nations)' treatment and National Treatment. The former is discrimination against foreign investment based on the source of investment, while the latter is discrimination against foreign firms in favor of local firms.

Section IV. *Ownership and Operation*. Section IV will evaluate difficulties associated with regulations and measures affecting ownership, and forms of investment and operation of firms.

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Section V. *Others*. In section V, foreign investors are asked to evaluate difficulties associated with other types of measures and environments affecting businesses in host economies. Questions in this section are about 'performance requirements', 'employment issues' and 'incentives and disinvestment'.

2.2. Overall assessment of the survey results

Motivation

Overall, investors responded that the most important motivation for FDI was the access to local markets. The degree of importance (4.51) is significantly bigger than the second most important motivation (3.12). All the investors in developed economies responded that their primary FDI motivation was access to local markets. The importance of accessing local markets as an investment motivation is true for foreign investors to developing economies. Investment incentives played an important role in the case of developing countries while they mattered significantly less in developed economies.

Table 1. Motivations for Investment

Rank	Developed	Developing	Overall
1	Local market	Local market	Local market
2	Technology	Incentive (host)	Incentive(host)
3	Third market	Partnership	Partnership
4	Natural resources	Import barrier	Third market
5	Partnership	Third market	Technology

Note: 'Third Market' indicates the investment motivation is to export to other markets than the host economy

Investment Admission

Investment admission procedures are divided into Notification and Authorization. Difficulties associated with notification procedures are higher than those of authorization, though the differences turn out to be insignificant. In all categories, investors in developing economies expressed significantly higher difficulties than investors in developed economies.

Table 2. Admission to Invest

Rank	Developed	Developing	Overall
1	Attitudes of Officials	Investment Size	Attitudes of Officials
2	Screening	Attitudes of Officials	Investment Size
3	Public Safety	Technology Transfer	Public Safety
4	Investment Size	Public Safety	Technology Transfer
5	Technology Transfer	Screening	Screening
6	Employment Requirement	Employment Requirement	Employment Requirement

Discrimination

Investors expressed moderate difficulties due to violation of MFN principles. In both cases of developed and developing economies, the average degree of difficulty is around 2.5, which is the medium score on a scales of 1 to 5. No significant differences exist between each category of questions. Investors in developing economies regard 'performance requirement' as a relatively more difficult problem among others. Regarding National Treatment, investors consider themselves discriminated against, while the degree of difficulty in all other categories is below 2.5.

Table 3. Discrimination

Rank	Developed	Developing	Overall
1	General	Performance Requirement	General
2	Performance Requirement	General	Performance Requirement
3	Tax Treatment	Investment authorization	Investment authorization
4	Establishment of Branch	Tax Treatment	Tax Treatment
5	Investment authorization	Public Contracts	Public Contracts
6	Public Contracts	Subsidies	Subsidies
7	Subsidies	Establishment of Branch	Establishment of Branch
8	Tax Preference	Tax Preference	Tax Preference

Forms of Investment, Ownership, etc.

Among categories of ownership, difficulty associated with the ceiling on ownership is higher than other categories. In developed economies, all the three categories do not show much difference.

Table 4. Forms of Investment, Ownership

Rank	Developed	Developing	Overall
1	Gov't Discretion on Foreign Controlled Business	Ceiling on Ownership	Ceiling on Ownership
2	Ceiling on Ownership	Work Permit	Work Permit
3	Work Permit	Business Activities	Gov't Discretion on Foreign Controlled Business
4	Acquisition	Facilities	Acquisition of real estate
5	Acquisition of real estate	Acquisition of real estate	Business Activities
6	Quota system	Gov't Discretion on Foreign Controlled Business	Acquisition
7	Facilities	Establishment of Branch	Facilities
8	Business Activities	Acquisition	Establishment of Branch
9	Establishment of Branch	Quota system	Quota system

However, investors in developing economies regard the degree of difficulty with ceilings on ownership (2.78) as significantly higher than 'acquisition' (2.27)

It is possible to infer that the ceiling on ownership is a significant drawback for foreign investors. Survey results of other categories show that they do not seem to be influential when it comes to investment and business activities. However, it should be noted that the degree of difficulty expressed by foreign investors to developing economies is generally higher than those expressed by investors in developed economies.

Others (Performance Requirements, Labor Issues)

Survey responses show that performance requirements are not significant impediments to foreign investment in all categories, while the degrees of difficulty in developing economies are slightly bigger than in developed economies. Regarding labor issues, responses vary in different categories. In the category of layoffs, investors in developing economies indicated a higher degree of difficulty than investors in developed economies. In the category of fringe benefits, investors in developed economies said they had more difficulty. However, the degree is lower in the labor union category for both developed and developing economies. Foreign investors in developing economies expressed significantly greater difficulty with the tax environment than investors in developed economies, with the degree of difficulty being higher than moderate.

Table 5. Others

Rank	Developed	Developing	Overall
1	Fringe benefits	Layoffs	Layoffs
2	Labor unions	Fringe benefits	Fringe benefits
3	Layoffs	Domestic sourcing	Labor unions
4	Domestic sourcing	Technology transfer	Domestic sourcing
5	Technology transfer	Export performance	Technology transfer
6	Export performance	Labor unions	Export performance

3. A COMPARISON OF FDI ENVIRONMENTS IN ASIA-PACIFIC ECONOMIES

In this chapter, we compare FDI regimes of selected Asia-Pacific economies. The results will be used to identify major areas of FDI regimes at which effective policy measures should aim.

3.1. Admission to Invest

In the category of ‘screening’, New Zealand (72.0,) and Australia (70.0) scored high, while investors evaluated Japan (58.3) less favorably. Foreign investors in Japan consistently indicated that they had more difficulties in all categories of notification procedures than investors in other developed economies. Foreign investors in Korea expressed the lowest level of satisfaction, with a remarkably low 37.7. The negative evaluation of Korean FDI environments consistently appears in other categories.

As for developing countries, a distinct pattern of responses has been observed. First of all, investors in Mexico and Chile expressed relatively higher satisfaction than investors in other economies. Second, investors in Korea and Taiwan responded that they experienced significantly high difficulties than investors in other developing economies. Third, the investors' evaluation of Southeast Asian economies showed no significant differences in general.

Table 6. Admission Procedures

	Screening	Investment size	Employment requirement	Technology transfer
Japan	**58.3**	74.2	74.2	71.4
Australia	70.0	84.0	72.6	76.0
New Zealand	72.0	68.5	74.3	82.9
Korea	**42.6**	**47.5**	**57.5**	85.0
China	69.9	60.0	53.3	46.6
Taiwan	58.8	54.0	60.0	64.0
Hong Kong	85.0	**60.0**	**60.0**	**40.0**
Malaysia	50.6	46.6	46.6	**26.6**
Thailand	**45.5**	53.4	70.0	65.0
Chile	72.6	70.0	73.3	60.0
Mexico	**65.0**	76.6	90.0	90.0

3.2. Discrimination

There is no distinct pattern of responses in the MFN categories. First, investors to New Zealand expressed the least difficulty in all categories of the MFN. Second, investors to Asian economies seem to feel significantly deeper concerns over discrimination, depending on the sources of FDI, than investors in Latin American economies. Third, Australia was least favorably evaluated in categories on tax treatment and performance requirements.

Table 7. Discrimination (MFN)

	Investment authorization	Tax treatment	Performance requirement
Japan	82.0	78.0	70.0
Australia	80.0	60.0	60.0
New Zealand	88.3	90.0	90.0
Korea	63.1	62.7	62.7
China	60.0	60.0	**46.7**
Taiwan	58.3	60.0	63.6
Hong Kong	65.0	65.0	65.0
Malaysia	**66.7**	80.0	**53.3**
Thailand	66.7	75.0	60.0
Chile	96.7	86.7	84.0
Mexico	80.0	80.0	76.6

3.3. National Treatment

Investors responded that they are generally satisfied with the National Treatment extended to foreign investments in developed economies; scores range between the 70s and 80s. Investors particularly in New Zealand expressed the highest satisfaction in all categories. Also, in all the categories on National Treatment, the degree of difficulty expressed by investors to all developed economies, except for New Zealand, are not significantly different from one another. Similar to the MFN categories, Mexico and Chile consistently had liberal regimes with respect to the National Treatment. For Asian developing economies, there were varying responses. Investors in Asian economies generally indicated a high degree of difficulty. In contrast, investors expressed relatively higher satisfaction in other categories.

Table 8. Discrimination: National Treatment

	Tax Preference	**Establishment of Branch**	**Public Contracts**	**Subsidies**
Japan	80.0	77.2	73.3	80.0
Australia	82.8	77.1	**68.6**	74.3
New Zealand	96.0	94.0	94.0	84.0
Korea	85.7	72.5	**61.0**	**66.0**
China	70.0	72.5	**61.0**	**66.0**
Taiwan	80.0	86.6	**56.4**	**60.0**
Hong Kong	90.0	80.0	80.0	80.0
Malaysia	80.0	73.3	**60.0**	**40.0**
Thailand	**66.7**	72.7	**53.4**	**66.0**
Chile	90.0	85.0	93.3	93.3
Mexico	90.0	95.0	86.6	96.6

3.4. Ownership, etc.

Developed economies, excluding Japan, recorded high scores of difficulty ranging from the 70s to 90s, in all categories of ownership. Investors in Japan expressed much difficulty in this regard while investors in New Zealand expressed the least. The scores of the category on 'ceiling on ownership' and 'acquisition' were 51.7 and 63.3 respectively, which implies that forms of ownership is relatively restrictive in the Japanese investment regime. Compared to other categories, investors in developing economies favorably evaluated investment regimes pertaining to ownership.

3.4.1. Performance Requirement

Investors expressed varying levels of difficulty in performance requirements though they are relatively low compared to categories of other sections. Investors in New Zealand expressed the least difficulties in all categories of performance requirement. Responses from investors in developed economies are generally favorable. In almost all categories, scores are higher than 70. With scores in the 40s and 50s, it is implied that Southeast Asian economies impose restrictive standards in performance requirements. In contrast, Korea scored high in all categories.

Table 9. Ownership

	Ceiling on ownership	**Acquisition**	**Government Discretion on foreign controlled business**
Japan	**51.7**	63.3	73.3
Australia	77.1	94.3	80.0
New Zealand	95.3	98.4	92.3
Korea	60.0	60.0	67.5
China	60.0	80.0	65.0
Taiwan	65.0	73.4	63.3
Hong Kong	40.0	50.0	60.0
Malaysia	**46.7**	86.7	73.3
Thailand	70.0	73.4	66.6
Chile	93.3	93.3	96.0
Mexico	90.0	100	83.4

Table 10. Performance Requirements

	Export Performance	**Domestic Sourcing**	**Technology Transfer**
Japan	76.0	72.0	74.0
Australia	80.0	82.8	85.7
New Zealand	95.0	96.7	93.3
Korea	85.3	76.4	78.0
China	65.0	60.0	**45.0**
Taiwan	80.0	74.0	72.0
Hong Kong	73.5	80.0	80.0
Malaysia	70.0	**46.7**	60.0
Thailand	**46.6**	60.0	80.0
Chile	95.0	85.0	90.0
Mexico	96.6	96.6	100

3.4.2. Labor Issues

Regarding labor issues, investors in developed economies gave lower scores. In the layoffs category, Japan and Australia scored 65.0 and 57.1 respectively. The responses are similar in the cases of fringe benefits and labor unions. Investors in Australia responded that they experienced very high levels of difficulty with layoffs and fringe benefits, while investors in New Zealand expressed relatively higher satisfaction in all categories. Responses from investors in developed and developing economies were similar, excluding Korea and Taiwan. Chile and Mexico scored significantly higher than other economies, except Mexico scoring 70.0 in the category of labor unions. Remarkably, Malaysia scored 100 in the category of labor unions, while Korea consistently recorded significantly lower scores than other economies in these categories.

Table 11. Labor Issues

	Layoffs	**Fringe Benefits**	**Labor Union**
Japan	65.0	71.7	66.7
Australia	57.1	54.3	65.7
New Zealand	75.7	73.3	80.0
Korea	40.0	38.3	48.3
China	**65.0**	**65.0**	85.0
Taiwan	72.7	65.0	**58.3**
Hong Kong	60.0	60.0	75.0
Malaysia	73.3	86.7	100
Thailand	**46.6**	**66.7**	93.4
Chile	92.0	92.0	84.0
Mexico	80.0	73.4	70.0

3.5. Others

Responses from investors in developed economies are generally favorable. Their scores mostly range in the 70s and 80s. New Zealand had significantly higher scores in the categories of 'Quota system' and 'Acquisition of real estate'. Investors in Japan and the United States expressed some concern over categories on 'work permit' and 'quota system', respectively.

Table 12. Others

	Work permit	**Acquisition of real estate**	**Tax Environment**	**Incentive Measures**
Japan	65.5	71.6	63.6	74.0
Australia	77.1	80.0	**40.0**	71.4
New Zealand	72.8	87.7	70.0	100
Korea	78.5	60.0	55.4	70.0
China	60.0	65.0	65.0	65.0
Taiwan	58.3	66.7	61.8	65.5
Hong Kong	80.0	60.0	60.0	60.0
Malaysia	53.3	73.3	66.7	66.7
Thailand	55.0	40.0	46.6	53.4
Chile	**76.7**	96.0	**60.0**	100
Mexico	96.6	95.0	**60.0**	91.4

Except for a few cases, investors in developing economies indicated that they had significantly fewer difficulties. Excluding the category of work permits, scores ranged from the 70s to 90s. In some Asian economies, investors seemed to experience difficulties in acquiring real estate. Mexico and Chile were consistently evaluated most favorably in the categories of quota system and real estate acquisition.

4. EVALUATION OF FDI POLICY COMPETITIVENESS

4.1. FDI Policies and Performance

The results of the survey discussed in this paper imply that developing economies' investment regimes are significantly more restrictive than developed economies. In most categories, investors expressed less favorable attitudes in developing economies than in developed economies. In the case of developing countries, most problems are concentrated in Section II (i.e, investment admission procedures). Nine out of the top 10 categories of unfavorable responses are related to investment notification or authorization procedures. The degrees of difficulty are higher than 3(or scores of 60 or lower). Investors in developed economies expressed lower scores of difficulties except those investors whom expressed relatively higher difficulties in investment admissions. Incentive measures would seem to be the important determinants of investment decisions for investors in both developed and developing economies. Tax environments are also important categories in which investors experience difficulties in both developed and developing economies.

From these observations, we may arrive at several policy implications. First, greater efforts need to be directed at liberalizing investment regimes of developing economies than those of developed economies. This implication is directly obtained from significantly higher degrees of difficulty expressed by investors in developing economies. As investment regimes of developed economies are freer than those of developing economies, there are bigger opportunities for developing economies to gain by further liberalization of their systems. Emphasis should be put on finding ways to mitigate impediments regarding investment admission procedures in developing economies. As impediments are scattered in different areas of developed economies FDI regimes, it is impossible to solicit general policy implications for this group.

In order to effectively improve FDI environments and induce more foreign capital, policies must focus on problematic areas indicated by investors in each economy. There are direct and indirect ways to assess the effectiveness of FDI policies. Assuming that an economy seeks more investment from abroad, one should evaluate the competitiveness of FDI policies by indirectly looking at FDI performances. In order to directly assess the competitiveness of FDI policies, one can list policy initiatives taken by each economy and compare the list directly with that of major areas of FDI impediments.

Table 13 shows the trend of FDI inflows for selected Asia-Pacific economies. In most economies, FDI has increased significantly since 1999. World FDI flows have rapidly increased recently, reaching an estimated US$ 1,271 billion in 2000, recovering from the slowdown in the early 1990s. The annual growth rate of FDI between 1996-1995 recorded 40.9%, almost double the growth rate of 20.8% between 1991 and 1995. In Asian developing economies, investment inflow recorded US$143.5 billion in 2000 after a sharp decline in 1998. Relatively faster growth of FDI inflows to Asian developing countries implies that investment flows from developed economies was directed to Asian developing economies.

Table 13. FDI inflows for selected Asia Pacific Economies

	Foreign Directed Investment flows (Billion, $)					**As a percentage of gross fixed capital formation(%)**			
	1985-1995	1997	1998	1999	2000	1985-1995	1997	1998	1999
Japan	0.7	3.2	3.3	12.7	8.2	-	-	-	1.1
Australia	6.1	7.7	6.0	6.4	11.7	9.2	8.1	6.9	6.7
New Zealand	1.9	2.6	1.2	1.4	1.5	22.8	20.0	11.7	11.4
Korea	0.8	2.8	5.4	10.6	10.2	1.1	1.7	5.7	9.3
China	11.7	44.2	43.8	40.3	40.8	6.4	14.6	12.9	11.3
Taiwan	1.0	2.2	0.2	2.9	4.9	2.9	3.4	0.4	4.4
Hong Kong	4.0	11.4	14.8	24.6	64.4	18.9	19.8	29.9	60.2
Malaysia	2.9	6.5	2.7	3.5	5.5	14.5	15.1	13.9	20.1
Thailand	1.4	3.6	5.1	3.6	2.4	4.1	7.2	20.7	13.7
Chile	1.1	5.2	4.6	9.2	3.7	14.4	27.2	24.4	62.4
Mexico	5.3	13.8	11.6	11.9	13.2	10.5	17.7	13.2	11.7

Source: World Investment Report, various issues.

This trend resulted in a bigger investment contribution to capital formation in developing economies. Due to the decline of investment flows in 1989-92, investment contribution to gross fixed capital formation decreased until 1991, and later picked up after 1992. In 1995, world investment inflow accounted for 5.2% of total gross fixed capital formation. The ratio in developing economies is almost twice as big as developed economies, standing at 8.2% and 4.4% respectively. FDI used to be the dominant form of resource flows to developing economies and the primary source of private capital for low-income countries before the Asian Financial Crisis. The recent rebound of FDI in Asian developing economies is expected to resume such a role.

However, it is difficult to evaluate the effectiveness of FDI policies by looking at the absolute changes in FDI alone. This is because aggregate economic variables such as economy sizes have a big effect on FDI inflows. In World Investment Report(2001), the UNCTAD introduced a new measure of FDI performance, the Inward FDI Index. This index facilitates the comparison of each country’s abilities attracting FDI. The Index is “the unweighted average of three ratios reflecting the propensity to attract FDI after adjusting for the relative economic size and strength of a host economy in the world. The distribution of FDI inflows to countries or regions exactly matches other economic aggregates. Table 14 shows changes in the index for the Asia Pacific economies. If the FDI index is higher than 1, the economy can be regarded to have relatively high capacity to attract FDI.

Table 14. Inward FDI Index of selected Asia Pacific Economies

Economy	1988-1990				1998-2000			
	GDP share	Employ-ment share	Exports	FDI Index	GDP share	Employ-ment share	Exports	FDI Index
Japan	0.0	0.0	0.0	0.0	0.1	0.3	0.1	0.2
Australia	2.7	9.4	3.2	5.1	0.5	1.8	0.8	0.9
New Zealand	3.9	10.6	2.8	5.8	1.0	2.4	0.8	1.4
Korea	0.4	0.5	0.3	0.4	0.5	0.9	0.3	0.5
China	1.0	0.1	1.3	0.8	1.3	0.1	1.3	0.9
Taiwan	0.8	1.5	0.3	0.9	0.3	0.6	0.1	0.4
Hong Kong	5.0	11.8	0.7	5.8	6.3	24.5	1.1	10.6
Malaysia	4.3	2.4	1.1	2.6	1.8	1.0	0.3	1.0
Thailand	2.4	0.6	1.4	1.5	0.9	0.3	0.4	0.5
Chile	3.5	2.1	2.0	2.5	2.4	2.4	2.1	2.3
Mexico	1.3	1.0	1.3	1.2	0.8	0.7	0.6	0.7

Source: World Investment Report(2001)

First, the number of economies with FDI index higher than 1 has significantly decreased. During 1988-1990, seven out of 11 surveyed economies showed relatively high FDI attractiveness. However, the number of economies decreased to four. Also, except for Hong Kong, the absolute size of those indices has shrunk. For instance, the number diminished from 5.8 to 1.4 in New Zealand's case. Therefore, it would be safe to say that the FDI attractiveness of Asia Pacific economies has significantly decreased over the past decade.

Secondly, Hong Kong, Chile and New Zealand show greater power to draw FDI than their economic share in the world, although the former has experienced significant deterioration. This fact seems to be generally consistent with the favorable survey responses of investors in these economies. However, it should be noted that there were some areas in which investors in Hong Kong expressed strong complaints, such as 'ownership' though the FDI index of the economy almost doubled. However, this could simply imply that investors think the 'ownership' category is relatively problematic even though Hong Kong is generally more open to FDI than other economies in the world.

Thirdly, the indices for Australia, Malaysia, Taiwan and Thailand have significantly decreased over the last decade. For Australia, according to the survey results, 'Tax Environment' and 'Fringe Benefits for Labor' seem to be the main reasons for decreased FDI attractiveness. In contrast, there seem to be a wide variety of impediments against FDI including performance requirements, regulations on labor, ownership, and so on. Significant requirements of domestic sourcing and technology transfer especially appear to have influenced on the contraction of Malaysian FDI index.

Fourth, the indices for Korea and Japan are significantly smaller than those of all other economies, while they have increased slightly over the decade. It reflects these countries' very restrictive tradition of FDI policy. Investors in these economies expressed relatively higher difficulties in many areas of FDI policy environments in the survey. At the same time, the recent change of policy in favor of foreign capital is somewhat reflected in the slight increase of indices. The size of China's FDI index remains below one. While it seems odd considering the massive inflow of foreign capital during 1990s, the rapid economic growth and its share in the world economy must be the reason. However, the improvement of FDI index over the decade implies that FDI increased even faster than the China's economic growth. Even though investors evaluated the FDI environment as problematic in many areas, the Chinese economy seems to provide sufficient motivations for foreign capitals.

The assessment above is based on the assumption that different FDI regimes and policy explains, at least to some extent, different performance of inward FDI influences. Or, it could be the change of FDI Index caused by the practicality of FDI policies of the economies. For instance, high indices of New Zealand and Hong Kong reflect highly liberalized FDI regimes of these economies, although no notable measures for further improvements have been made. In Malaysia's and Taiwan's case, significant decrease of the indices is noted. These economies have not made sufficient changes in policy although there are various areas for improvements as the survey results showed in the previous chapter. Also, it is interesting to note that Australia does not seem to have made enough efforts to improve FDI environment and experienced a striking decline of inward FDI index. However, as the performance of FDI Index reflects not only FDI policy changes but also other factors like political stability, growth prospects, level of labor skills, cultures and so on, it would be more appropriate to directly compare the list of policy changes and the survey results in order to evaluate FDI policy competitiveness.

4.2. Assessments of FDI Policies of Major Asia Pacific Economies

In this section, we examine the FDI policies of major Asia-Pacific economies. One can list policy initiatives taken by each economy then compare the list directly with that of major areas of FDI impediments.

Table 15 summarizes the list of major problematic areas of FDI and investment measures undertaken by economies. Obviously, these two lists are not an appropriate match. It is also premature to relate the correctness of FDI policies and the change of FDI index.

Table 15. Major Areas for Improvement vs. Measures Undertaken

	Investment Regimes for Improvement based on the Survey Results	**Measures Undertaken**	**Change in FDI Index**
Australia	1. Tax Environment 2. Labor 3. Investment Admission	1.Transparency 2.Non-Discrimination 3.Avoidance of Double Taxation	-2.3
New Zealand	1. Investment Admission 2. Capital exports		-4.4
Japan	1. Investment Admission 2. MFN	1.Transfers of Capital Related to Investments	+0.2
China	1. Investment Admission 2.MFN 3.Performance Requirement 4. Labor	1.Transparency 2.Non-discrimination 3.Performance Requirement	+0.1
Hong Kong	1. Investment Admission	1.Non-discrimination	+4.8

Taiwan	1. Investment Admission 2. MFN 3. Labor	1..Non-discrimination 2.Transfers of Capital Related to Investments	-0.5
Korea	1. Labor 2. Investment Admission	1.Admission 2.Tax Environment	+0.1
Malaysia	1. Investment Admission 2. Labor		-0.8

4.2.1. Regional Developed Economies

Australia

According to the survey results, major areas of Australia's FDI regime turned out to be tax environment, labor and admission procedures. In the category of tax environment, Corporate Income Tax Rate is applied at a flat rate of 36%, which is also applied to capital gains in real terms. There are other taxes adversely affecting foreign companies: Dividend Withholding Tax (DWT, 30%), Interest Withholding Tax (IWT, 10%), and Royalty Withholding Tax (RWT, 30%). According to labor issues, Australia has a long list of regulations including minimum labor conditions in legislation, occupational superannuation, long service leave, public holidays, occupational health and safety, maternity leave and unpaid parental leave, equal employment opportunity, termination of employment, and conditions of public sector employment. At the federal level, strikes and lock-outs are lawful in certain circumstances. Unlawful industrial action may lead to the imposition of penalties under federal and state industrial relations legislation. Finally, investors expressed some difficulties with admission procedures because there are notification requirements based on the size of investments, direct investments by foreign governments or their agencies irrespective of size, requirement of notification for investments in real estates, acquisitions of developed non-residential commercial buildings valued at $5 million or more, acquisitions of urban real estate irrespective of size and acquisitions of residential real estate irrespective of size.

While Australia has made progress in reforming the FDI regime in general, there have not been enough measures to meet the complaints. For instance in the area of tax environment, Australia has not taken any significant measures since it entered into DTAs with Argentina, Slovakia, South Africa and Chinese Taipei since 1996. On the other hand, Australia has taken several steps to enhance national treatment by liberalizing and lifting limits of ownership in some industries. For example, in 1996, the Australian Government lifted the notification threshold that applied to portfolio investments in several sectors (media sector, mining, etc.) as well as the foreign ownership restrictions that were specific to Optus and Vodafone (Australian telecommunications carriers). In 1999, foreign persons (including foreign airlines) can now generally expect to get approval in acquiring 100% of the equity in an Australian domestic airline, unless this is contrary to the national interest. (1999)

New Zealand

The survey results showed that New Zealand needs to improve investment admission procedures and regulation on capital exports. For instance, merger and acquisitions and joint-ventures are approved based on the level of share and investment sizes. Also, sectoral restrictions also exist and economic Benefit Criteria is applied. Investments by foreigners that require the consent of the OIC (Overseas Investment Commission) are assessed on an ad hoc basis. Regarding capital exports, permits may be needed to export goods of a strategic nature that have both military and non-military purposes. No notable policy changes on these measures are reported yet.

Japan

Investment admission procedures and discrimination (MFN) are the major areas of difficulties of the FDI framework in Japan. For instance, foreign investment is subject to ex post facto report or prior notification from the Minister of Finance and competent Minister(s), who determine if an inquiry is necessary from a national security viewpoint, any adverse material influence on the national economy, reciprocity, and so on. Also, prior notification is necessary for investments related to national security, public order and safety as well as investments in some industries. The Foreign Exchange Law requires prior notification of acquisition by a non-resident of any real property existing in Japan or rights related thereto only when it is acquired for the purpose of commercial activity. As far as discrimination issue is concerned, the establishment of branches or subsidiaries of foreign banks or foreign securities houses requires authorization and is subject to reciprocity considerations. An operation permit or governmental registration for international freight forwarding services is granted only to those firms of countries in which Japanese firms are eligible for such permits or qualified for such registrations.

Since 1997, some measures were undertaken to reduce discrimination. However, these measures do not match with the source of complaints. All limitations on foreign investment in Type I telecommunications carriers, including those for radio station licenses, except for NTT and KDD, were removed by the revision of the Telecommunications Business Law and the Radio Law in February 1998. In addition, the KDD law was abolished in July 1998, and restrictions on foreign investment in KDD were also removed. In regards to the cable television industry, the regulations on foreign investment and non-Japan officers were abolished. In 1998, the Foreign Exchange Law, which required foreign exchange through authorized foreign exchange bank, was revised to facilitate transfers of capital related to investments. Also Japan abolished the restriction on the maximum period of stay for status of residence of “Intra-company Transferees”. Also, Japan extended the maximum period of validity from 1 year to 3 years for a permission of residence such as “Intra-company Transferee” and the minimum period of validity from 6 months to 1 year for a permission of residence such as “Investor / Business Managers”.

4.2.2. Regional Developing Economies

China

The main areas of FDI environment that should be improved in China is the inclusion of investment admission procedures, MFN, Performance Requirement and labor issues. The establishment of a wholly foreign-owned enterprise must be beneficial to the development of the Chinese national economy. It must meet one of the following requirements: using advanced technologies and equipment, or a large proportion of its production used for export. Restrictions are based on the nature of the technology, on the infant industry argument, and the nature of industries (exploiting natural resources, valuable minerals, etc.). Also, sectoral restrictions exist with forms of prohibition, limitation, special conditions and special screening. In Agreements for the Promotion and Protection of Investment between China and other countries, there is an exception to MFN treatment resulting from arrangement for facilitating frontier trade. Also, local contents requirements for some industries are included in government policies such as in the automobile industry. In China, it requires approval from the Labor Administration department for foreign enterprises to employ staff members trans-regionally, including employing personnel with special technical ability, senior technicians and senior administrators from abroad who are not available in China. Employment of child labor under 16 years old is strictly prohibited. Foreign funded enterprises must make social insurance of endowment, medical treatment, unemployment, injury at work, bearing and so on for their employees. Enterprises and employees must pay full basic endowment insurance fee to designated social insurance organizations in time according to rules issued by local governments. They should also pay unemployment insurance fees to unemployment insurance organizations of the labor administration departments according to the proportion stipulated by local governments. Meanwhile, enterprises must set aside funds such as housing subsidiary fund according to stipulations.

The three basic laws on FDI have been revised in accordance with WTO TRIMs agreement and the rules of National Treatment in WTO. The Industrial Catalogue for Guiding Foreign Investment was revised in 1997. The ongoing work on the revision of the Provisional Regulation on Foreign Investment Guidance and the Industrial Catalogue for Guiding Foreign Investment will reduce the sectors which require equity ownership, relax the proportion of foreign equity ownership and open up more sectors to foreign investors. The restrictions on requiring balances on foreign exchange, export performance and localization of supplies and so on have been removed.

Hong Kong

There have been restrictions in few sectors, including banking services, broadcasting and airport support services in Hong Kong. Some improvements have been reported. The “one building” condition (imposed on prudential ground to avoid excessive competition in the retail banking market) applicable to banks incorporated outside Hong Kong was relaxed in the second half of 1999. These banks are now allowed to open up to three branches in Hong Kong. The newly enacted Broadcasting Bill provides for relaxation of the incremental steps requiring the Broadcasting Authority’s approval in respect to voting control by unqualified voting controllers (who are not ordinarily resident in Hong Kong).

Taiwan

There are three major areas that should be improved in Taiwan: investment admission procedures, MFN and labor environment. Improvement requires the prior approval of mergers & acquisitions based on the market share in Taiwan. Foreign green-field investment must obtain the approval of the Investment Commission and the MOEA(Ministry of Economic Affairs). Also, approval is necessary for joint-venture and sectoral restrictions must be kept in mind. Case-by-case approval procedures have been adopted for Chinese (People's Republic of China) investors coming to China-Taipei who engage in economic and trade investigation. These are based on restrictions in the Guidelines for National

Unification and statutes governing relations across the straits. Finally, a business entity must convene labor-management conferences to coordinate relations and promote cooperation between labor and management as well as to increase work efficiency. The Collective Agreement Law regarding labor relations further provides standards for the concluding written contracts between employers and workers' organizations.

Taiwan has revised its "Negative List for Investment by Overseas Chinese and Foreign Nationals" six times in order to relax restrictions on foreign investment and reduce the range of industries in which foreign investment is prohibited or restricted. The amendment to the Telecommunications Act of 1996 was promulgated and put into effect on November 3, 1999 to raise the ceiling on foreign shareholdings in Type I telecommunications enterprises from 20% to 60% with direct ownership limited to 20 percent. The revised rule on the foreign shareholdings in Type I telecommunications enterprises was effective on Jan. 31, 2000. The annual limit for each company to freely settle foreign exchange against NT dollars was increased from US$20 million to US$50 million in June 1997. Restrictions on the rights of remittance for New Chinese Taipei Dollar investment were eliminated, and obstacles to the inward and outward flow of capital were reduced.

Korea

Labor environment and investment admission procedures turned out to be most problematic foreign investment issue in Korea. The Ministry of Labor fixes the minimum wage every year and is indiscriminately applied to domestic and foreign companies (per hour: 1,275 Won, per day: 10,200 Won). The Labor Union Act provides for: 1) the free establishment and democratic management of labor unions; 2) the autonomous collective bargaining and signing of collective agreements; 3) the legal validity of the effect and period of agreements; and 4) the relief and restriction of unfair labor practices by employers. As far as investment admission procedure is concerned, an investor, who desires to operate a business is subject to notification and should receive a notification acceptance. One thousand forty three businesses are subjected to advance notification to foreign exchange banks. Forty-nine businesses are subject to the competent minister's approval. The business categories subject to approval are stipulated and listed in the Presidential Decree of the Act and Regulation on Foreign Investment. The foreign investment ratio is allowed up to 100%, except under restriction of individual laws. Mergers or acquisition of the Korean companies by foreign investors were not allowed.

Currently, out of 1,121 classified sectors, only 4 sectors remained closed to FDI, and 99.6 percent of Korea's economy open to the world. There has been some improvement in tax environment: the Special Tax Treatment Control law augmented the scope of businesses eligible for tax reduction/exemption incentives, and the ratio and period of tax reduction/exemption incentives.

Malaysia

While investors expressed some difficulties in investment admission procedures, export performances and labor issues, Malaysia has not taken any significant measures to improve on these problems. Manufacturing licenses require companies to obtain prior approval from the Ministry of International Trade and Industry before entering into any agreement in joint ventures, management and technical assistance, know-hows, licensing, patenting and trademarking and turnkey projects which involve foreign partners. Ceiling on ownership varies on the following factors: the level of technology, nature of industry (projects manufacturing priority products for the domestic market, mineral developing, etc.), the level of investments, technology and risk, availability of Malaysian expertise, degrees of integration and level of value-added factors involved in the projects. For approval of acquisitions, mergers and take-overs, net economic benefits relate to the extent of Malaysian participation, particularly Bumiputera participation, ownership and management, income distribution, growth, employment, exports, quality, range of products and services, economic diversification processing and upgrading of local raw materials, training efficiency, and research and development. Export performance as proposed by the foreign investor in undertaking a manufacturing project will determine the level of foreign equity participation that can be allowed. The Employment Act sets out the minimum conditions of employment which include the period of notice required to terminate it, wage payment, work house of female workers, holidays and diseases. The Employees Provident Fund Act, 1951 provides for a compulsory contributory provident fund which is fully payable to employees at the age of 55 years. All employers and employees are required to contribute to the Fund at the rates of 12% and 10% respectively of the employees' monthly wages. The Employment Injury Insurance Scheme provides employees with coverage in the event of any disablement or death due to employment injury paid in cash benefits and medical care. The contribution is made solely by the employer and is about 1.25% of the wages of an employee. The Invalidity Pension Scheme provides 24-hour coverage to employees against invalidity and death due to any cause before the age of 55 years. The total contribution is about 1% of the wage of an employee and is shared by the employer and the employee equally.

4.3. Summary and Conclusion

Considerable FDI regulatory changes had been made worldwide to improve the FDI environments. It seems that many countries are in ‘reform competition’. However, there are wide differences in inducing FDI among economies and regions. It may be due to the difference in the competitiveness of FDI policies of countries around the world. A competitive FDI policy should correct the most restrictive aspects of FDI regimes. In this study, the survey results on FDI environment for Asia Pacific economies are used to assess the FDI environments of Asia Pacific economies. We have also looked into the performance of FDI and evaluated the appropriateness of policy measures against the survey results. Different FDI regime and policy seems to explain, at least to some extent, different performance of FDI Indices. Economies with high indices seem to reflect highly liberalized FDI regimes. Economies, which have not made necessary measures, showed significant decrease of the indices. Of course, the performance of FDI Index reflects many other non-policy factors. Therefore, this study examined the details of policy measures undertaken by Asia Pacific countries. Most countries have taken various measures to improve their FDI environment. However, most of their actions do not seem to be directed to problematic areas of their FDI regimes as identified by the survey. Countries have taken numerous policy measures but they seem to have missed the target.

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