CHAPTER 4

DESCRIPTIVE ANALYSIS

From the result provided in last chapter, the study shall be conducted to analyze further relation between countries' environment and the value of inward FDI. This is to provide readers with dynamic picture of FDI determinants in the longer period. The extension also aims to descriptively analyze the finding in chapter 3 that the foreign direct investment in the East Asia countries can be explained by the market size hypothesis, cost hypothesis, and export hypothesis. Also, the analysis will present and describe other majors, if any, that are found as factors that affect the volume of inward FDI to the countries. By this, the study employed the most recent data of sample country, which is the data since 1991-2000, to analyze correlation between inward FDI and determinants.

During the chapter, national profile of each sample is described to show the country historical background, economic environment –including economic growth, inflation interest rate, and export performance- and investment climate. Later, the national economic factor will be analyzed and described if they determine FDI based on eclectic model. Hence, the analysis will be separated into three main groups according to their relation to our hypothesis, which are i) market-size hypothesis, ii) cost-efficiency hypothesis, and iii) export-oriented hypothesis. However, for some countries, other characteristics of the country are presented as the factors that influent the flows.

Economic factors are grouped and analyzed according to its relation to the study's hypothesis as follows;

1. Market-size hypothesis comprises of determinants that describe the size of the host economy, which are GDP, population, and Per Capita Income. It is expected that the larger economy shall perform better in FDI attraction as it acquires more purchasing power and economy of scale.
2. Cost-efficiency hypothesis is analyzed by number of labor forces, inflation, and interest rate within the host country. It is expected that the country with more population can attract more FDI as it provides investor cheap labor cost. Also, the number of labor implies market size. Beside the number of labor, the stable inflation and interest rate shall make the country more attractive as it brings confidence to the investors.
3. Export-oriented hypothesis is analyzed by the country's export volume and its exchange rate. The country with high volume of export could attract more FDI comparing to the country with less export. One reason is as the high export volume implies the country's openness to international markets, tariff advantage, and skilled labor. Meanwhile, the movement of the country's exchange rate is considered, unless the country applied a fixed exchange rate regime, if the depreciation of the exchange rate supports the country's inward investment.

Overview

As mentioned in Chapter 1 and 2, China is a major FDI recipient in the region. The country's growth in inward FDI has increased dramatically since 1993. Meanwhile, the role of Hong Kong has increased magnificently in 1996, one year before its colonial change. Besides that, there are more interesting changes in the regions over the years.

To illustrate, inward FDI in East Asia during 1991-2000 has increased hugely. The volume of FDI inflows to the eight sampled countries were as high as 145.5 billion USD, compared to only 13.6 billion in 1991, which was almost ten times increase in ten year. Even in 1997, the year of Asian crisis, the value of inward FDI to the selected countries dropped only by 1.83%. In addition, the situation recovered quite fast as in 1998 the value of inward FDI to the country grew by 5.84%.

More surprisingly, in 2000, when there was a colonial shift in Hong Kong, the largest destination of inward FDI in the region changed from China to Hong Kong. The value of inward FDI to the country had risen from 24.6 billion US dollars in 1999 to 61.9 billions in 2000. This reflects a position of Hong Kong as a gateway to Chinese mainland. (UNCTAD, 2002) By this, Hong Kong is then used as a transit center for investors who are not confident enough to invest in the mainland, but want to test the market first.

In addition to 2000, UNCTAD reports in 2002 that inward FDI to the region has been even higher in 2001 and 2002 according to the statement of UNCTAD. UNCTAD also announces that there has been the doubling flows to Hong Kong and China. China regained its position as the largest recipient in the East Asia region and among the developing countries. (UNCTAD, 2002) Singapore and Hong Kong are other high-shared destinations. Hong Kong has been regarded as a business hub for China. Moreover, it is expected to remain its role for a while. (UNCTAD, 2002) Inward FDI to Korea has re-raised again after the 1997 economic crisis. Huge part of the flows targets to acquire, or merge, the host strong businesses. The flows to Taiwan remain high. Taiwan's accession to WTO increased its attractiveness for MNEs, particularly in service sector. (UNCTAD, 2002)

Along with the increase in inward FDI to the region, the study can observe that national characteristics of the countries have been changed during the time as well. The changes are either in terms of market-size, cost fluctuations, and export competitiveness. The factors are changed in various directions, depending on times and countries. As a result, these changes are studied and present within each country profile.

Table 9: Inward FDI to the Sampling Countries During 1991-2000

Million USD

Year	China	Hong Kong	Indonesia	Korea	Malaysia	Philippines	Thailand	Vietnam	Total
1991	4,366	N/A	1,482	1,180	3,998	544	2,014	N/A	13,584
1992	11,156	N/A	1,777	727	5,183	228	2,113	N/A	21,184
1993	27,515	N/A	2,004	588	5,006	1,238	1,804	N/A	38,155
1994	33,787	N/A	2,109.00	810	4,342	1,591	1,366	N/A	44,005
1995	35,849	N/A	4,348.00	1,776	4,178	1,478	2,068	N/A	49,697
1996	40,180	10,460	6,194	2,325	5,078	1,520	2,271	1,803	69,831
1997	44,237	11,368	4,677	2,844	5,137	1,249	3,626	2,587	75,725
1998	43,751	14,776	-356	5,412	2,163	1,752	5,143	1,700	74,341
1999	40,319	24,596	-2,745	9,333	1,553	578	3,561	1,484	78,679
2000	40,772	61,938	-4,550	9,283	N/A	1,241	2,813	1,289	112,786

Source: UNCTAD

Table 10: Inward FDI Share in the Selected Countries During 1991-2000

Percent

Year	China	Hong Kong	Indonesia	Korea	Malaysia	Philippines	Thailand	Vietnam	Total
1991	32.14	N/A	10.91	8.69	29.43	4.00	14.83	N/A	100.00
1992	52.66	N/A	8.39	3.43	24.47	1.08	9.97	N/A	100.00
1993	72.11	N/A	5.25	1.54	13.12	3.24	4.73	N/A	100.00
1994	76.78	N/A	4.79	1.84	9.87	3.62	3.10	N/A	100.00
1995	72.14	N/A	8.75	3.57	8.41	2.97	4.16	N/A	100.00
1996	57.54	14.98	8.87	3.33	7.27	2.18	3.25	2.58	100.00
1997	58.42	15.01	6.18	3.76	6.78	1.65	4.79	3.42	100.00
1998	58.85	19.88	- 0.48	7.28	2.91	2.36	6.92	2.29	100.00
1999	51.24	31.26	- 3.49	11.86	1.97	0.73	4.53	1.89	100.00
2000	36.15	54.92	- 4.03	8.23	N/A	1.10	2.49	1.14	100.00

Source: UNCTAD

Table 11: Inward FDI Growth in the Selected Countries During 1991-2000

Percent

Year	China	Hong Kong	Indonesia	Korea	Malaysia	Philippines	Thailand	Vietnam	Total
1991	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1992	155.52	N/A	19.91	- 38.39	29.64	- 58.09	4.92	N/A	55.95
1993	146.64	N/A	12.77	- 19.12	- 3.42	442.98	- 14.62	N/A	80.11
1994	22.79	N/A	5.24	37.76	- 13.26	28.51	- 24.28	N/A	15.33
1995	6.10	N/A	106.16	119.26	- 3.78	- 7.10	51.39	N/A	12.93
1996	12.08	N/A	42.46	30.91	21.54	2.84	9.82	N/A	40.51
1997	10.10	8.68	- 24.49	22.32	1.16	- 17.83	59.67	43.48	8.44
1998	- 1.10	29.98	- 107.61	90.30	- 57.89	40.27	41.84	- 34.29	- 1.83
1999	- 7.84	66.46	671.07	72.45	- 28.20	- 67.01	- 30.76	- 12.71	5.84
2000	1.12	151.82	65.76	- 0.54	N/A	114.71	- 21.01	- 13.14	43.35

Source: UNCTAD

China

1. Historical Background

For centuries China has stood as a leading civilization, outpacing the rest of the world in the arts and sciences. But in the first half of the 20th century, China was beset by major famines, civil unrest, military defeats, and foreign occupation. After World War II, the Communists under MAO Zedong established a dictatorship that, while ensuring China's sovereignty, imposed strict controls over everyday life and cost the lives of tens of millions of people. After 1978, his successor DENG Xiaoping gradually introduced market-oriented reforms and decentralized economic decision making. Output quadrupled in the next 20 years and China now has the world's second largest GDP. Political controls remain tight even while economic controls continue to weaken.

In 1980s the Chinese leadership began moving the economy from a sluggish Soviet-style centrally planned economy to a more market-oriented system. Whereas the system operates within a political framework of strict Communist control, the economic influence of non-state managers and enterprises has been steadily increasing. The authorities have switched to a system of household responsibility in agriculture in place of the old collectivization. The authority of local officials and plant managers in industry is increased, permitted a wide variety of small-scale enterprise in services and light manufacturing, and opened the economy to increase foreign trade and investment. (US. Department of Commerce [DOC], 1999)

Special Economic Zones and Open Coastal/Port Cities have been established and expanded gradually since 1980s to attract more investment and technology from other countries and lift up its economic growth. The zones offer the lowest corporate tax for international investments that meet condition. The special zones, however, are concentrated in the West Coast. Later, the Chinese government has loosened its regulation and become more opened to international foreign investment year by year. The government has also eased the regulations concerning company establishment, joint venture restriction, for example.

After the success in establishing Special Economic Zones (SEZ) and Open Port Cities (OPC), the country has continued its opening progress. The country has established Open Economic Zone for investors where there are as few restrictions on investment as in SEZ and OPC. The country also developed its cities in borders and established Border Economic Zones, wishing to encourage trade and investment with its neighboring countries. Also, the government encouraged investment distributions by establishing Economic and Technology Development Zones in small cities throughout the country to attract small and medium size foreign enterprises.

Though the main purpose of opening the economy is to shift up its technology, China doesn't only encourage industrial investment but also support those investments in agricultural sectors.

China's government has encouraged investment in various sectors from time to time. In first stages, the government focused on hi-tech industries. And export promotion such as electronics, computer, textile, etc. Later in 1990s, the country highly promoted investments in infrastructure and fundamental industry, which are electricity, ports, airports, industrial estates, and roads, for example.

In addition, the country had tried to entry WTO, the country had gradually deregulated its restrictions in service sector. As a result, on November 11, 2001, the country has become a member of WTO, leading to a shift in foreign investment policy. The new policy separates foreign investments into four groups, which are a) promoted investment b) permitted investment c) permitted investment with some restrictions and d) restricted investment.

2. Economic Environment

China has pursued Central Planning policy since the revolution in according to its political regime. The country however continuously opens itself through times. The result of the open has been a quadrupling of GDP since 1978. In 2000, with its 1.26 billion people but a GDP of just $3,600 per capita, China stood as the second largest economy in the world after the US (measured on a purchasing power parity basis). Agricultural output doubled in the 1980s, and industry also posted major gains, especially in coastal areas near Hong Kong and opposite Taiwan, where foreign investment helped spur output of both domestic and export goods. From statistics, the country's GDP and Exports are growing up constantly during 2000s. The economy has grown up by 34.09% during 1996 to 2000. Meanwhile, the country's export has grown more than 20% before and after the crisis. When the export data of

2000 is compared with that of 1996, the study found that China's export has expanded by 64.88%

China is regarded as a very good example for exchange rate stability via its fixed exchange rate regime. After the depreciation in 1994, the country can successfully maintain its exchange rate during the decade. Even in Asian 1997 crisis, the country can stabilize its rate very well and this supported the recovery of the crisis. During 1995-2000, China's exchange rate has been moved between 8.278 and 8.314 Yuan per US dollars.

The country is also successful in providing jobs to the people. From statistics in table 12, the country can control its unemployment rate to be stable at 3.0-3.1 per cent during the late 2000s.

Besides the recorded economic performance, the country has another major attraction to the international investors as its accession to WTO in 2001. The accession would definitely lead to an extensive change in the country's international policies, concerning trade, tariff, and investment. This would later create a better economic environment for international investors, leading to a lower cost. For example, the country would have to deregulate its restrictions on imports and trade barriers, hence foreign firms face lower cost in importing intermediate goods for their productions.

In addition, China' non-tariff barriers of the country have to be removed with in a certain period, according to WTO rules. Also, the country has to improve its custom procedures. These conditions should allow investors to be more competitive and more comfortable in investing in China. Moreover, the firms should also enjoy lower cost and higher profit from investing in China.

Table 12: China's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	5.3234	5.5146	5.7620	8.6187	8.3514	8.3142	8.2898	8.2790	8.2783	8.2785
Export (M. USD)	71,910	84,940	90,970	121,047	148,797	151,197	182,877	183,589	195,150	249,297
FDI (M. USD)	4,366	11,156	27,515	33,787	35,849	40,180	44,237	43,751	40,319	40,772
GDP (B. USD)	406.09	483.05	601.08	541.74	700.61	821.85	903.46	964.52	991.19	1,079.95
Labor Force (Thousands)	597,379.73	608,311.16	618,275.15	632,397.12	699,763.13	709,793.81	717,525.77	721,950.46	N/A	N/A
Lending Interest Rate	8.64	8.64	10.98	10.98	2.06	10.08	8.64	6.39	5.85	5.85
PCI (USD)	347.06	408.12	502.40	448.16	574.04	666.81	726.14	768.12	782.44	N/A
Population	1,170.10	1,183.60	1,196.40	1,208.80	1,220.50	1,232.50	1,244.20	1,255.70	1,266.80	N/A
Unemployment Rate	2.30	2.30	2.60	2.80	2.90	3.00	3.00	3.10	N/A	N/A
WPI	3.54	6.34	14.58	24.24	16.90	8.32	2.80	- 0.80	- 1.40	0.30
Productivity of Labor (USD)	679.79	794.08	972.18	856.65	1,001.21	1,157.87	1,259.13	1,336.00	N/A	N/A

Source: IMF, International Financial Statistics, Various Editions

3. Investment Climate

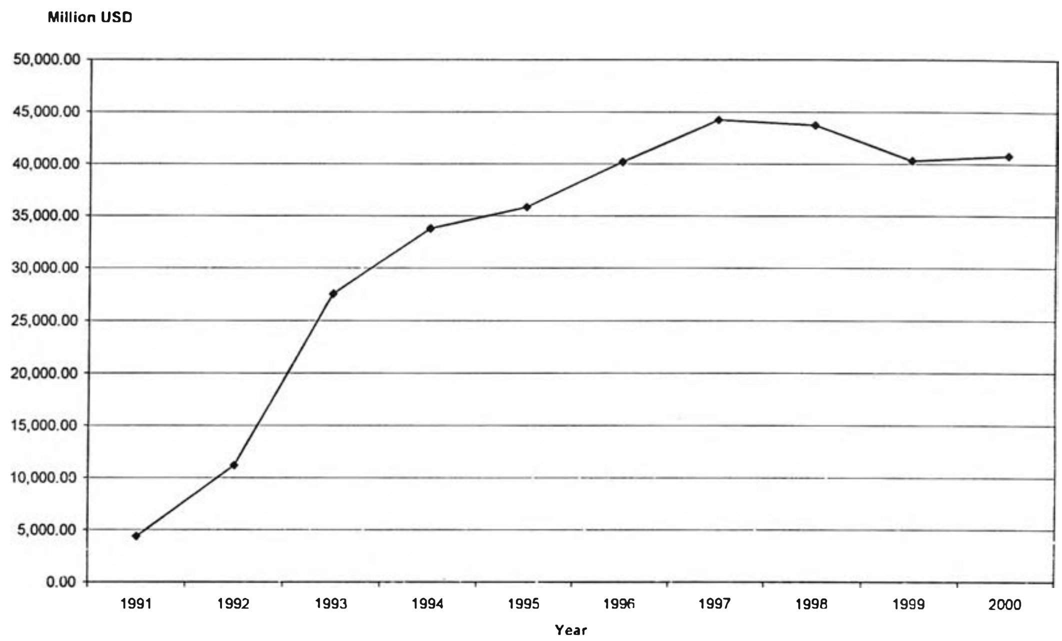
China has been attracting more and more inward FDI as the time passes. This should be a result of the country's policy of openness and liberalization. With the policy to open the country wider, China has reformed a number of laws and regulations.

For instance, the country has reformed its foreigner's income tax law in 1990 to encourage more FDI to the country. Also, in late 1990, the country set up Padong New economic Area in Shanghai to attract advanced technological businesses and financial industries. In 1992, the country announced its socialist market economy policy to the public. By the policy, investors were informed that the market was going to be more opened. In addition, the country has expanded its various types of special economic zones throughout the country in order to attract more FDI through various forms of incentives offered to investors.

During the time, major sources of investors in China are Hong Kong SAR, Japan, Taiwan, United States, European Union, Singapore, and Korea, respectively. Hong Kong and Taiwan are major investors in the country as it is located really close. Moreover, they share similar language, culture, and belief.

FDI in China is concentrated in manufacturing, almost 60%. Next are real estate, distribution, construction, and primary. (IMF, 2002) Geographically, foreign investments in China are concentrated in the east and south coast area. One reason is as the result of the country's policy to control the spread of free economic activities by establishing Special Economic Zone in some specific area. Meanwhile, another reason for the concentration is the poor infrastructure and facilities in deeper areas.

Figure 1: Foreign Direct Investment in China during 1991-2000



Source: UNCTAD, World Investment Reports

The investment inflows to China would not only aim to serve the huge domestic demand, but also to approach a lower production cost. Some flows to China are expected economy of scope, and transactional cost reduction. Tseng and Zebregs showed in their study in 2002 that approximately 50 percent of china's exports are foreign affiliate products.

Another remark for FDI in China is the geographical pattern of distribution. More than 80 percent of direct investment inflows to China settle in the eastern region. The reason of the concentration is that, in the early developing period, China chose to reform its different policies in different selected area of the country and the eastern region was selected first to serve the country's openness policy. (Tseng and Zebregs, 2002)

Table 13: Major Investors in China

Unit: Percent of total

	1991	1995	1999
Hong Kong SAR	55.3	53.4	41.0
Japan	13.1	8.5	7.2
Taiwan, Province of China	10.1	8.4	6.5
United States	7.1	8.2	9.9
European Union	5.7	5.7	11.0
Singapore	1.2	4.9	6.2
Korea	0.0	2.8	3.0
Other	7.5	8.2	15.1

Source: Statistical Yearbook of China, cited by IMF

Most of FDI are concentrated in manufacturing industry, estate industry, and distribution industry. More than a half of the flows are directed toward labor-intensive production, textile, clothing, food, for instance. (Tseng and Zebregs, 2002)

4. FDI and Major Economic Factors Relationship

4.1 Market Size Hypothesis

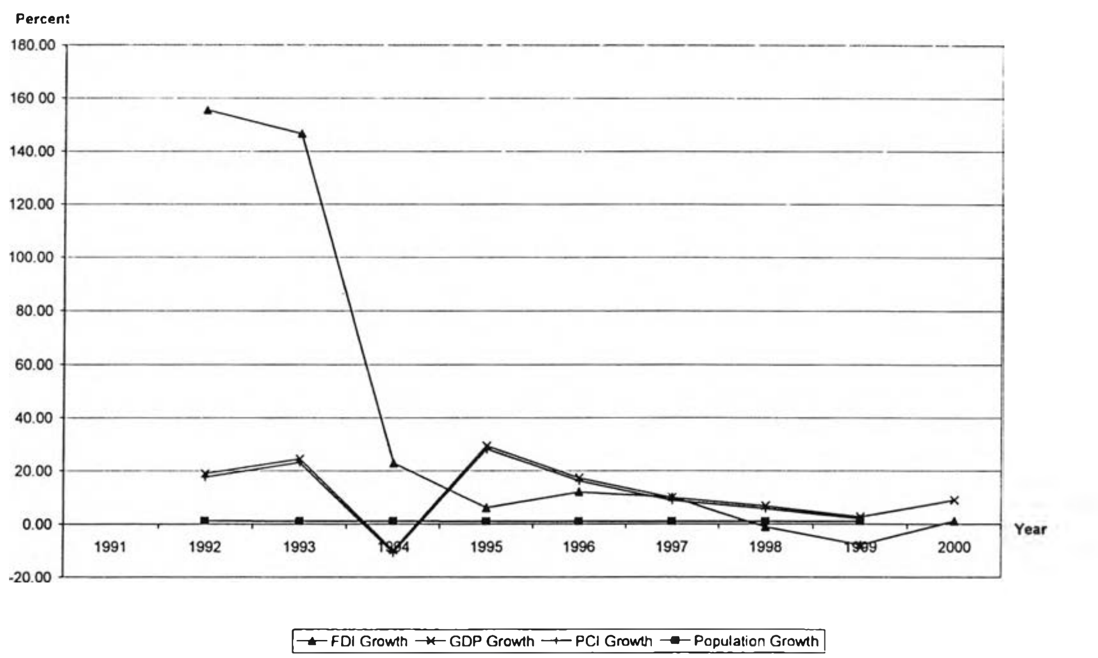
During the year 1991 – 2000, the economy had expanded rapidly with the growth of 265.94% in GDP and 225.45% in Per Capita Income. Meanwhile, the value of inward FDI had increased by 933.85%. From these statistics, an increase in the country's market size is positively related to the country's inward FDI with multiplier effect more than 1.0. This assumption is confirmed by the study of correlation coefficients among the factors.

By reviewing china's major economic factors during 1991-2000, the correlation coefficients support the study's market-size hypothesis. The study reports positive relationships between the country's inward FDI and its proxies for market size, either GDP, or GDP per head. The correlation coefficient between the country's inward FDI and the country's GDP is 0.85. Meanwhile, the correlation coefficient between the country's inward FDI and its GDP per capita is 0.90.

However, when the study is investigated further relationship, by measuring the relationship between the growths of the factors, to reaffirm the relations among the factors, the study report only a moderate relation between the country's growth in market size and the country's growth in inward FDI. The correlation between the country's inward FDI growth and its GDP growth equals to 0.42. This supports the market size hypothesis that the bigger size of an economy. Meanwhile, the correlation between the country's growth in inward FDI and its per capita income equals to 0.41. As a result, the positive relation between the country's inward FDI and the country's size of market cannot be rejected.

According to the correlation coefficients reported above, the study concludes that the market-size if the country is positively related to the value of inward FDI to the country. This implies that an increase, or a decrease, in the country's inward FDI is happened in the same time that with an increase, or decrease, in the country's purchasing power. However, the study cannot strongly confirmed the market-size hypothesis in the case of China as the study reports only a moderate correlation between the country's growth in inward FDI and the country's growth in market size.

Figure 2: China's Growth in inward FDI, GDP, Per Capita Income, and Population during 1991-2000



4.2 Cost Hypothesis

In terms of cost, the study reports that, during 1991-2000, the study's cost hypothesis is not supported in the case of China. This is because the correlation coefficient between the countries's inward FDI and its proxy, either one-year lending interest rate or WPI, for cost are weak. The correlation coefficient between the country's inward FDI and its interest rate is reported at only -0.20 whilst the coefficient between the country's inward FDI and WPI is as small as -0.11.

Moreover, the study of the relationship between the country's growth in inward FDI and its cost proxies still report the inconclusive relationship. The correlation coefficient between the country's growth in inward FDI and its interest rate is reported at 0.32. Nevertheless, the study reports a positive relation of 0.55 between the growth of inward investment to the country and its growth in WPI.

Figure 3: China's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

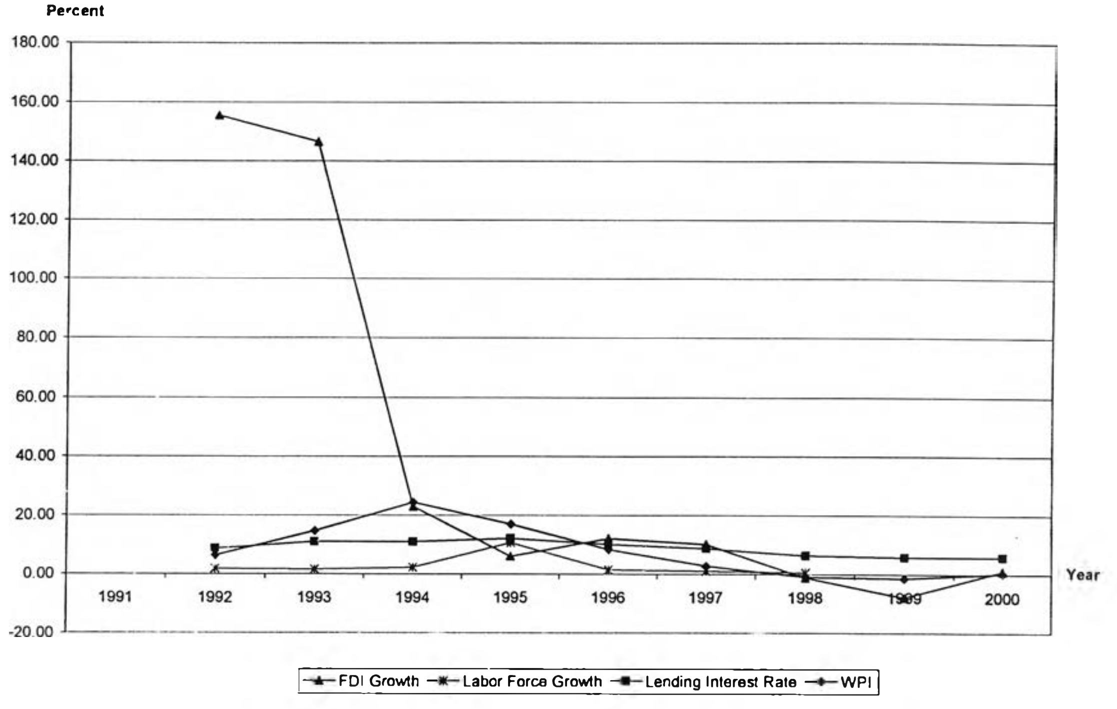
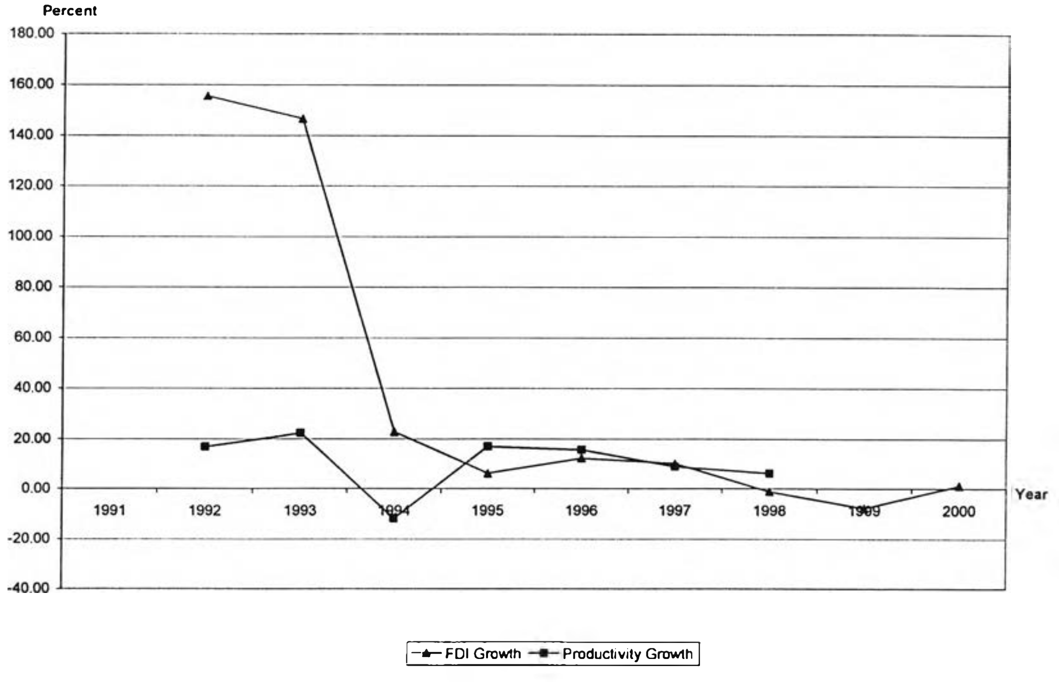


Figure 4: China's growth in inward FDI, and Productivity of Labor during 1991-2000



As a result of the coefficients computed, the negative relation of the cost hypothesis is not supported by the study. This brings to an interesting point that challenges whether the hypothesis is not supported only in the case of China or throughout the sampled nations.

4.3 Export hypothesis

By observing the relationship between the country's export proxies, which is the country's export value, during 1991-2000, the study has to exclude the data prior to the year to the country's currency devaluation in 1993. This is because the approximately 33% devaluation in Chinese Yuan cam distort the reliability of the relation.

After excluding the data, 1991-1993, the study reports that the export hypothesis is supported. The hypothesis is supported by the correlation coefficient between the country's inward FDI and its export value. The correlation coefficient is reported at 0.51. Moreover, the relation is also supported by the correlation coefficient between the country's growth in inward FDI and the country's growth in exports. The coefficient is reported at 0.60.

The above results do not only support the study's export hypothesis, but also imply that the Chinese government policy in attracting FDI for export promotion is implemented successfully. This is also consistent to the characteristics of foreign investment in the country described in the previous section that foreign affiliates, located in various special economic zones, take a considerable role in the country's export performance.

In addition to the export values, the country's exchange rate is another proxy for export hypothesis. However, as China applies a fixed exchange rate regime, the movement of the country's exchange rate is minimal during the period. As a result, the study would not investigate and report the relationship between the country's exchange rate and its inward FDI.

Figure 5: China's inward FDI, and Export during 1991-2000

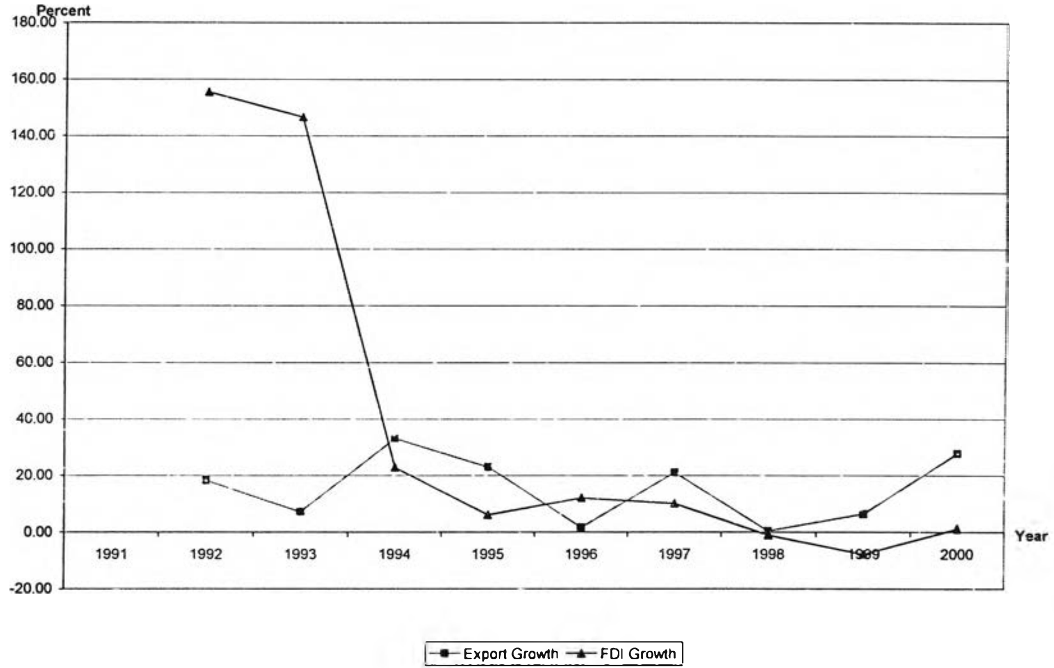
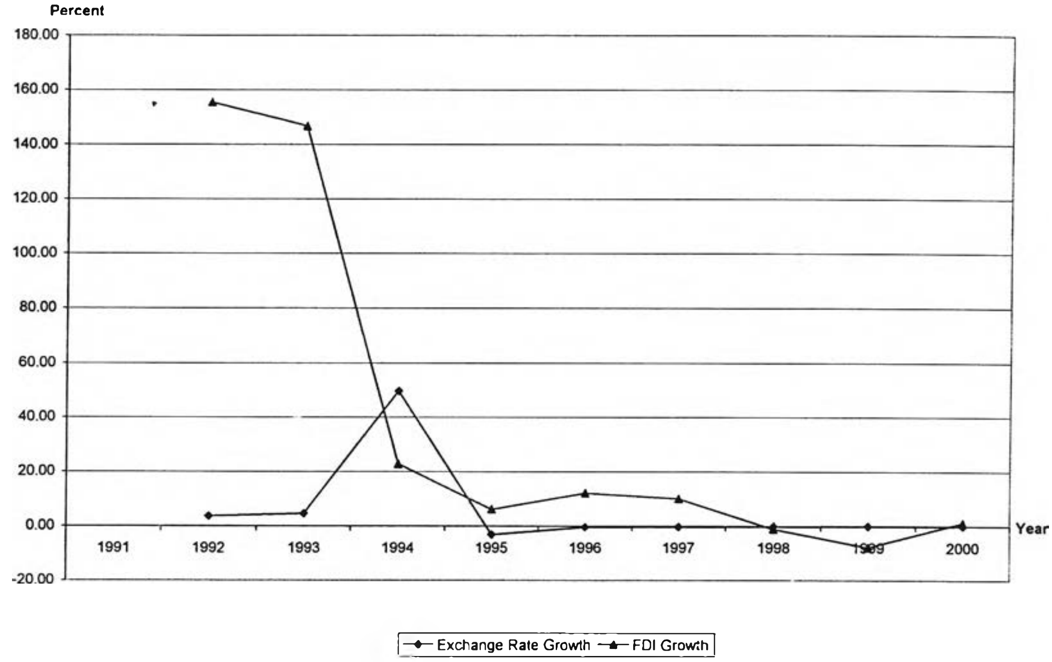


Figure 6: China's inward FDI, and Exchange Rate during 1991-2000



4.4 Other determining factors

Besides the three hypotheses described, there are many other factors that affect the country's attractiveness for foreign direct investment. One remarkable factor is the fact that the country is entering to WTO in 2002. As described in the previous chapter, the country's accession to WTO arouses investors' interest and brings about confidence to international investors as when the country enters to WTO system, regulations custom procedures and trade barriers must be removed not long later. This would later create a better economic environment for international investors, leading to a lower cost. As a result, investors should be more competitive in global community and enjoy higher profit from investment.

Besides that attractiveness, nevertheless, the country is commented for some inferiors. The government's transparency and anti-corruption practice is one of the factors that destroy investor confidence. Tseng and Zebregs reports in 2002 that China is graded relatively low, 3.5 out of 8, by Transparency International Corruption Index.

To sum up, China has so many advantages against other countries in terms of location advantage. The study concludes that the country market size, low production cost, and the growth in productivity of labor are significant determinants of inward of FDI. However, the country export volume is not found as the determinant.

5. Conclusion

By reviewing the Chinese data during 1991-2000, the market size hypothesis, the cost hypothesis, and the export hypothesis of the study have been supported. The study found high correlation between inward FDI to the country and economic indicators, such as GDP, PCI, and export value.

The study reports a strong positive relation between the country market size, either measured by GDP or PCI. However, the growth of market size is just moderately related to the growth of FDI.

In terms of cost hypothesis, the study reports an inconclusive relationship between the country's inward FDI and the country's cost of funding. This is because domestic interest rate does not really affect investors' cost of funding directly as investors can globally finance their projects. In addition, the study reports a positive relationship between the country's inward FDI and the country's WPI growth, which is consistent to the assumption.

The export hypothesis is supported by a strong positive relation between the country's export value and the country's inward FDI. Meanwhile, the correlation between the value of inward FDI and the country's exchange rate also supports the assumption that the weakening exchange rate should encourage more FDI.

As a result, the study concludes that the increasing inward FDI is supported by the strong economic growth, supported by huge and expanding market size, low cost of production, growing export value, and the depreciating exchange rate. Also, the country has become more attractive to international investors as it is opening the economy to the global investor and entering WTO. This is another strong attribute that determines a high growth in inward FDI to the country.

Hong Kong

1. Historical Background

Hong Kong, a Special administrative Region (SAR) of China, is formerly a British colonial area, according to a hundred-year rental contract signed by the British government and the Chinese. After a hundred year under the administration of the British government, the country had been developed in the British-style. As a result, a number of Hong Kong people can speak fairly good English. Also, the country's technology and business's culture is leaned to the western style, rather that Asian-style. However, the agreement of rental has ended in 1997, so the island is returned to be a part of the mainland's Chinese government.

Nevertheless, the two parties agree to allow Hong Kong to retain its economic and legal system for another 50 years. This is to ensure that the changes would be carried out efficiently and the market is not affected by the paradigm shift.

After the year, when Hong Kong was merged to China and transformed its political structure to a Special Administrative Region (SAR), the island is governed by a policy called "one country, two systems". The policy aims to allow Hong Kong government to administrate the island by the democracy system, under a supervision of the Chinese government, who govern the whole country by the socialism system.

As a result of the policy to allow Hong Kong to retain its governing style and free market system, the country can maintain its status as a financial center of the region. Also, Hong Kong has been able to attract more and more inward investment.

2. Economic Environment

During the years of 1991-2000, the economy of Hong Kong has passed through the expansion and the contraction. The country recorded a high growth, in double digits, for many years in early 2000s. In average, 1991-1997, the economy has grown up by 12.92% each year. However, as a result of the Asian economic crisis, the economy contracted by 8.63% in 1998 and 2.62% in 1999. Fortunately, the country has recovered from the recession only in two years after the crisis. In 2000, the country reports a GDP growth of 2.73%.

In terms of trade and investment, becoming a Special Administrative Region, SAR, of China, increased the country's performance in exports and inward FDI. According to table 14, the country reports a high growth of inward FDI during 1998-2000. Also, the value of intra-trade between Hong Kong and China heads up rapidly as a number of companies in Hong Kong expand its market segments to the mainland. (UNCTAD, 2001) Also, a number of foreign companies initiate their affiliates in Hong Kong to test the market before completely competing in the mainland. (UNCTAD, 2001) Nevertheless, it is expected that Hong Kong's role as an entrant city for investments in the mainland will slightly drop off. Inward investment to Hong Kong will change again in these few years. (IMF, 2002)

Table 14: Hong Kong's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	7.77	7.74	7.74	7.73	7.74	7.73	7.44	7.75	7.76	7.79
Export (M. USD)	98,580	119,510	135,250	151,400	173,750	180,750	188,060	174,000	173,890	201,860
FDI (M. USD)	N/A	N/A	N/A	N/A	N/A	10,460	11,368	14,776	24,596	61,938
GDP (B. USD)	86.09	100.64	115.96	130.82	139.22	154.12	177.91	162.55	158.30	162.62
Labor Force (Thousands)	2,850.70	2,850.90	2,931.63	3,029.56	3,100.21	3,183.13	3,288.34	3,524.66	0.00	0.00
Lending Interest Rate	8.50	6.50	6.50	8.50	8.75	8.50	9.50	9.00	8.50	9.50
PCI (USD)	14,971.67	17,321.55	19,587.40	21,658.31	22,601.11	23,783.74	27,119.94	24,480.45	23,556.31	23,914.61
Population	5.75	5.81	5.92	6.04	6.16	6.48	6.56	6.64	6.72	6.80
Unemployment Rate	1.80	2.00	2.00	1.90	3.20	2.80	2.20	4.70	6.30	5.00
WPI	3.40	5.30	6.00	8.20	11.30	6.30	6.20	3.20	-4.60	-4.20
Productivity of Labor (USD)	30,198.56	35,300.56	39,553.86	43,179.91	44,907.60	48,417.37	54,102.25	46,117.99	N/A	N/A

Source: IMF, International Financial Statistics, Various Editions

By this, the study reports a well-performed economic environment of the country during the early 2000s. Also, the country can provide exchange rate stability for economic agents through its currency board system. Nevertheless, the unemployment rate of the country had been fluctuated from 1.80% in 1991 to 6.3% in 1998 as a result of economic crisis and the country's economic contraction.

3. Investment Climate

The Hong Kong Special administrative Region provides investors with opened and free market. The country offers no incentives and disincentives for foreign investors. (DOC, 1999) Moreover, the country does not impose any direct subsidies to domestic industries. In addition, the country does not impose tax on capital gains, dividends and royalties. Besides, profits from investment can freely convert and remitted. (DOC, 1999)

In terms of trade, the country collects no tariff on imports. Also, the country does not implement any system of quotas, and non-tariff barriers to protect its domestic industry. The country, furthermore, encourage investment with no limitation on currency exchange and transfer. A few restrictions are applied in only few sectors for security reasons. (DOC, 1999)

From statistics, in 1996, FDI towards Hong Kong accounts for approximately six thousands million US dollars. The main sources of investment were Japan, U.S.A., China, U.K., and The Netherlands. The investment is distributed all over its area. Most of them are directed to technology intensive and capital intensive as Hong Kong's natural resources and market size is limited. Hong Kong has promoted high valued added productions to compete the world. However, Hong Kong's role as an entrant city for investments in the mainland is expected to slightly drop off. Inward investment to Hong Kong will change again in these few years. (IMF, 2002)

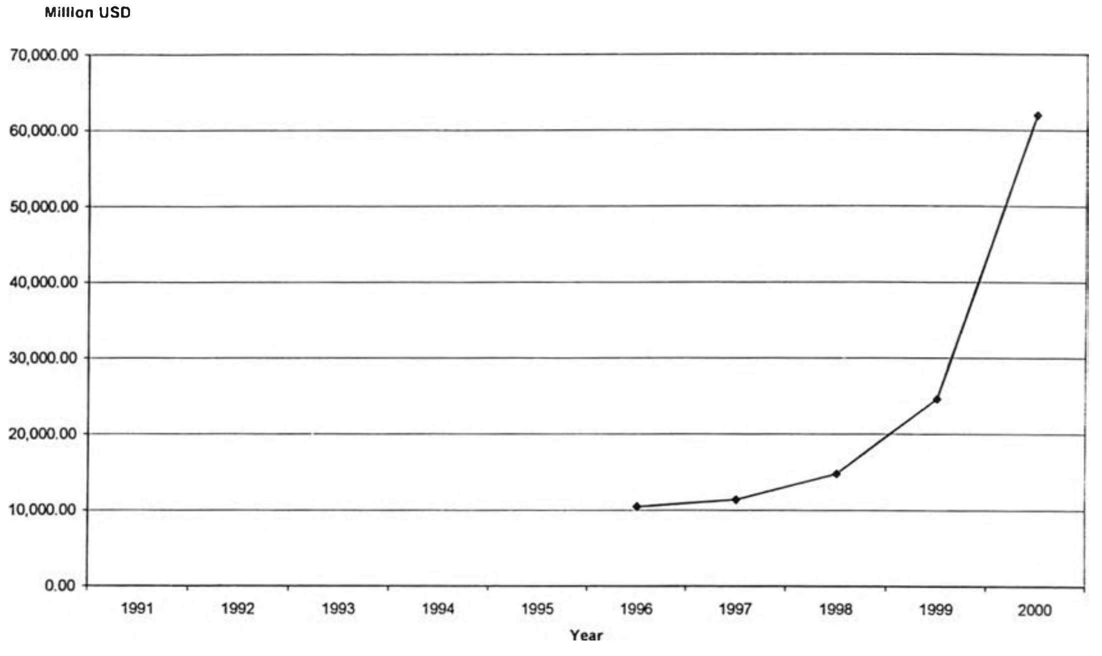
In addition, in 1997, there were 2,530 foreign companies operated in Hong Kong. Among those, 924 affiliates were presented as regional headquarters of companies. Major headquarters are American, Japanese, and Chinese companies. Meanwhile, major lines of businesses are trading, finance and banking, manufacturing, and transports and related services.

Table 15: Foreign Investment in Hong Kong in 1996

Country	Number of Investments	Investment (US$ Million)
Japan	142	2,323
USA.	77	1,648
China, Mainland	31	337
U.K.	39	309
The Netherlands	11	281
Total	483	6,150

Source: The Government of Hong Kong Special Administrative Region: Invest Hong Kong [InvestHK]

Figure 7: Foreign Direct Investment in Hong Kong during 1991-2000



Source: UNCTAD, World Investment Reports

Major sources of investors in Hong Kong are Hong Kong SAR, Japan, Taiwan, United States, European Union, Singapore, and Korea, respectively. Hong Kong and Taiwan are major investors in the country as it is located really close. Moreover, they share similar language, culture, and belief.

4. FDI and Major Economic Factors Relationship

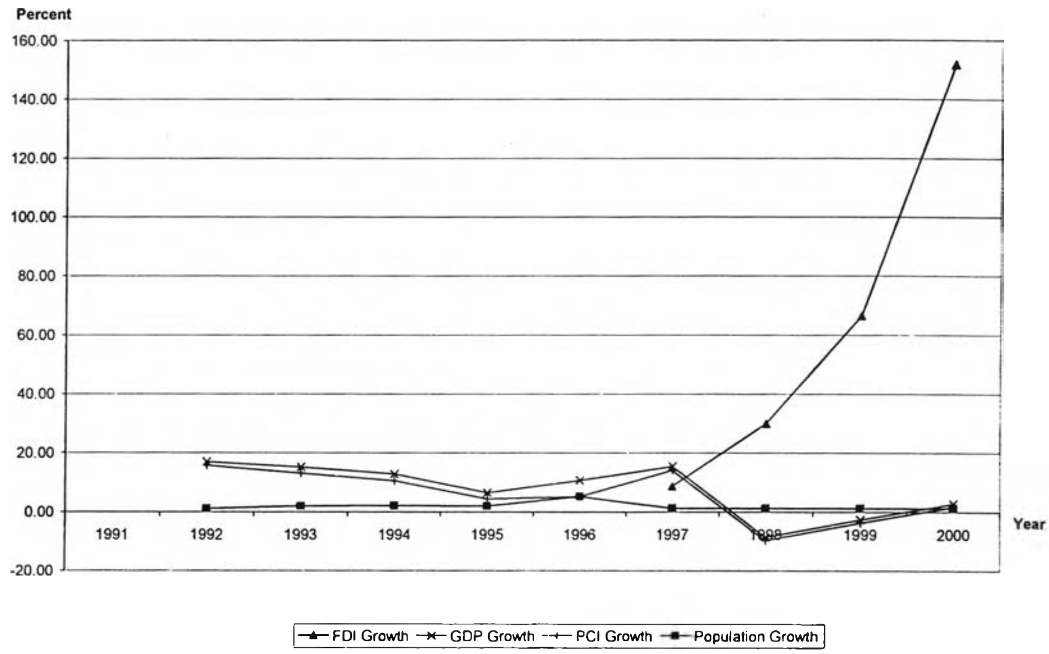
4.1 Market Size Hypothesis

By reviewing Hong Kong's economic data during 1996-2000, the study's market-size hypothesis is not supported as the correlation coefficients computed from the country's inward FDI and its proxies for market size are very weak. The correlation coefficient between the country's inward FDI and its GDP lies at –0.10. Meanwhile, the correlation between the country's inward FDI and the country PCI equals to –0.37.

However, it is necessary to remark that the data of the country studied is limited only in the year 1996-2000. The period is a relatively short period, compare to other nations. Also, a half of the period is dominated by effects of Asian crisis. As a result, the study's results may be less unreliable, compared to other cases.

In addition, the study conducted deeper to investigate the relation between the investment growth and the growth of market size. The results are similarly weak. The correlation coefficients are reported as small as -0.17, either measured by GDP or PCI. The small negative correlation coefficients among the factors are a result of a huge increase in the country's inward FDI during the year of the economic recession in late 2000s. This should imply that the impacts of contracted market size on inward FDI is offset by the country's other attractions, such as the country's reunion and the country's gateway position.

Figure 8: Hong Kong's Growth in inward FDI, GDP, Per Capita Income, and Population during 1991-2000



4.2 Cost Hypothesis

In terms of production cost, the study reports that the country's interest rate and whole sale price index are not supported by any strong correlation between the country's interest rate to the country's foreign direct investment, with the correlation coefficient of 0.44. This is contrast to the basic assumption of the study that an increasing cost of funding should be a negative determinant of inward FDI to the country. However, this is explainable by the fact that, in this globalized world, investors have so many choices for their sources of funding, particularly for those in developed countries. (Major investors in Hong Kong are USA, UK, and the Netherlands.) As a result, an increase cost of funding in a country should not affect investors' decision concerning FDI.

In addition, the study reported a negative correlation between the country WPI and it's the value of inward FDI to the country. The correlation coefficient was at –0.77. Meanwhile, the growth of inward FDI to the country is correlated with the country's inflation rate with the correlation coefficient of 0.18. This supports the study's hypothesis that an increasing cost of production in Hong Kong negatively determines the value of inward FDI to the country. As a result, the study reaffirms that price stability of the recipient economy is a determining factor of inward FDI in the case of Hong Kong during 1991-2000.

Figure 9: Hong Kong's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

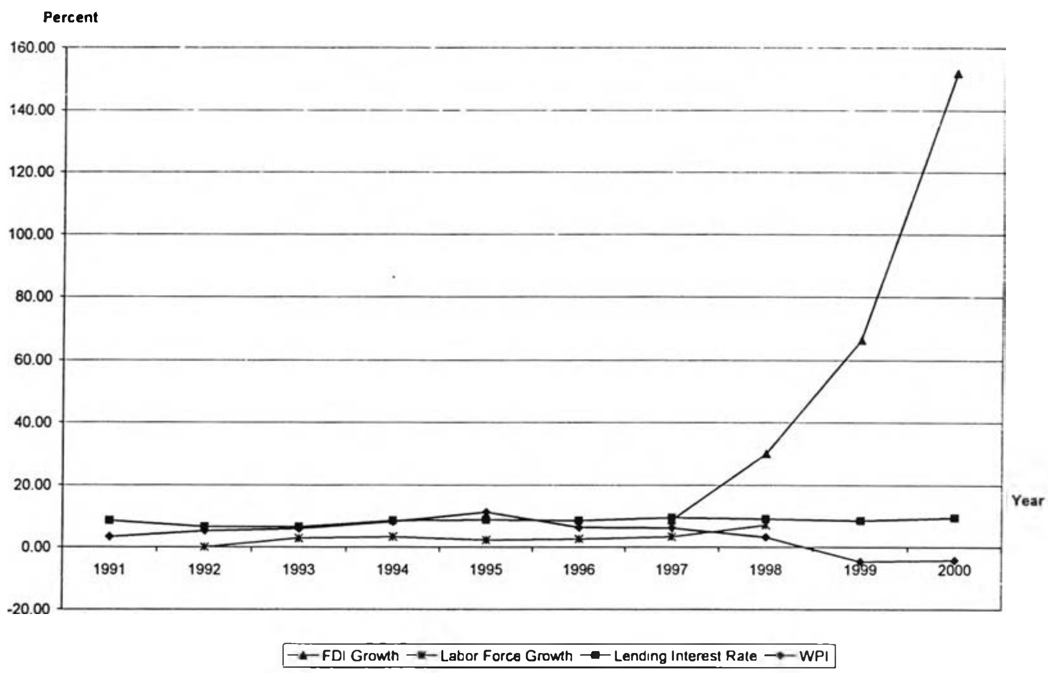
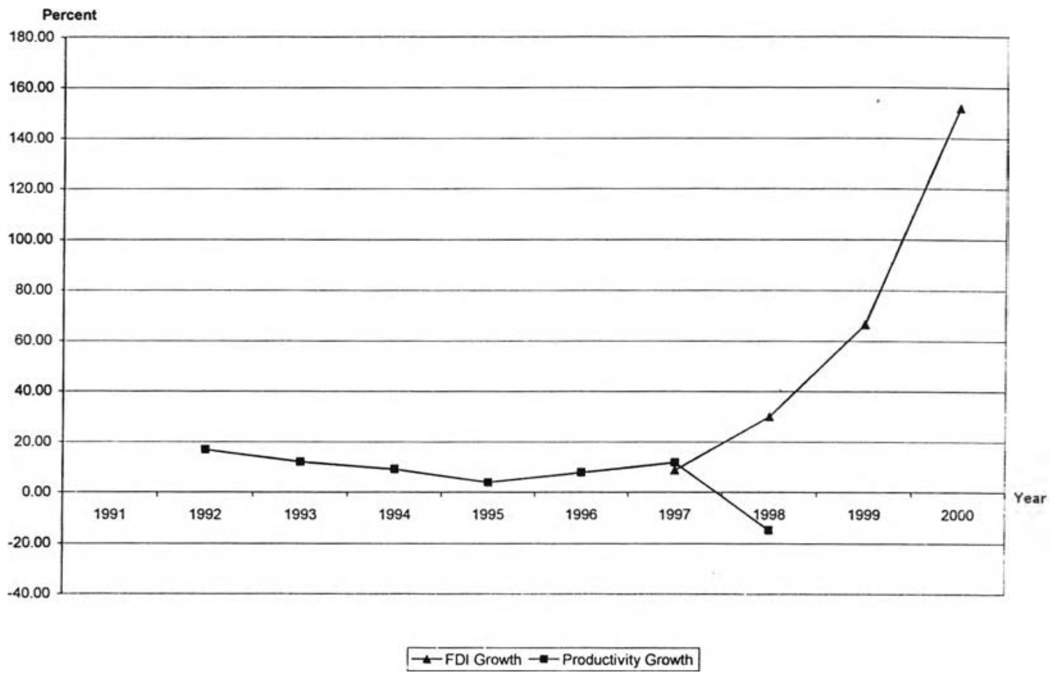


Figure 10: Hong Kong's growth in inward FDI, and Productivity of Labor during 1991-2000



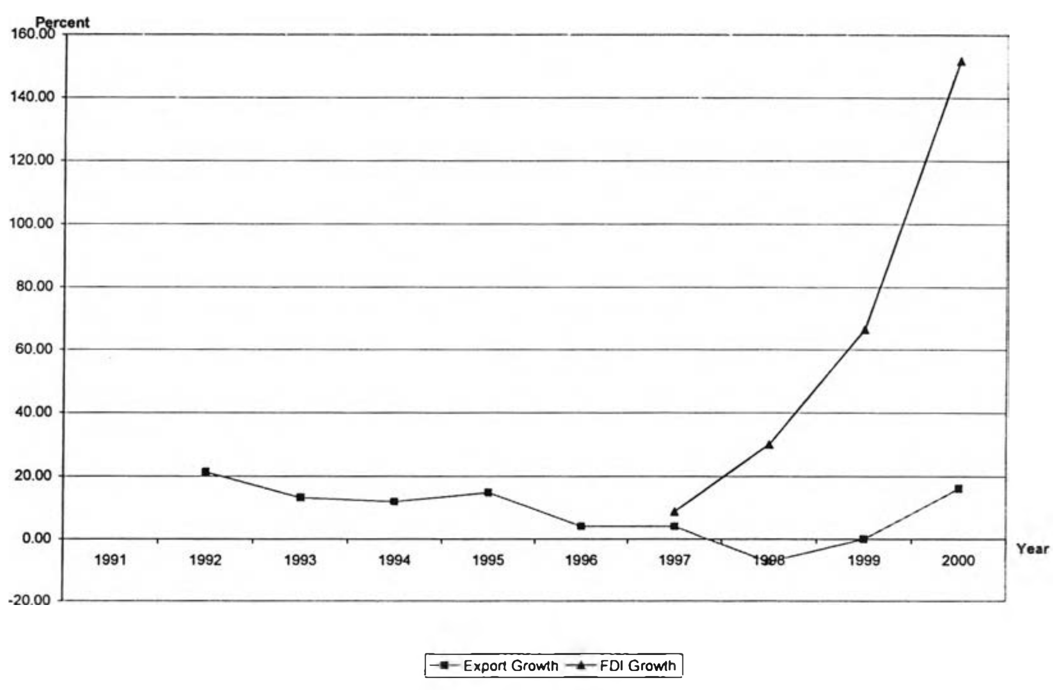
4.3 Export hypothesis

As Hong Kong is a small country, and depends highly on international activities, the study discovers a positive relationship between the inward FDI to the country and its export value with the correlation coefficient of 0.75. Meanwhile, the correlation coefficient between the FDI growth of the country and its export growth lies at 0.77. The coefficients support the study's export hypothesis of the study. This is also consistent with the fact that Hong Kong is a major trader in the region and investors can cheaply export products from Hong Kong. As a result, it brings to a conclusion that a higher value of exports makes Hong Kong become more attractive to international investors, leading to an increase in inward FDI to the country.

In terms of exchange rate, the study reports that the depreciation of Hong Kong's dollar is positively correlated inward FDI of the country. The correlation coefficient between the growth of inward FDI and the exchange rate is 0.48. However, that between the FDI growth and the depreciation rate is not significant at 0.18. Hence, these coefficients do not support the hypothesis.

By the statistics, the study reports the supportive information to the study's export hypothesis that an increasing export value of the country positively determines the country's inward FDI. However, a depreciating of the country's currency exchange rate is not confirmed that a weakening exchange rate can lead to an increasing in inward FDI in the case of Hong Kong during 1996-2000.

Figure 11: Hong Kong's inward FDI, and Export during 1991-2000



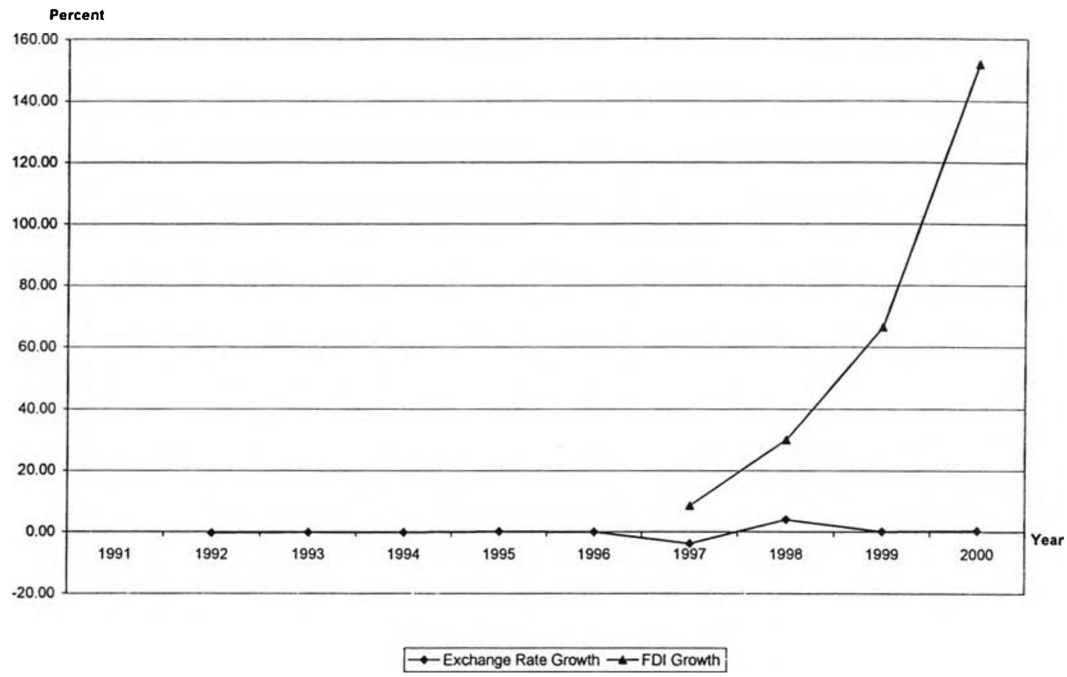
4.4 Other determining factors

Though, market size hypothesis, either measured by GDP or PCI, and The country's cost of production were not found as significant determinants of inward FDI in Hong Kong, the study found that there are several supporting factors that make Hong Kong, which is a small GDP country, with fluctuations in prices, is a prime destination for foreign direct investment.

Hong Kong has attracted a large amount of FDI as its higher level of accountability compared with other nations in the region. Its former western government had provided reliability and fine regulations for foreign investors. (IMF, 2002) Its exchange rate regime adds more confidence. Even during the crisis, the skillful officials coped with the situation very well. The island can maintain its status as a financial center of the region. The banking system still performed very well, while the banking capitalization remained well above the Basel standards. (IMF, 2002) Hence, the country can gain a significant level of confidence from international investors.

Furthermore, Hong Kong's government is promoting its attractions to international investors to invest directly in the area. Besides the confidence that the officials had shown to investors how well they managed the country in crisis moment, Hong Kong is very attractive destination for foreign direct investment as its relatively low tax rate, prime location for business settlement, market condition, and abundant skillful labor.

Figure 12: Hong Kong's inward FDI, and Exchange Rate during 1991-2000



Hong Kong charges business-earning tax only 16%, which is relatively low compare to its neighbors. (DOC, 1999) Moreover, the profits gained from running the business can be transferred outside the territory unconditionally. No capital gain tax will be charged. No national discrimination against foreign investors is found. Moreover, bureaucratic procedures are equally transparent for both local and foreign investors. Red-tape procedure is not reported. (DOC, 1999)

Besides, Hong Kong is located in the middle of North Asia and South East Asia, and very close to China. Hence, it is easy for businessmen to travel among important cities; namely, China, Japan, Korea, Singapore. Infrastructures in Hong Kong have been well developed. Hong Kong's international airport is regarded as one of the prime and busiest aviation centers in the world. (The Government of Hong Kong Special Administrative Region: Invest Hong Kong [InvestHK], 2002) The location also allows the SAR to develop a number of China-specialists. Its merging with the mainland helps businesses that invest and produce in the island distribute their product to the mainland easier and cheaper. (InvesHK, 2002)

Regarded as one of the freest markets in the world, Hong Kong becomes more attractive for competitive firms. The island offers no incentives or subsidies to investors, no matter what nationality he is. For international trade, the country is free from all duties. No tariff and non-tariff barrier is applied. No Value-added tax, VAT, is charged as well. Thus, the price of items on the island is relatively low, compared to others. Moreover, it is reported that the country's government is clean, free from corruption. (DOC, 1999) As a result, entrepreneurs can fully enjoy their business challenges by no concerns of illegal competition or extra-expense. (InvestHK, 2002)

In term of human resource, Hong Kong is a pool of skillful labor. People of the SAR are computer-literate, flexible and entrepreneurial. The government strongly promotes competitive, productive, and knowledge based workforces to differentiate itself from the mainland. (InvestHK, 2002)

The United States that the country can exercise it intellectual property laws successfully (DOC, 1999), which can encourage the investment climate and do not destroy its opportunity to trade unconditionally with the US.

The efficient capital market of Hong Kong highlights the country's attractiveness. The government allows perfect mobility of capital, with non-intervention policy. The regulations and legal environment are well designed. (DOC, 1999) The private sectors have various financial instruments to choose. Accounting system is transparent and consistent with the international standard.

Moreover, Hong Kong is regarded as a politically stable nation. There has been no major social unrest after the China's Cultural Revolution.

For international trade, Hong Kong has special trade agreements with 12 nations; namely, Australia, Austria, Belgium, Denmark, France, Germany, Italy, Japan, the Netherlands, New Zealand, Sweden, and Switzerland. It is now negotiating for agreements with Canada, Korea, Singapore, Thailand, the United States, and Vietnam. (DOC, 1999)

5. Conclusion

In conclusion, the study of correlation coefficients among the factors, the market size hypothesis and the cost hypothesis are not strongly supported for the case of Hong Kong though a negative correlation between the country's WPI and inward FDI is reported. A huge volume of the inward FDI to the country during its recession is explained that it is aiming to test the Chinese mainland market rather than the local market. However, the results support the hypothesis that an increase in exports is positively related to the increasing value of inward FDI to the country.

Besides the hypothesis, the study discovers that Hong Kong is very attractive to international investors as its geographical location and political status. Geologically, Hong Kong is located in a middle of the region and can easily connect to other countries. Moreover, as the country was colonized by the British government and later turned to a special administrative region of China. By this, the country does not only gain market creditability in terms of business standard, but the country also turns to be a potential gateway to the

Chinese mainland market. Hence, investing in Hong Kong should allow investors to learn about contemporary Chinese commercial practices and regulation before getting to the traditional one that require more skills, connections, and market understanding.

In addition, Hong Kong attracts a huge volume of FDI as it provides investors with business confidence, either in terms of economic stability or business reliability. FDI in Hong Kong is also encouraged by its liberalized economy, free trade, skilled labor, and efficient financial and capital markets.

Indonesia

1. Historical Background

Indonesia achieved independence from the Netherlands in 1949. Since then afterwards, the country has govern under the law of democracy. However as the country are divided into groups of Christian and Muslim, the whites and the natives. The country has been growing up under the shade of rebellion, and social unrest.

The governments are also not Current issues include: implementing IMF-mandated reforms of the banking sector, effecting a transition to a popularly elected government after four decades of authoritarianism, addressing charges of cronyism and corruption, holding the military accountable for human rights violations, and resolving growing separatist pressures in Aceh and Irian Jaya. On 30 August 1999 the people of Timor overwhelmingly approved a provincial referendum for independence. Concurrence followed by Indonesia's national legislature, and the name East Timor was provisionally adopted. The independent status of East Timor has just been formally established.

2. Economic Environment

Indonesia, a nation with a number of interest and political groups, faces severe economic problems during the late 2000s. Prior to that, the country had been growing continuously in terms of economic performance. The country's GDP had increased by almost 100% from 1991 to 1997. However, in 1997, the country reports the growth of -5.11% in 1997. Worse, with the 244% depreciation in the country's exchange rate in 1998, its GDP dropped severely by -55.76%.

By this, the country encountered with domestic social dilemma, stemming from secessionist movements, rebellion, and social disorders. Mainly, the movements were against the country's political leaders and his interest groups.

During the time then, Indonesia government could provide investors with the low level of security, the lack of reliable legal recourse in contract disputes, corruptions, and weaknesses in the banking system. Moreover, according to table 16, the country is not very successful in providing economic stability for investors. For example, its exchange rate has been fluctuated dramatically during the recent years, whilst the Whole Sale Price Index has been fluctuated as well. As a result, investors' confidence remained low and investors pulled out their investment under these circumstances.

Even the Indonesian economy has reported the growth of 8% in 2000, it is regarded as "not sustainable" as it might be only short-term recovery induced by high world oil prices, a surge in non-oil exports, and increased domestic demand for consumer durable.

Table 16: Indonesia's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	1,950.30	2,029.90	2,087.10	2,160.80	2,248.60	2,342.30	2,909.40	10,013.60	7,855.20	8,421.80
Export (M. USD)	29,142	33,967	36,823	40,055	45,417	49,814	53,443	48,847	48,665	62,124
FDI (M. USD)	1,482	1,777	2,004	2,109	4,348	6,194	4,677	-356	-2,745	-4,550
GDP (B. USD)	116.62	128.03	158.01	176.89	202.13	227.37	215.75	95.45	141.31	153.26
Labor Force (Thousands)	78,455	80,704	81,447	83,848	85,738.00	89,327	91,247.00	92,735	N/A	N/A
Lending Interest Rate	25.53	24.03	20.24	17.10	18.85	19.22	21.82	32.15	27.66	18.46
PCI (USD)	642.98	693.96	842.25	927.67	1,037.90	1,155.28	1,079.44	466.91	681.19	728.09
Population	181.38	184.49	187.60	190.68	194.75	196.81	199.87	204.42	207.44	210.49
Unemployment Rate	0.03	0.03	0.03	0.04	0.04	0.04	0.05	0.05	N/A	N/A
WPI	5.10	5.50	4.10	6.20	12.20	6.20	8.20	91.90	0.00	0.00
Productivity of Labor (USD)	1,486.50	1,586.39	1,940.00	2,109.63	2,357.55	2,545.36	2,364.43	1,029.23	N/A	N/A

Source: IMF, International Financial Statistics, Various Editions

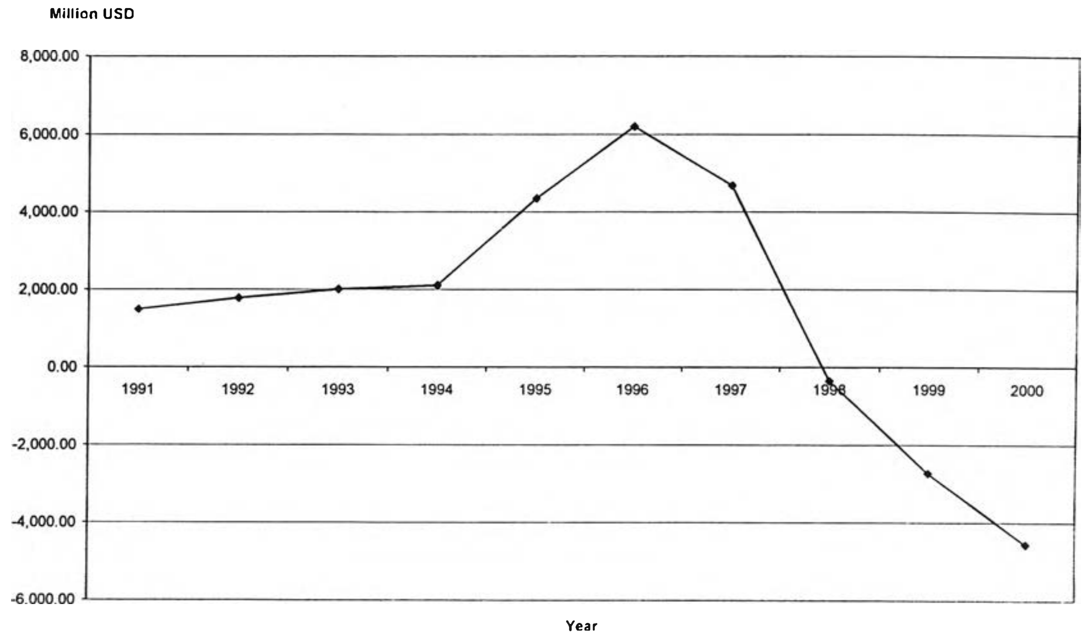
As a result, it is necessary for the study to be aware of such a dramatic change in the Indonesian economy. The study, hence, will have to illustrate the relationships between the country's inward FDI and economic factors both during the whole period of 1991-2000 and, by excluding the data during the crisis, only during the period of 1991-1996 in order to provide readers with clearer pictures.

3. Investment Climate

The financial crisis also dropped Indonesians' purchasing power. The exchange rate volatility hurts business profit and confidence. Moreover, Indonesian's great confusion and social disorder expel thousand of investors and investment projects.

The Indonesian government, hence, put high attempt to attract foreign investment. Several new regulations were proposed to ease the entry of foreign firms. Sectors have been opened for international investors to acquire domestic businesses by the government approval. As a result, Indonesia's FDI inflow rose from –4,550 millions of dollars in 2000 to –3277 millions in 2001. Most of investments are directed to labor-intensive industries, chemical industry –including oil production, and consumer products. (Destination Indonesia Network, 2002) Japan is the biggest cumulative source of FDI, take a share of approximately 20 percent of the total. The other main sources of investor are the U.K., Hong Kong, Singapore, The U.S., The Netherlands, Taiwan, and South Korea. (DOC, 1999)

Figure 13: Foreign Direct Investment in Indonesia during 1991-2000



Source: UNCTAD, World Investment Reports

4. FDI and Major Economic Factors Relationship

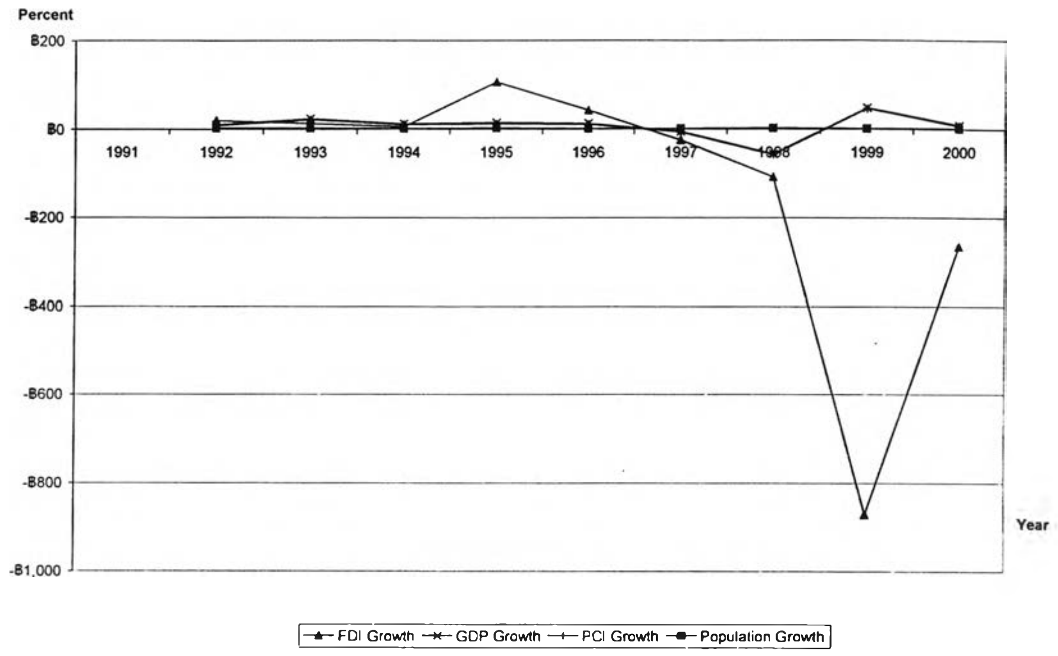
4.1 Market Size Hypothesis

Economic and FDI data of Indonesia during 1991-2000, the study found that the market size hypothesis is strongly supported in the case of Indonesia. Both GDP and PCI are highly correlated with the country's inward foreign direct investment. The correlation coefficient between the inward FDI to the country and its GDP is 0.66. Meanwhile, the coefficient between that to the PCI of the country is as high as 0.74. By excluding the data during the crisis, the study reports stronger coefficients of 0.92 for the relationship between the country's inward FDI and the country's market size, either measured by GDP or PCI. The coefficients, hence, support the validity of market size hypothesis that the bigger market size of the country takes part in encouraging higher level of inward FDI to the country.

However, the study found that the market size of the country has been fluctuated during the late 2000s, resulting in a negative relationship between the country's growth in market size and the country growth in inward FDI. The correlation coefficients were -0.41 for the relationship between the country's growth in inward FDI and the country's growth in market size, either measured by GDP or PCI. When the study excludes the data during 1998-2000, the study then reports a moderate positive relationship between the country's growth in market size and the country's growth in inward FDI.

The results assure that the size of the economy is positively related with its inward FDI to the country during the period. However, only providing bigger market size to investor is not enough to attract a stable growth in inward FDI to the country, but it also necessary for the country to provide confidences to the investor bye stabilizing the economic growth of the country.

Figure 14: Indonesia's Growth in inward FDI, GDP, Per Capita Income, and Population during 1991-2000



4.2 Cost Hypothesis

In terms of cost of production, it is noticed that Indonesian market provides investors with relatively high cost of funding. The average one-year lending interest rate during 1991-2000 was as high as 22.17%. This is because lending business in the economy has to counter a high credit risk, leading to a high cost of services, resulting in a high charge. Meanwhile, the country's inflation rate was quite stable, prior to the crisis. However, after the crisis, the inflation shot dramatically from 8.20 in 1997 to 91.90 in 1998 as a result of the country's financial and currency crisis.

By reviewing the relationship between the country's lending interest rate and the country's inward FDI, the study reports the correlation coefficient of -0.33. Meanwhile, the coefficient between the country's growth in FDI and the country's interest rate was –0.45. By excluding the data during the crisis, the study does not report much different relations. This reflects that the increasing country's interest rate destroys the country's attractiveness to international investors. However, the relations are not very strong as investors do not have to fund their investment by local borrowing. Instead, they can fund their investment globally, depending on the costs of funding.

In addition, in terms of WPI, the country is also successful in managing the economy's cost of production to be quite constant during 1991-1997. However, as a result of the currency crisis, the inflation of the economy shot up from 8.20 in 1997 to 91.90 in 1998. By this, the study reports the negative correlation coefficient between inward FDI to the country and the WPI of –0.56. However, when the data during 1998-2000 was omitted, the relation is positive with the correlation coefficient of 0.51. This should reaffirm the validity of cost of production hypothesis that a small and stable inflation should encourage more FDI inflow to the country.

However, the coefficient between the inward FDI growth and the growth of WPI is 0.49 during 1991-2000 and 0.29 during 1991-1997. By the coefficients, the relations are too weak to support the hypothesis that the country's increasing cost has any effects on the attractiveness of the country to the inward FDI.

In conclusion, the results of the study do not strongly support the cost hypothesis. However, the study reports that the increasing cost of production would encourage investors to invest in the economy. However, the increase of the cost will distort the growth of inward FDI to the country. As a result, to attract higher volume of inward FDI, it is suggested that the government of the country to provide multinational enterprises with confidence through small stable interest rate and inflation rate.

Figure 15: Indonesia's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

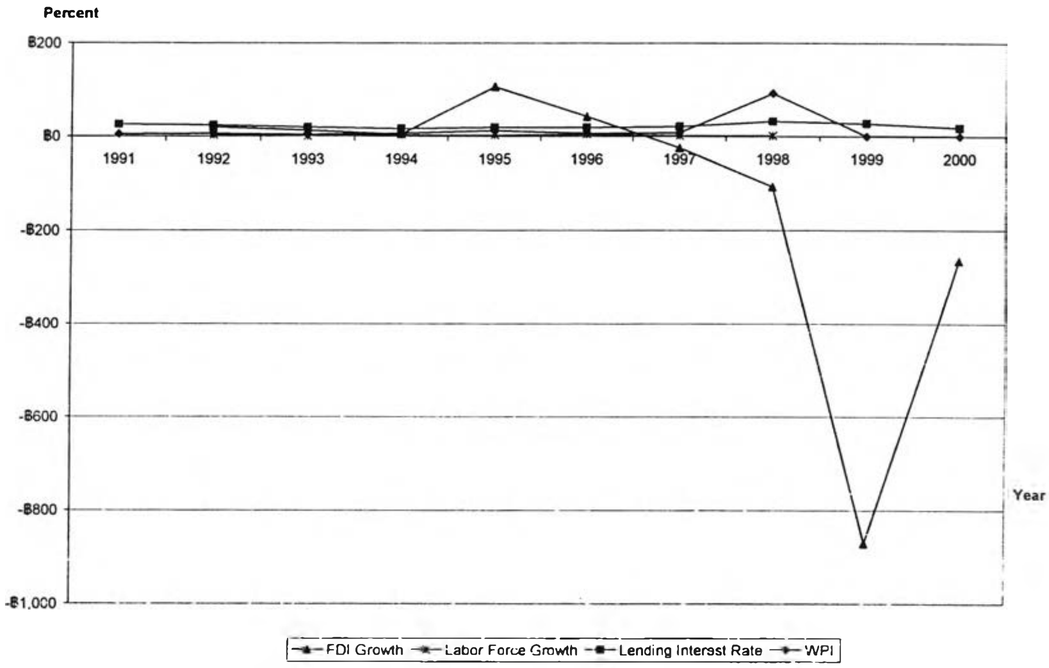
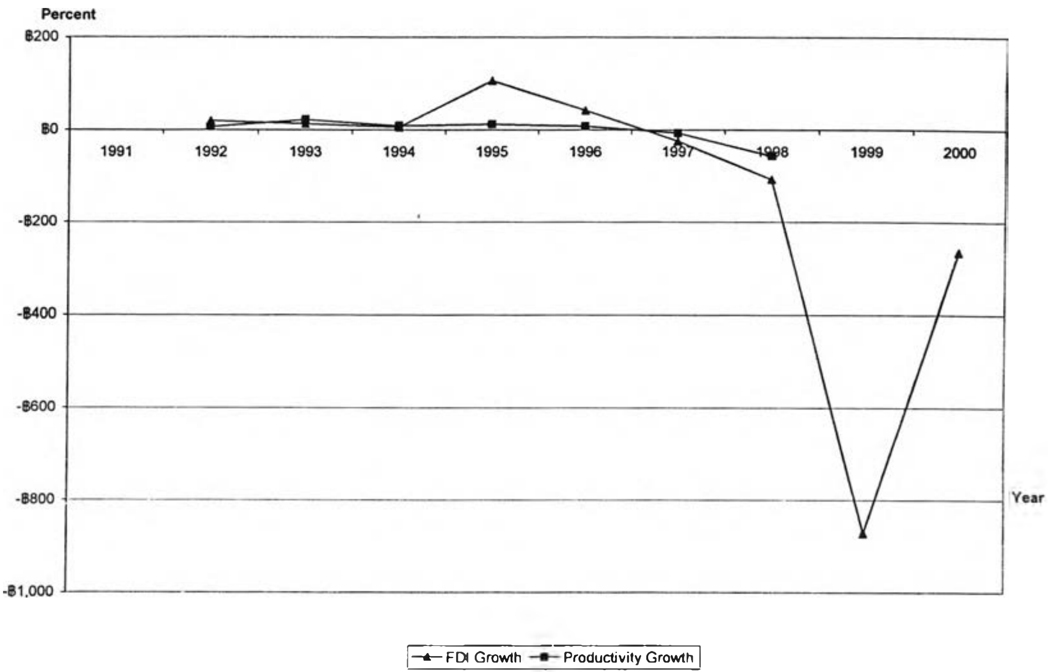


Figure 16: Indonesia's growth in inward FDI, and Productivity of Labor during 1991-2000



4.3 Export hypothesis

Now, let's turn to the study of export hypothesis. As there was a huge depreciation of Indonesian exchange rate, then it is necessary for the study to omit the data of export and FDI during 1998-2000 to provide a consistent analysis in the case of Indonesia.

By reviewing the data of Indonesia during 1991-1997, the study's export hypothesis is strongly supported. The correlation coefficient between the country's export value and inward FDI value was 0.90, compared to -0.29 for the time horizontal of 1991-2000. Meanwhile, the study also reports a positive relationship between the country's growth in inward FDI and the country's growth in export value with the correlation coefficient 0.51. This strongly supports the export hypothesis that the country's strong export competitiveness should take a magnificent role in encouraging inward FDI to the country.

In addition, the study of the relationship between the depreciation of Indonesian's Rupiah and the country's inward FDI also supports the export hypothesis as well. The study reports a significant positive relationship with the correlation coefficient of 0.67. This means the depreciation of the exchange rage takes part in determining inward FDI to the economy with a positive relationship.

However, the study of the relationship between the growth of depreciation and the growth of inward FDI to the economy reports a negative relationship with the correlation coefficient of -0.54. This is consistent with the fact that the growth of inward FDI to the country is still increased even the exchange rate has depreciated in a smaller percentage, compared to a previous year. This reaffirms the study's assumption that an increase in the country's growth in inward FDI is not determined by how much the exchange rate has depreciated, but it depends on how stable the movement is.

As a result, the study reaffirms that, in attracting higher growth of FDI to a country, all the country has to do is to provide stability to investors via the stable exchange rate.

Figure 17: Indonesia's inward FDI, and Export during 1991-2000

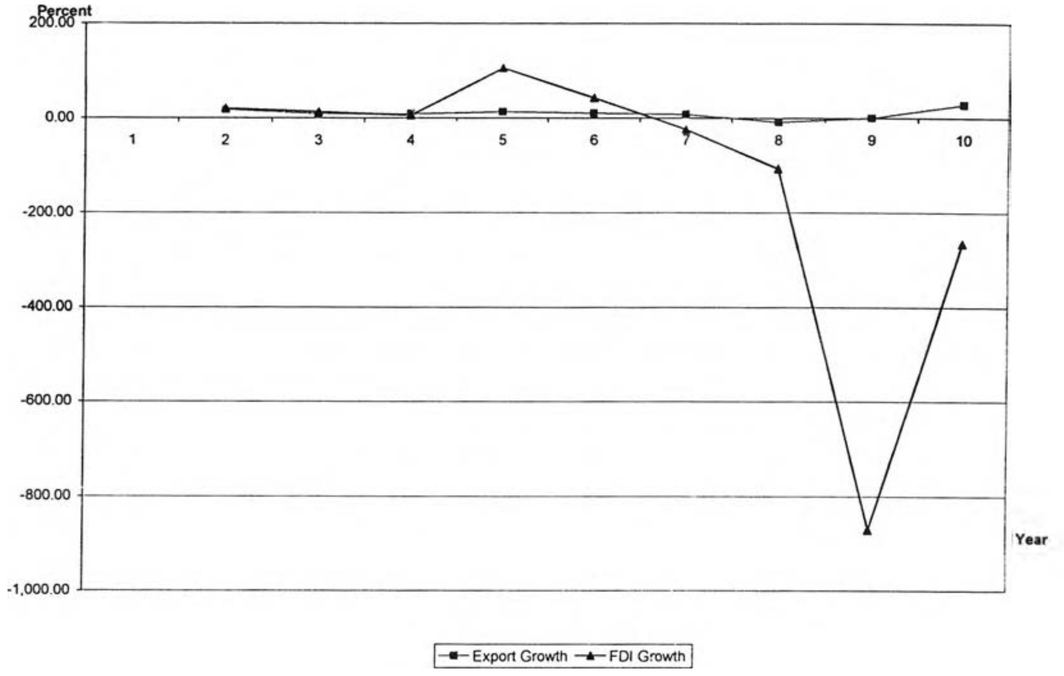
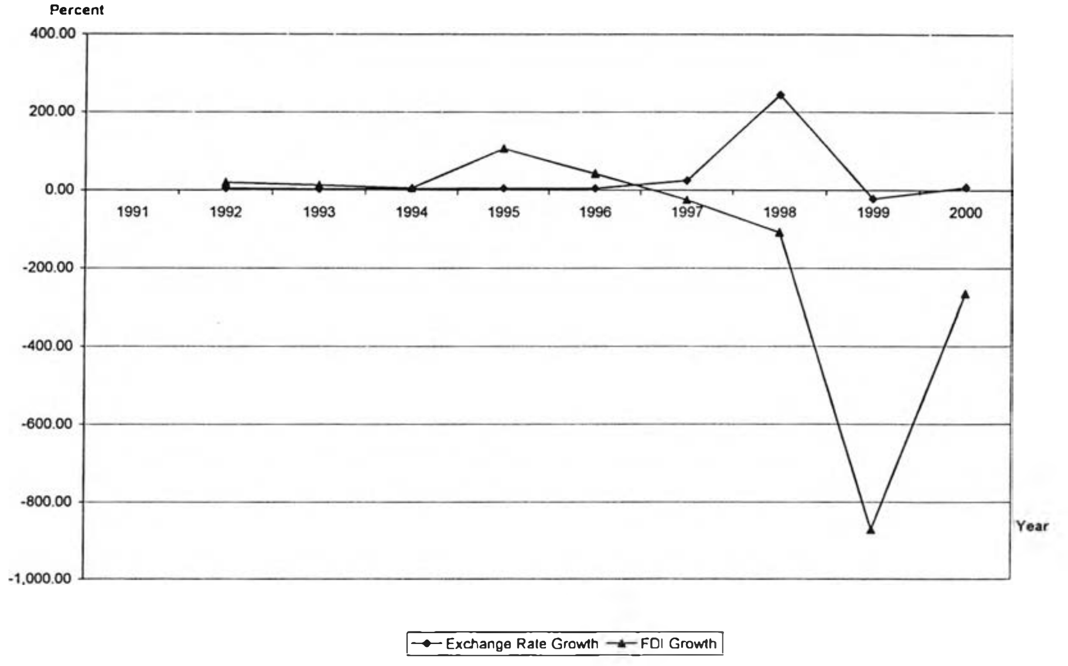


Figure 18: Indonesia's inward FDI, and Exchange Rate during 1991-2000



In conclusion, the study supports that export value and export growth of the country is positively related to the country's inward FDI during the period. Also, a depreciating exchange rate is reported as a supportive evidence for higher FDI to the country. However, an increasing exchange rate can distort the country's attractiveness, resulting in a decrease in the country's inward FDI growth. Hence, it is necessary for the government to provide a stabilized and manageable exchange rate to the markets.

4.4 Other determining factors

The economic crisis in the region in 1997 forces the country to turn to IMF for assistance. Giving up the currency control led the Rupiah's substantially depreciation. The rising inflation, banks collapses, and social chaos are what followed the situation. Several new regulations were approved to ease the entry of foreign firms. International investors are allowed to acquire domestic businesses by approval in many industrial sectors.

At present, The Indonesian government had cancelled out all capital control regulations. The Rupiah is now convertible freely. Foreign investors are allowed to repatriate their profits and capital unconditionally. The regulatory lift up help the country more attractive to the international investors. (DOC, 1999)

Indonesian government has signed many agreements to encourage international trade for investors. The country has agreement with, for instance, Belgium, Denmark, France, Germany, Korea, and the Netherlands.

However, the obstacles of FDI attraction for Indonesia are the low level of security, unreliable legal procedures and regulations. Politician' relative business protection made onward FDI toward Indonesia grew quite slowly. (DataConsult, 2002 and Chung and Lian, 2002)

5. Conclusion

In conclusion, the results of the study support the market size hypothesis, and export hypothesis in the case of Indonesia during 1991-1997.

By the market size hypothesis, the study reports a strong relationship between the country's size of market, either measured by its GDP or PCI. However, in terms of cost hypothesis, the study is not be able to support the relationship between the country's cost of capital and the country's inward FDI. This reaffirms the global financial markets and the fact that investors can internationally funded. Nevertheless, the cost hypothesis is supported by the strong positive relationship between Indonesian's productivity of labor and the value of inward FDI to the country.

In addition, the study of export hypothesis is reaffirmed by the relationship between the economy's exports and the inward FDI to the economy. Moreover, the study of the country's exchange rate and the inward FDI to the country reaffirms that a depreciating exchange rate is positively related to the value of inward FDI. Meanwhile, a growth of depreciation rate should harm the country's attractiveness as it reflects the instability of the economy and destroys investors' confidence. This conclusion is supported by the negative correlation coefficient between the factors.

Nevertheless, the country's regulations and legal enforcement has discovered as determinants of inward FDI. Hence, in attracting more FDI, the country has to deregulate and enforce the laws and regulations concerning international investment. Also, the country has to fairly treat businesses, no matter the business has any connection with the country's politicians or not. These are to provide investors with business security and confidence.

Korea

1. Historical Background

As the country was governed by Japan prior to World War II, Japanese culture plays a significant role in Korea society. Also, Korea people are ambitious to develop their country to be as civilized as Japan. By the study of Pasuk, 1998, she stated that Korea follows Japanese model for country industrial development.

Later, after World War II and Korean War, United States has come to substitute the Japanese's roles. However, Korea, which has opened for assistance from the States, has not fully followed the instructions of the United States. The country chose to adapt the instruction for import substitution policy by proper government interventions. Foreign investments are allowed with strict condition to transfer technology to the local people. During 1990s, imports were strictly controlled. Only those for export manufacturing were allowed, whilst imprudent goods were prohibited.

Hence during 1990s, foreign investments in Korea are limited in only some industries, which is textile for example. Later, the government eased the regulation and allowed foreigners to invest in heavy industries such as construction, petrochemical, and electronics. However, the investments were settled mostly via licensing and joint venture.

Thereafter, South Korea achieved rapid economic growth, with per capita income rising to 13 times the level of North Korea. In 1997, the nation suffered a severe financial crisis from which it continues to make a solid recovery. South Korea has also maintained its commitment to democratize its political processes. In June 2000, a historic first south-north summit took place between the south's President KIM Dae-jung and the north's leader KIM Chong-il. In December 2000, President KIM Dae-jung won the Noble Peace Prize for his lifelong commitment to democracy and human rights in Asia. He is the first Korean to win a Nobel Prize.

2. Economic Environment

As one of the "Four Dragons of East Asia", South Korea has achieved an incredible record of growth. Three decades ago GDP per capita was comparable with levels in the poorer countries of Africa and Asia. Today its GDP per capita is seven times India's, 16 times North Korea's, and comparable to the lesser economies of the European Union. This success through the late 1980s was achieved by a system of close government/business ties, including directed credit, import restrictions, sponsorship of specific industries, and a strong labor effort. The government promoted the import of raw materials and technology at the expense of consumer goods and encouraged savings and investment over consumption. The Asian financial crisis of 1997-99 exposed certain longstanding weaknesses in South Korea's development model, including high debt/equity ratios, massive foreign borrowing, and an undisciplined financial sector. By 1999 GDP growth had recovered, reversing the substantial decline of 1998. Seoul has pressed the country's largest business groups to restructure and to strengthen their financial base. Growth in 2001 likely will be a more sustainable rate of 5%.

However, during the late 2000s, Korea cannot provide stable economic environment for investors as a result of the crisis. The country's exchange rate and interest rate had been fluctuated during the years. The country's exchange rate rose significantly after the liberalization in 1997. At that time, Won depreciated for 47%, from 951.29 Wons per US dollars to 1,401.45. However, the currency appreciated to 1188.82 Wons per dollar and continuously in 2000. The country's interest rate had move from 8.8 in 1996 to 15.3 in 1998, but declined to 8.5 in 2000. Meanwhile, WPI has dropped hugely in 1999. Also, the country's unemployment rate has risen significantly since 1998.

3. Investment Climate

Historically, Korea does not open much for FDI. However, with the aggressive foreign investment promotion of the government of Kim Dae-Jung's government, Korea is now fully opened to foreign investors. (Korean Ministry of Finance and Economy, -) Hundred-percent-foreign-ownership is permitted. Real estate is also liberalized. Only for national security, public order, public health, social moral, and environmental preservation concerns, some industries face a few restrictions. However, the regulations are stated out clearly every year by related authorities. (Korean Ministry of Finance and Economy [MOFE],-) As a result the investment inflows to Korea has risen significantly. The value of the flows has increase by 400% in 2000, compared to that in 1996.

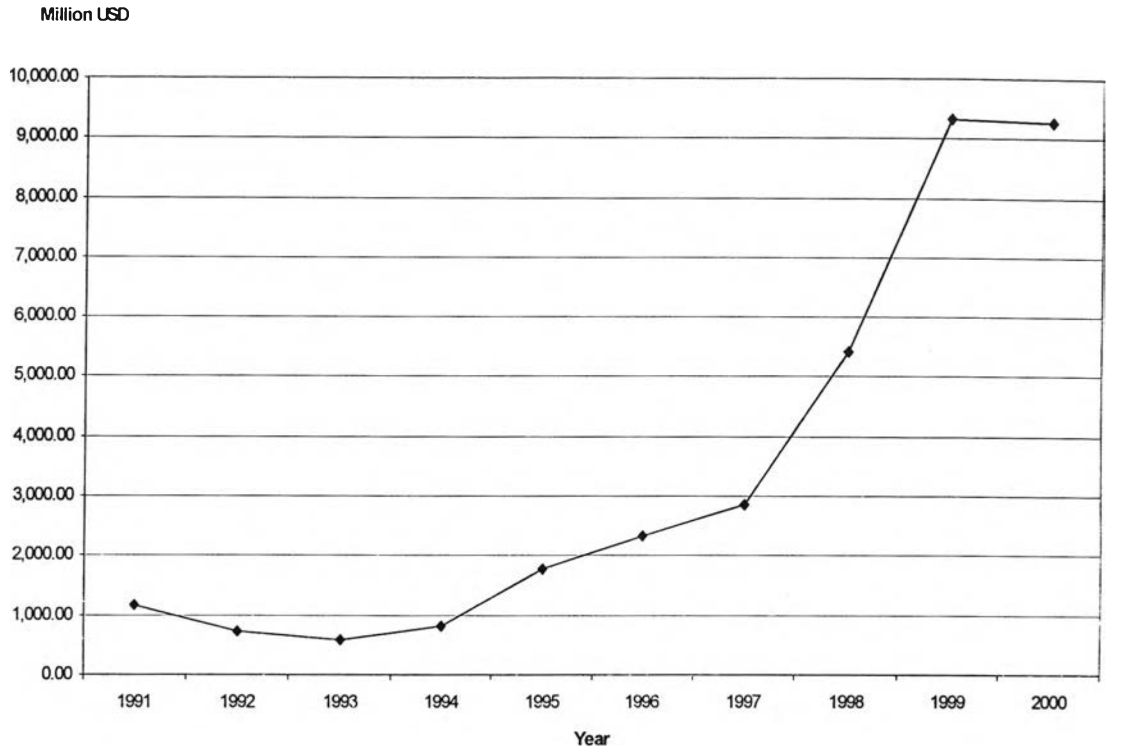
United Stated and Canada are the largest sources of FDI in Korea. By industry, FDI concentrates in manufacturing industry, particularly in information technology and electronics. Most of FDI are export-oriented purpose. Foreign products accounted for approximately 15 per cent of Korean total export. (Korean Times, 2000)

Table 17: Korea's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	733.35	780.65	802.67	803.45	771.27	804.45	951.29	1,401.45	1,188.82	1,130.96
Export (M. USD)	71,870	76,632	82,236	96,013	125,058	129,715	136,164	132,313	143,686	172,268
FDI (M. USD)	1,180	727	588	810	1,776	2,325	2,844	5,412	9,333	9,283
GDP (B. USD)	294.18	307.94	332.82	402.52	489.26	520.21	476.49	317.08	406.07	457.22
Labor Force (Thousands)	19,050.15	19,427.25	19,807.61	20,324.80	20,794.90	21,187.76	21,609.86	21,379.83	21,644.61	21,950.00
Lending Interest Rate	10.00	10.00	8.60	8.50	9.00	8.80	11.90	15.30	9.40	8.50
PCI (USD)	6,798.61	7,053.10	7,553.83	9,017.09	10,850.70	11,423.04	10,360.64	6,829.13	8,665.60	N/A
Population	43.27	43.66	44.06	44.64	45.09	45.54	45.99	46.43	46.86	N/A
Unemployment Rate	2.30	2.40	2.80	2.40	2.00	2.00	2.60	6.80	6.30	4.05
WPI	4.70	7.00	8.60	11.60	4.50	3.20	4.00	13.10	-2.50	2.40
Productivity of Labor (USD)	15,442.19	15,850.84	16,802.72	19,804.52	23,527.79	24,552.16	22,049.46	14,830.64	18,760.79	20,830.05

Source : IMF, International Financial Statistics, Various Editions

Figure 19: Foreign Direct Investment in Korea during 1991-2000



Source: UNCTAD, World Investment Reports

4. <u>FDI and Major Economic Factors Relationship</u>

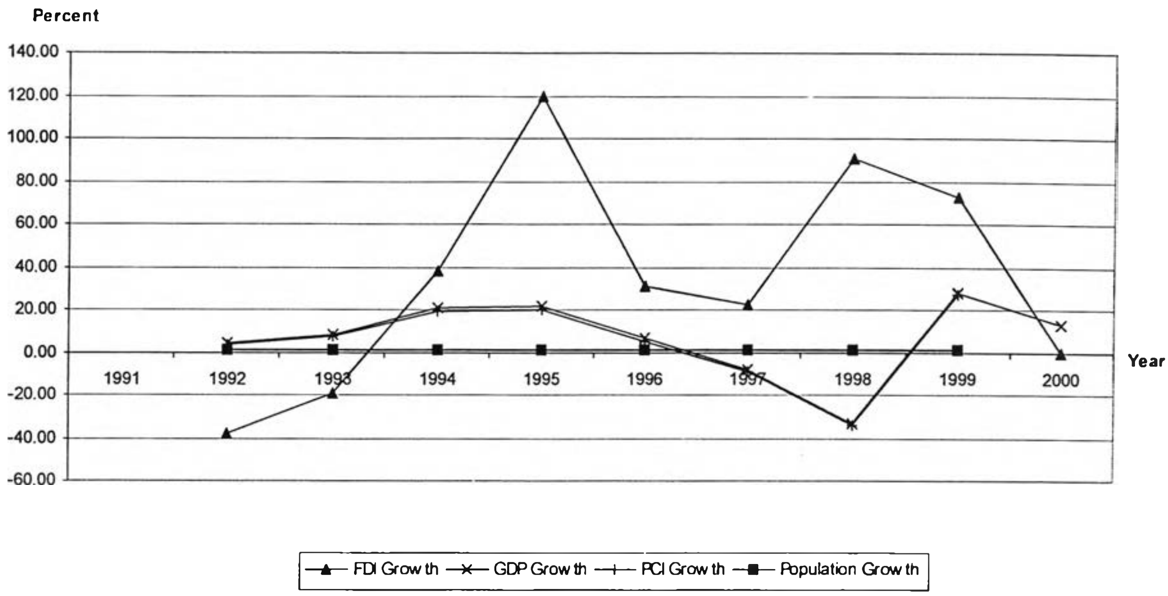
4.1 Market Size Hypothesis

By reviewing the data of Korea during the period of 1991-2000, the study cannot conclude the relationship between the country's market proxies and its inward foreign direct investment either by scattered diagrams and correlation coefficient. By studying the pattern of relationship by observing scattered diagrams, the data shows fluctuations and inconsistency pattern. Meanwhile, the study of correlation coefficient reports insignificant and inconsistent relationship. The correlation coefficient between the country's inward FDI and its GDP is reported at only 0.22. Whilst, the coefficient between the investment and PCI is reported at only 0.00.

However, when the study focuses only on the data during 1991-1997, pre-crisis and economic instability period, the study reports a high correlation between the country's market size and its inward FDI. To illustrate, The study reaffirms the validity of market size hypothesis with the correlation coefficient between the country's GDP and its inward FDI of 0.80. Meanwhile, the study reports the correlation coefficient of 0.79 between the country's PCI and its inward FDI. In addition, the growth of country's market size during 1991-1997 is another evidence that supports the hypothesis concerning the positive relationship between the country's market size and the country's inward FDI. The country's inward FDI is correlated with its GDP and PCI with the correlation coefficient of 0.55.

In conclusion, the correlation between the factors reaffirms the validity of market size hypothesis in the case of Korea. By this, the healthy and expanding market of a country is accepted as a strong economic factor that positively determines a higher inward FDI. As a result, the country may strengthen its economic size and provide sustainable growth for investors to attract more FDI.

Figure 20: Korea's Growth in inward FDI, GDP, Per Capita Income, and



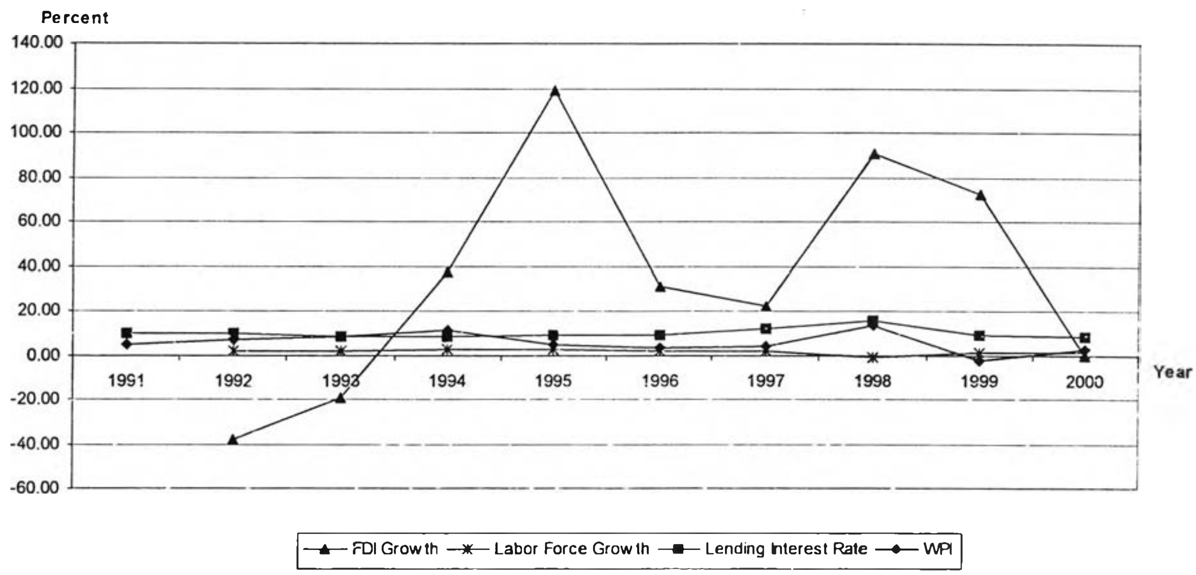
Population during 1991-2000

4.2 Cost Hypothesis

In terms of cost hypothesis, the study reports a supportive correlation among the factors. The correlation coefficient between the country's lending interest rate and FDI lies at 0.55 during 1991-1997. This reaffirms the study's finding that the higher cost of funding of a country does not distort the its attractiveness to international investor as investors, particularly those in developed countries, can always fund their investment projects globally. As a result, the increasing interest rate shall attract more FDI as it provides investors higher rate of return. Also, the higher interest rate can reflect the healthier economy and exchange rate that bring about more confidence to international investor.

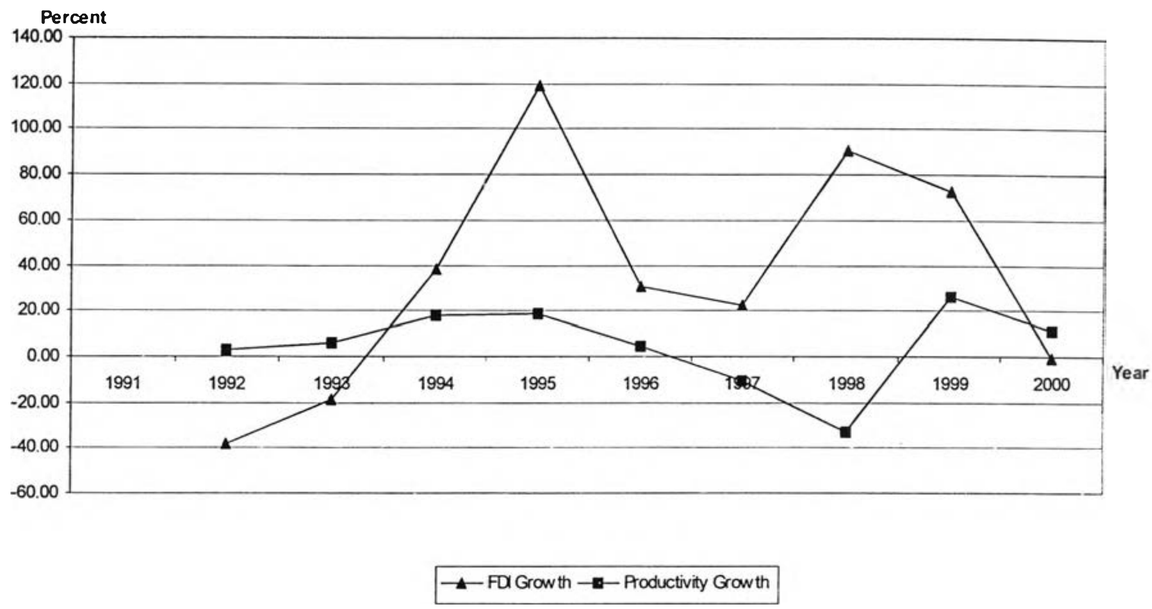
In contrast, the study of the relationship between the country's cost of production, measured by WPI, and its inward FDI reports a negative correlation coefficient of –0.76. The study interprets the result that the high inflation in the country can distort its attractiveness to international investors. Also, the relationship between the inflation and the growth of inward FDI to the country reflects a negative correlation with the coefficient of –0.04.

Figure 21: Korea's growth in inward FDI, labor forces, Interest Rate, and WPI during 1991-2000



In terms of labor's productivity, the study's results also reports a strong correlation between the country's productivity of labor and its value of inward FDI with the correlation coefficient of 0.77. Meanwhile, the growth in the country's productivity of labor is correlated with the country's growth in inward FDI with the correlation coefficient of 0.54. The coefficients then support the hypothesis that the country's increase in labor efficiency shall encourage higher level of inward FDI to the country. Hence, the government may pursue policies concerning productivity promotions in order to attract more FDI to the country.

Figure 22: Korea's growth in inward FDI, and Productivity of Labor during 1991-2000



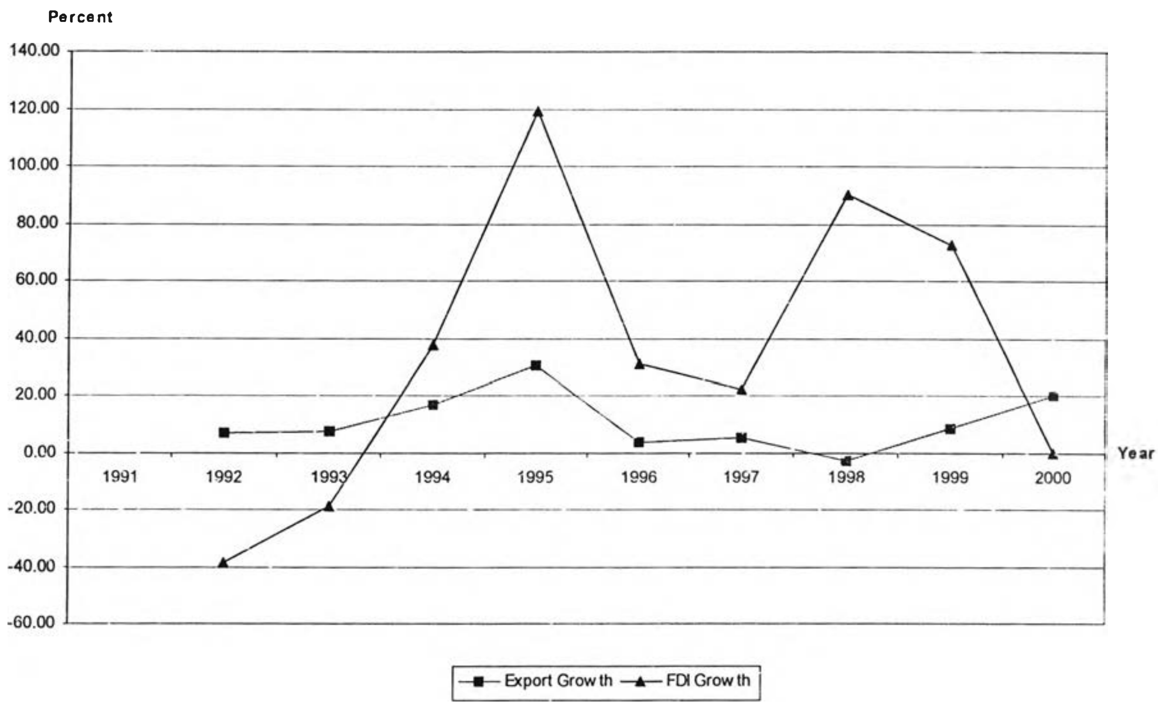
4.3 Export hypothesis

In terms of export hypothesis, the study also reports a strong relationship between the country's export and the country's inward FDI.

The study of the relation during 1991-2000 reports as high as 0.82 correlation coefficient between the country's export value and its inward FDI. This reaffirms that the country's increase in export sector brings about higher level of inward FDI as assumed. However, the relationship between the country's growth in exports and growth in inward FDI does not reports the same strong relation.

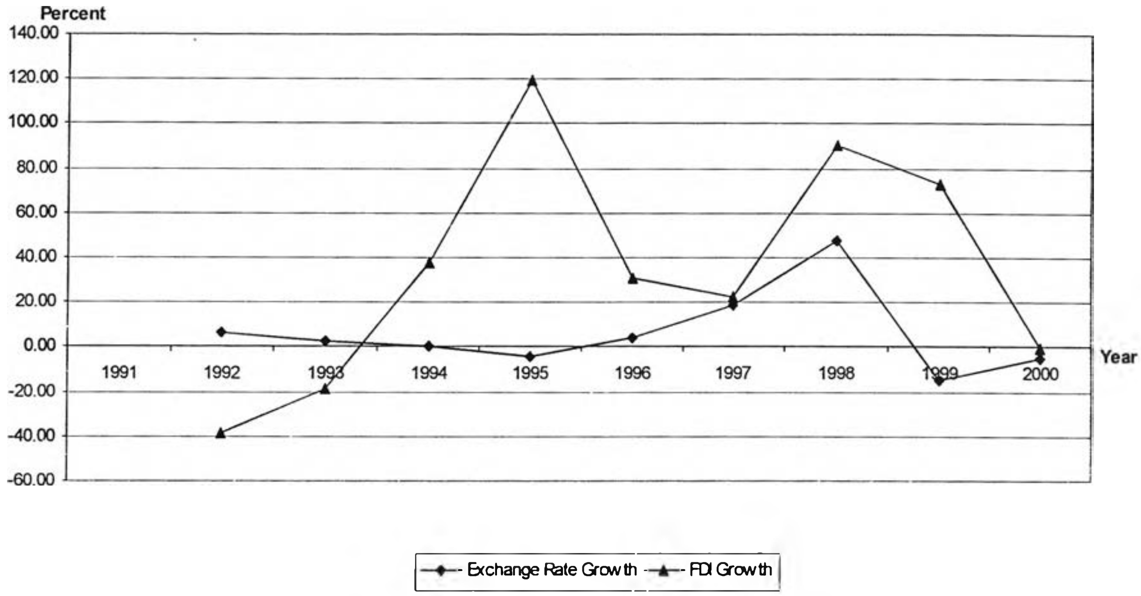
Nevertheless, when the study turns the focus to 1991-1997, the stronger relationships are reported. The study reports a correlation coefficient between the country's exports and its inward FDI as high as 0.89. Meanwhile, the country's growth in exports is also highly correlated with its growth in inward FDI with the correlation coefficient of 0.82. These relationships strongly support the study's export hypothesis that a country capability in export is a strong determinant of the country's inward FDI.

Figure 23: Korea's inward FDI, and Export during 1991-2000



In addition, the study of the relation between the country's exchange rate movement and the value of inward FDI to the country reports that a depreciation of the country exchange rate is positively related the country's inward FDI with the correlation coefficient of 0.80 (1991-2000) and 0.65 (1991-1997). However, the study reports a moderate negative relation between the country's growth in currency depreciation during 1991-1997 and its inward FDI during the same period. The correlation coefficient is reported at –0.45.

Figure 24: Korea's inward FDI, and Exchange Rate during 1991-2000



By this, the results support that a depreciated exchange rate is a determinant of inward FDI to the country during the period. The depreciation of the currency can encourage more FDI however exchange rate's stability is also required as an increasing rate of country's depreciation can lead to a decrease in the country's inward FDI growth.

4.4 Other determining factors

Besides the country's market size and exports that are the major determinants for the country's inward FDI, many policies and strategies have been implemented during the decades, aiming to attract more and more FDI to the country. Korean government focuses further to promote forward and backward linkage industry to reduce the cost of production and raw material imports, to improve products quality, and to raise product value added. Thus, Korean firms gain benefit in grabbing the overcome of foreign affiliates. (Korean Times, 2000) They learn first what kind of products those foreign affiliates need. Later they produce to supply them. Moreover, local firms are trying to use foreign firm international networks to expand their sales. As a result, export ratio on Korean GDP is growing up and it is the main source of GDP growth of Korea. (Korean Times, 2000)

Kim Dae-Jung's government practiced numbers of policies, aiming to reform its economy. To attract foreign direct investment, the country has removed, simplified, and deregulated laws and procedures to improve investment climate. The government announced to liberalize the economy by economic reforms and legal and regulatory environment changes. (DOC, 1999)

In 1999, the government allowed international investors to merge and/or acquire domestic firms in many sectors. However, foreign ownership limitation is still applied in some critical industry such as public corporations. National security, public order, public health, environment preservation, and social moral are topics that can lead to FDI restriction. These restrictions will be reviewed and announced annually by the Ministry of Commerce, Industry and Energy. (MOFE,-)

Tax and other incentives are taken to attract FDI as well, particularly in those investments that come along with advanced technology transfers. Corporate taxes on profit and dividends can be waived and/or reduced. (Korean 1996 Foreign Capital Inducement Act [FCIA] cited in DOC, 1999)

Kim's government has eased legal environment in Korea as well. Red tape procedures and bureaucratic difficulties has been deregulated and removed. National financial system has been restructuring.

However, Korea's historic characteristic in Chaebol system and the lack of legal and regulatory transparency threatens international investors. Korean government announced to improve and resolve these difficulties. The government commits to be more open and transparent to investors. (DOC, 1999) Corporate sector and Banking sector restructuring has been being carried out. Further reforms are crucial. Regulation imposed on Chaebol must be reviewed to promote competitive environment and market-based mechanisms. (IMF, 2001)

5. Conclusion

In conclusion, the study reaffirms the validity of the market size hypothesis, cost hypothesis, and export hypothesis. The market size hypothesis is reaffirmed, either measured by the country's GDP or PCI. Meanwhile the country's growth in market size is also reported as an encouraging factor for FDI.

Meanwhile, in terms of cost hypothesis, the study reports that the country's cost of funding is a positively related to the country's inward FDI, whilst the country's WPI is negatively correlated to the factor. By the study, it is found that an increasing in the country interest rate does not destroy the country's attractiveness. However, an increase in the country's WPI can lead to a decrease in the country's growth inward FDI as the negative relationship between the percentage change in WPI and the growth in inward FDI is reported.

In terms of export hypothesis, the study reports that the country's value of exports and its export growth are the strong determinants for the country's inward FDI. Meanwhile, the country's currency depreciation is also shown as an encouraging factor for inward FDI. However, it is necessary to remark that a dramatic change in the country's exchange rate could harm the country's attractiveness.

In addition, the study reports that numbers of policies that have been carried out during the decade do affect the country's attractiveness as a destination country for FDI. De-regulations and incentives are used as a tool to attract more FDI to the country, particularly during the years of recession.

Compared to other countries, the study reflects the same outline that market size hypothesis and export hypothesis are valid as positive determinants in most cases. However, in the case of interest rate, inflation rate, and exchange rate, the study reports that a slow and controllable change is required to encourage higher level of inward FDI to the countries.

Malaysia

1. Historical Background

Malaysia was a country under the government of England during the era of colonialism. The country, including Malaya, Sabah, Sarawak, and Singapore, became independent on August 31, 1957. However, in 1965 Singapore became an independent country. As a result, Malaysia is a country consists of three major groups of population. The first group was originally located in the mainland, which was called Malaya. The others were in the north Borneo island, which is presently called East Malaysia. The groups were composed of Sabah, and Sarawak.

After the independence, the country has governed under the parliamentary democracy system, with a constitutional monarchy. So, the country is ruled by the king, and administrated by the government, representing by the Prime Minister. The Malaysian legal system is followed the English common law that was formerly used during the colonized period.

At present, the country is composed of 13 states and two federal territories. Each state has its own government and assembly. The chief of states can be called either Governor, or Sultan, depending on the local governing system. One of these thirteen governors will be selected to become a king of the state.

In terms of production, the country is rich of tropical agricultural products, petroleum, natural gas, tin, and minerals. The famous agricultural products, for example, are palm oil, rubber, timber, and cocoa. These agricultural products are also widely exported along with its electronics and electrical products, which is promoted by the government.

During 1980s through 1990s, the country had reported a great success in economic development with the average annual growth of almost 8%. Also, the country has passed through a great economic transformation, from an agricultural based economy to a manufacturing based economy.

2. Economic Environment

During the past few years, the government of Malaysia has introduced number of policies to cope with the crisis. The government tried to minimize the effect of financial crisis by capital transfer limitation. At the very first step, the policy is criticized as harmful. But later, the country proved that the exchange rate could be stabilized.

Its GDP grew at 8.6% in 2000, mainly on the strength of double-digit export growth and continued government fiscal stimulus. As an oil exporter, Malaysia also benefited from higher petroleum prices. Higher export revenues allowed the country to register a current account surplus, but foreign exchange reserves have been declining - from a peak of $34.5 billion in April 2000 to $29.7 billion by December - as foreign investors pulled money out of the country. Despite this development, Kuala Lumpur is unlikely to abandon its currency peg. An economic slowdown in key Western markets, especially the United States, and lower world demand for electronics products will slow GDP growth to 3%-6% in 2001, according to private forecasters. Over the longer term, Malaysia's failure to make substantial progress on key reforms of the corporate and financial sectors clouds prospects for sustained growth and the return of critical foreign investment.

3. Investment Climate

Malaysian government established the Malaysian Industrial Development Authority (MIDA) to take responsibility in licensing foreign manufacturing establishment. Foreign Investments in Malaysia must follow the government's Promotion of Investment Act (1986), Industrial Coordination Act (1975), and the second Industrial Master Plan (1996-2005). (DOC, 1999)

Generally, foreign equity is limited to 30% share in non-promoted sectors. Whereas, 100% foreign ownership is applicable in area of promoted investments.

However, it is remarked that, during 1991-2000, there was no significant change, either increase or decrease, in the value of inward FDI to the country, compared to other East Asian nations. During 1991-19997, the country reported the average annual growth of 10% in inward foreign direct investment to the country. The growth rate is relatively low compared to 34.99% in Korea, 53.25% in the Philippines, and 21.46% in Thailand. Moreover, the FDI inflows it Malaysia has being declined since 1996. A sharp drop occurred in 1998 when the currency peg was introduced. The rise of FDI in 1999 is sustainable as the flows dropped again in 2000.

Malaysia attracts FDI, particularly in export-oriented industries and high-tech industries such as multimedia and information technology. (DOC, 1999) The government has pursued export promotion policies decades ago.

(Sekigushi and Kawagoe, 1995) However, domestic market-oriented investments, investments in service industry, agriculture, and construction are considerably discrete. (DOC, 1999)

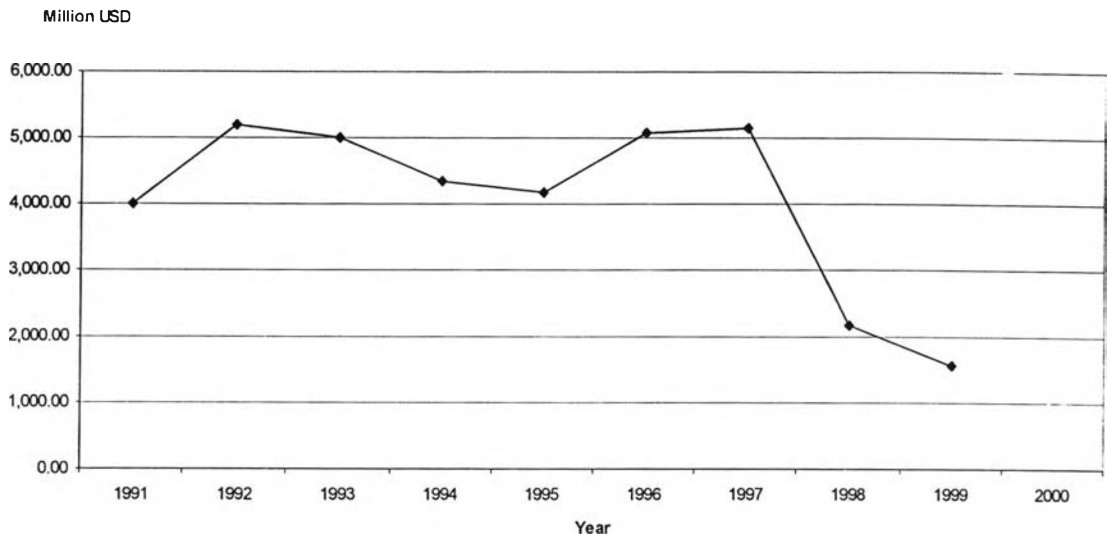
Currently, the United States takes the lion's share in foreign investment on Malaysia, particularly in manufacturing sector, followed by Japan, Germany. The three countries take more than 50% share of total foreign manufacturing investment in the country. (DOC, 1999)

Table 18: Malaysia's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	2.75	2.55	2.57	2.62	2.50	2.52	2.81	3.92	3.80	3.80
Export (M. USD)	34,361.30	40,691.29	47,099.18	58,652.21	73,864.80	78,312.33	78,519.12	73,070.02	84,455.00	98,135.00
FDI (M. USD)	3,998	5,183	5,006	4,342	4,178	5,078	5,137	2,163	1,553	N/A
GDP (B. USD)	47,045.93	57,602.65	62,848.76	74,480.81	88,832.45	100,851.39	100,202.26	72,488.53	78,858.42	89,321.05
Labor Force (Thousands)	7,490.00	7,498.00	7,743.00	7,731.00	7,893.00	8,617.00	8,784.00	8,884.00	9,152.00	N/A
Lending Interest Rate	8.13	9.31	9.05	7.61	7.63	8.89	9.53	10.61	7.29	6.77
PCI (USD)	2,536.17	3,025.35	3,213.13	3,703.67	4,297.65	4,763.88	4,626.14	3,268.19	3,472.41	3,840.11
Population	18.55	19.04	19.56	20.11	20.67	21.17	21.66	22.18	22.71	23.26
Unemployment Rate	6.54	6.00	4.65	2.99	3.14	2.52	2.45	3.20	3.43	N/A
WPI	4.00	5.20	6.70	10.90	5.10	4.90	2.70	-0.50	3.10	1.80
Productivity of Labor (Thousands USD)	6,281.16	7,682.40	8,116.85	9,634.05	11,254.59	11,703.77	11,407.36	8,159.45	8,616.52	N/A

Source: IMF, International Financial Statistics, Various Editions

Figure 25: Foreign Direct Investment in Malaysia during 1991-2000



Source: UNCTAD, World Investment Reports

4. FDI and Major Economic Factors Relationship

4.1 Market Size Hypothesis

The data of Malaysia during 1991-2000 reports a weak positive relationship between the country's inward foreign direct investment and market size hypothesis. Even when the study excludes the crisis period out of the observation, the data during 1991-1997 still reports the similar weak relation between the factors. The correlation coefficients between the country's inward FDI and its market size, either GDP, or PCI are found as low as 0.10 and 0.30 respectively. This is because during the high economic growth of the country during the decade, there had been no significant increase in the country's inward FDI.

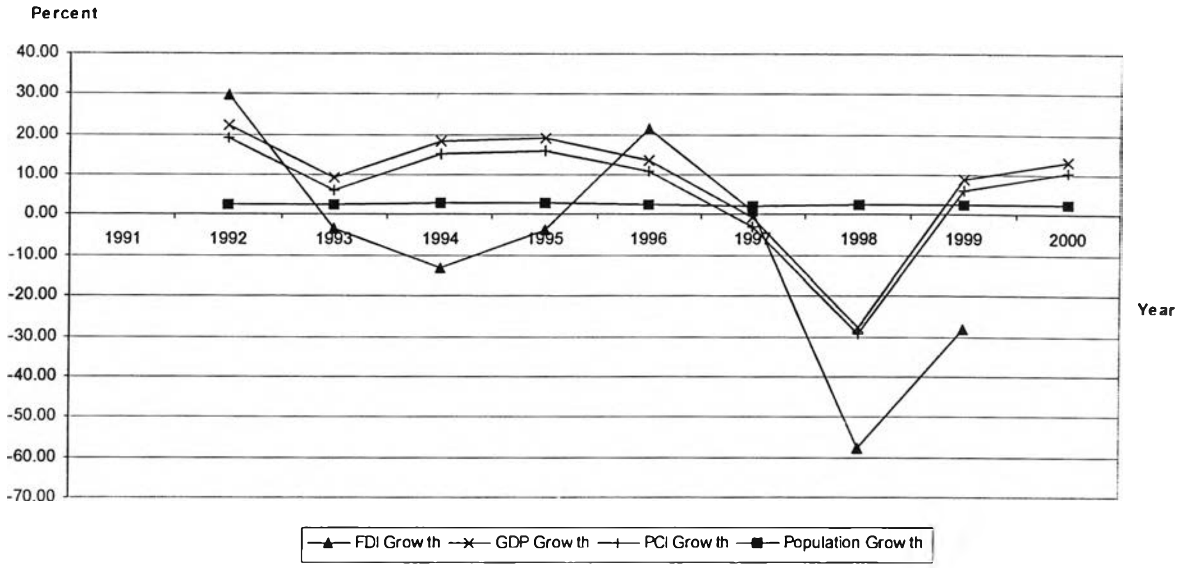
In addition, the study reports a strong positive correlation of 0.77 between the country growth in market size and its inward FDI, employing the data during 1991-2000. However, when data during the crisis is excluded the data, the study reports a weak relationship between the factors.

As a result, the study does not strongly support that a market size is a determinant of inward FDI in the case of Malaysia during the period.

4.2 Cost Hypothesis

In terms of production cost, the study reports a weak positive correlation between the country's inward FDI and its WPI during 1991-1997. The correlation coefficient is reported at 0.43. Meanwhile, a similar weak relationship between the country's inward FDI growth and its growth in WPI is reported with the correlation coefficient of –0.02. These findings, hence, do not strongly support the traditional economic hypothesis that a small inflation in an economy should encourage investment in the country.

Figure 26: Malaysia's Growth in inward FDI, GDP, Per Capita Income, and



Population during 1991-2000

However, the study reports a positive relationship between the country's inward FDI and its interest rate with the correlation coefficient of 0.90. Meanwhile, the country's growth in inward FDI is correlated with the country's interest rate with the reported coefficient of 0.59. As a result, the result does not support the study's hypothesis. However, this support an explanation that these day investors can fund their investment global, so the local interest rate may not be able to reflect investors' cost of funding. This is also consistent with the fact that major investors in Malaysia are those developed countries, with strong financial networks, such as US., Japan, Germany, for example. (DOC, 1999)

Figure 27: Malaysia's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

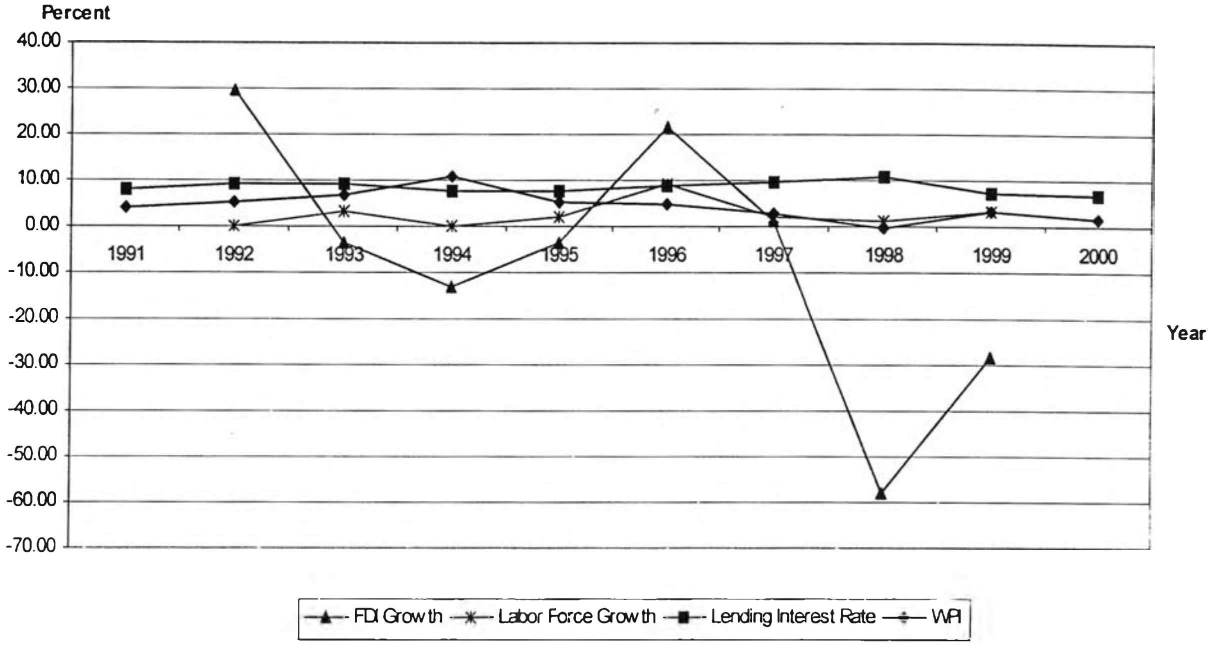
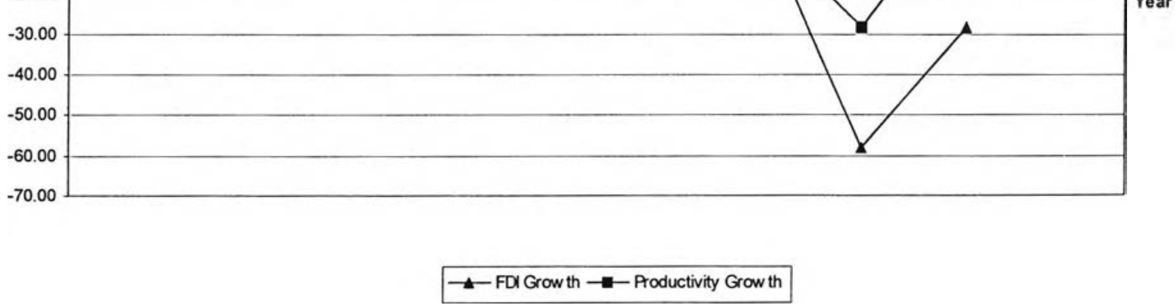


Figure 28: Malaysia's growth in inward FDI, and Productivity of Labor during 1991-2000



4.3 Export hypothesis

Besides the market size hypothesis and the cost hypothesis, the study reports that the export hypothesis is not reaffirmed in the case of Malaysia during 1991-1997.

The study reports weak correlation coefficients both between the country's inward FDI and its export, and between the country's growth in inward FDI and the country's growth in exports. The coefficients are reported at 0.23 and -0.34, consequently.

Moreover, the study reports a weak relationship between the country's exchange rate and its inward FDI. The study reports a weak relationship between the country's inward FDI and its currency depreciation, with the correlation coefficient of -0.10. Meanwhile, the study reports another weak correlation between the country's growth in inward FDI and it depreciation rate. The correlation coefficient is computed as –0.41.

From the above investigation, the study concludes that the study's export hypothesis is not supported by the data, either by applying the country's export value or exchange rate as a proxy.

Figure 29: Malaysia's inward FDI, and Export during 1991-2000

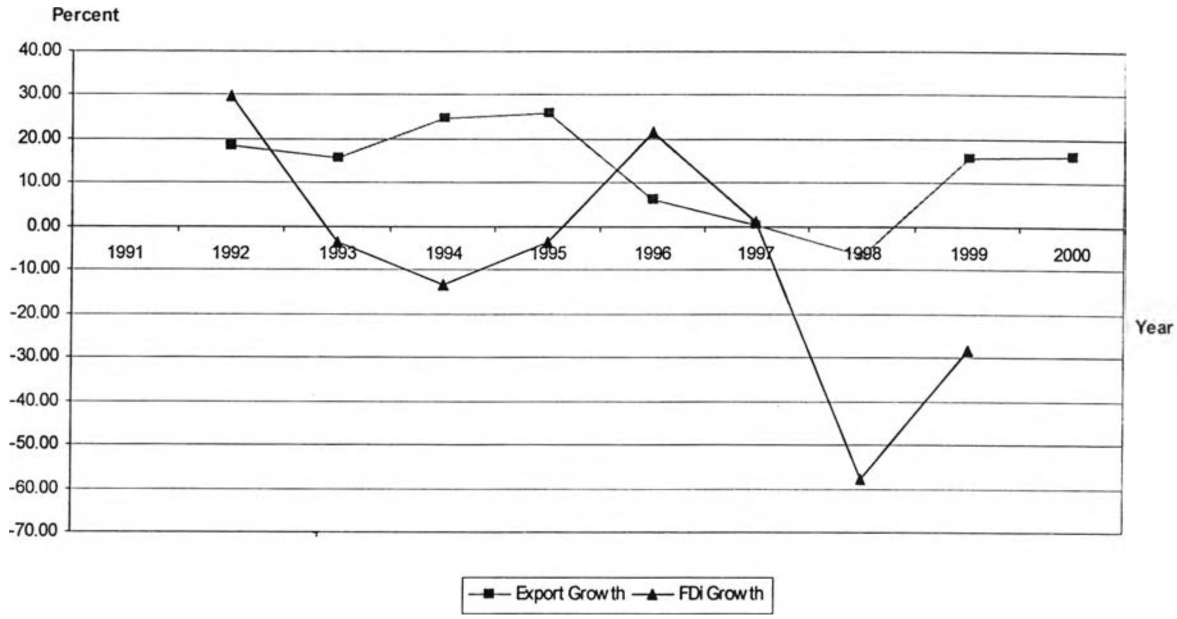
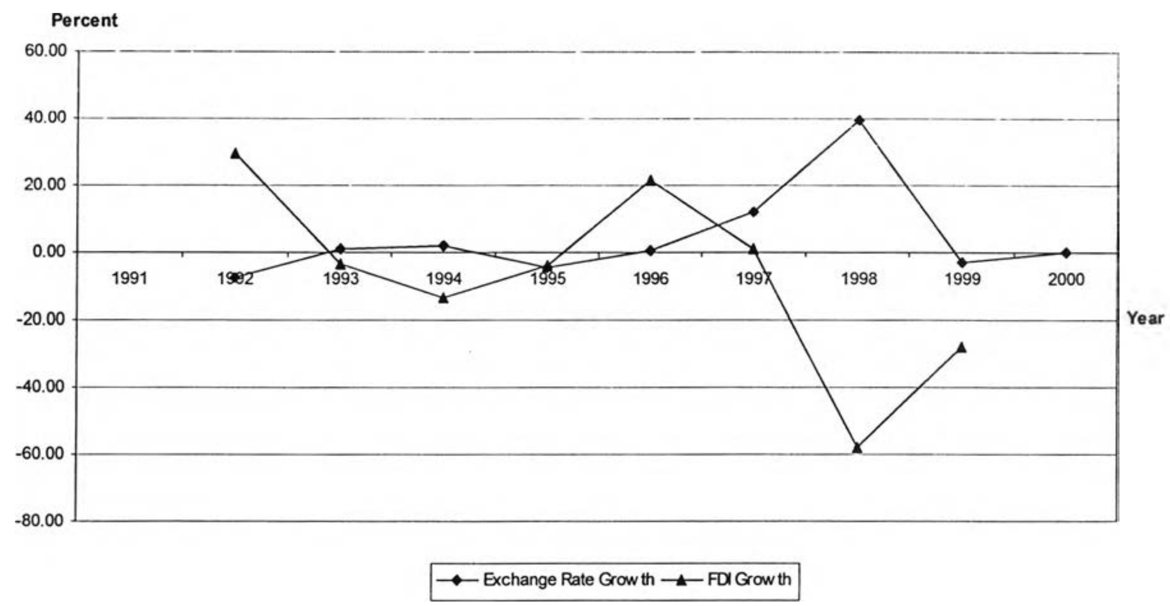


Figure 30: Malaysia's inward FDI, and Exchange Rate during 1991-2000



4.4 Other determining factors

In late 2000s, there are a numbers of investors invest in Malaysia, which reverse from world's expectation of very strict Malaysian government's international transaction regulations. One dominant factor that makes Malaysia still be able to attract a lot of FDI is the serious attempt of the government to create the attractive environment for competitive investment. The legal environment in Malaysia is reported as transparent, ranked above China, and South Korea, even behind Singapore and Hong Kong. (DOC, 1999)

Malaysia has tried to attract FDI, especially in the field of export oriented industries as it realizes the importance of its export sector, and whereas labor-incentive industries are no longer seeked for. (Business Times, 1999 and DOC 1999) Besides, Malaysia has been developing IT facilities and infrastructure to provide comfort to those industries that need high technological level for productions. Malaysia also relaxes foreign ownership regulations and export requirements for those industries that do not directly compete with its local firms. However, for domestic market-oriented industries, the government still restricts a certain percentages of foreign equity. Along, Malaysia's capital markets are broadening and deepening. Banking sector are being managed. Investors are able to access various credit instruments and are not restricted on portfolio investment. (DOC, 1999)

Fiscal incentives will be applied to international investors regarding their export proportion, capital/labor ration, type of financing, size of investment, local component ratio, and so on. Share of foreign ownership in any establishing firm will be considered according to these factors as well. The government announcements concerning its serious fight to the national corruption and intellectual property protections helps Malaysia becomes more attractive for FDI comparing to its neighboring countries. (Office of the United States Trade Representatives [USTR], 2000)

However, the government's restriction on foreign labor proportion distorts the country's attractiveness. Foreign firms face difficulties hiring professionals in specific areas, as they cannot take from aboard or find locally. (DOC, 1999)

Besides, as the wage rates in Malaysia has rose faster than labor productivity during these years, therefore the government is encouraging manufacturers to increase productivity and efficiency in order to compete with its neighbors. (DOC, 1999)

5. Conclusion

In conclusion, the market-size hypothesis, cost hypothesis, and export hypothesis are not supported by the data of Malaysia during 1991-2000, or even 1991-1997. An only support finding is a strong positive relationship between the country's interest rate and its inward FDI.

The phenomenon that the value of inward FDI of Malaysia had been stable during the decade and reports a relatively low growth should arise because the country's shortage of skilled labor, especially in the area that had been being promoted, electronics and electrical industries for export. As a result, the government's restriction on foreign labor proportion should be eased so foreign firms do not face difficulties in employing labor, leading to a more attractive environment to international investors. Also, as it is reported that the wage rates in Malaysia has rose faster than labor productivity, the government is encouraged to support their people and firms to develop their skills and productivity in order to compete with other countries in attracting FDI.

The Philippines

1. <u>Historical Background</u>

The Philippines was governed by Spain in 1521 and later by the U.S. During the Spanish period, the country passed through Spanish-American War. After the war, 1898, Spain ceded the country to the United States. During American period, the first legislative assembly was elected. In 1935 Philippines became a self-governing commonwealth. Later, after World War II, The Philippines has announced the independence in 1946.

During the early years of independence, the country has received a lot of support and assistance from the States. The Philippines has gradually developed through times.

The 21-year rule of Ferdinand MARCOS ended in 1986 when a widespread popular rebellion forced him into exile. The Philippines has had two electoral presidential transitions since Marcos' removal by "people power". President Corazon Aquino replaced the position. He had been the leader of the country for six years. During the time, he had to manage the country's social security, political stability, and economic development. However, his administrative was not really support by the military. (DOC, 1999)

In 1992, Fidel Ramos was elected to be the president. His priority mission was to reconcile groups of people, who were different in belief, culture, and religion. He signed agreements to unfold the national conflicts. An agreement of peace between the government and a major muslim insurgent group was successfully signed in 1996. (DOC, 1999)

In 1998, Joseph Estrada was elected by huge mass support. However, in January 2001, the Supreme Court declared Joseph Estada unable to rule in view of mass resignations from his government. Hence, the position was transferred to Vice President Gloria Macapagal-Arroyo. The government continues to struggle with ongoing Muslim insurgencies in the south and develop the country for economic prosperity.

2. Economic Environment

In 1998 the Philippine economy deteriorated as a result of spillover from the Asian financial crisis and poor weather conditions. Growth fell to about -0.5% in 1998 from 5% in 1997, but recovered to about 3% in 1999 and 3.6% in 2000. The government has promised to continue its economic reforms to help the Philippines match the pace of development in the newly industrialized countries of East Asia. The strategy includes improving infrastructure, overhauling the tax system to bolster government revenues, moving toward further deregulation and privatization of the economy, and increasing trade integration with the region.

In term of economic stabilization, the study found that the WPI of the country was highly fluctuated during 1996-2000. However, for exchange rate stability, we found only once shooting in 1998, when the crisis hit, besides the rate were quite stable.

Table 19: The Philippines' Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	27.48	25.51	27.12	26.42	25.71	26.22	29.47	40.89	39.09	44.19
Export (M. USD)	8,792.61	9,736.32	11,172.49	13,252.00	17,519.13	20,409.44	25,055.65	29,496.42	36,649.54	40,123.48
FDI (M. USD)	544	228	1,238	1,591	1,478	1,520	1,249	1,752	578	1,241
GDP (B. USD)	45.42	52.98	54.37	64.08	74.12	82.85	82.34	65.17	76.16	74.73
Labor Force (Thousands)	25,251.65	26,515.52	26,949.28	27,703.52	27,482.09	28,005.70	30,033.97	31,248.24	31,558.02	29,003.00
Lending Interest Rate	23.07	19.48	14.68	15.06	14.68	14.84	16.28	16.78	11.78	10.91
PCI (USD)	713.09	810.82	811.73	933.89	1,054.83	1,152.24	1,119.84	867.23	1,018.82	979.21
Population	63.69	65.34	66.98	68.62	70.27	71.90	73.53	75.15	74.75	76.32
Unemployment Rate	9.00	9.80	9.30	9.16	8.92	8.24	8.63	10.75	10.44	N/A
WPI	3.00	5.10	-1.30	9.60	5.20	8.90	0.50	12.80	7.00	2.20
Productivity of Labor (USD)	1,798.56	1,998.04	2,017.47	2,313.20	2,697.14	2,958.20	2,741.63	2,085.64	2,413.24	2,576.73

Source: IMF, International Financial Statistics, Various Editions

The country has performed very well in export expansion. The growth of export was above 20% during 1996-1999 in average. However, the growth declined, in term of US dollars, in 2000 as a result of currency depreciation.

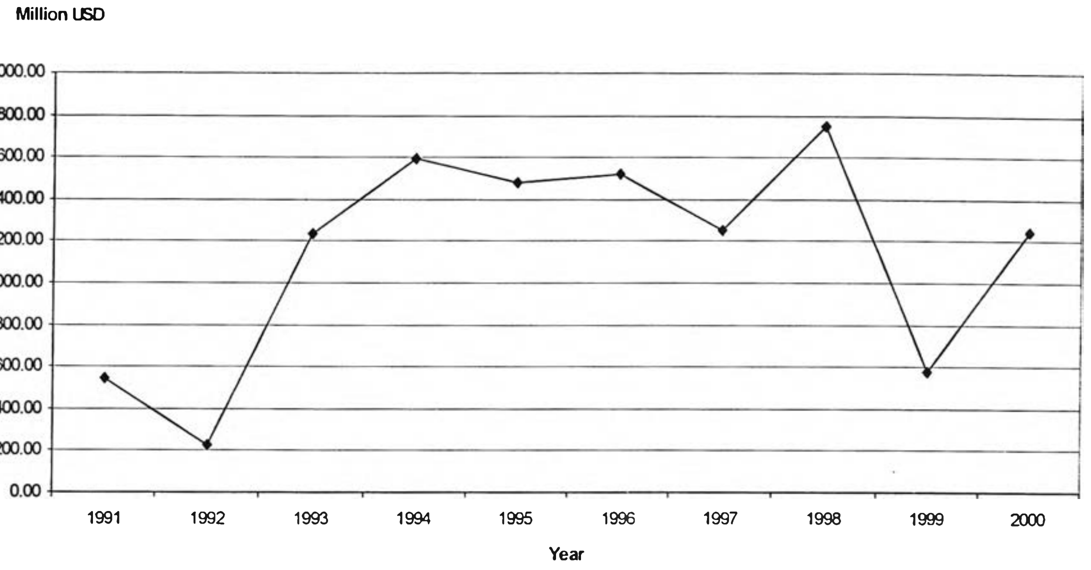
The country's performance on GDP is moderate in term of local currency. However, as a huge depreciation of the Peso in 2000, the country performs not very well in term of US dollars.

3. <u>Investment Climate</u>

Inward investments in Philippines mostly are labor intensive and market oriented industries. Natural resources of the country are attractive for foreign investors. (Economic and Social Commission for Asian and Pacific, 1998) However, FDI inward to The Philippines is relatively small compared to its neighbors. The country has a very hard task to do to attract more FDI.

Statistic shows that the inward FDI to the country had been average annual growth by 53.25% from 1991-2000. By comparing the data between 2000 and 1991, the study reports approximately 140% growth in inward FDI. However, in comparison to other Asian countries, the country is determined that it could attract relatively low inward FDI. The reasons may lie at its relatively low GDP, social dilemma, and political instability during the recent years.

Figure 31: Foreign Direct Investment in The Philippines during 1991-2000



Source: UNCTAD, World Investment Report

4. <u>FDI and Major Economic Factors Relationship</u>

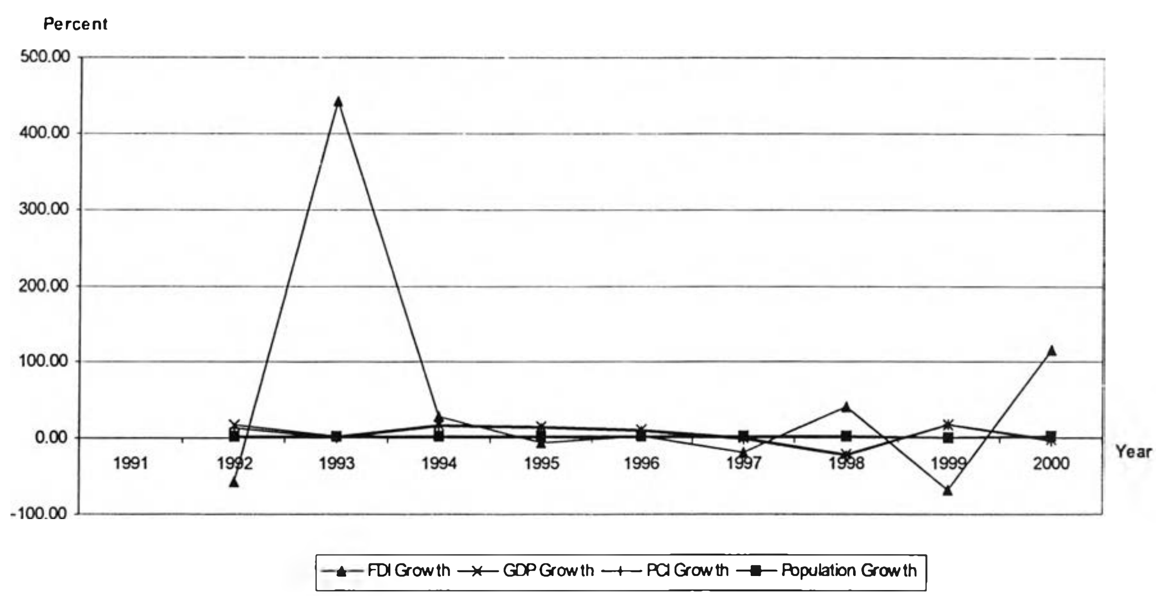
4.1 Market Size Hypothesis

The study reports that the market size hypothesis is supported by the data of 1991-1997. The study of correlation coefficient reports that the country's inward foreign direct investment is as high as 0.70 correlated with its GDP. Meanwhile, the correlation coefficient between FDI and its PCI is also reported at 0.70. This is consistent to the assumption that the increasing market size of the country is correlated to the country's inward FDI to the market.

Nevertheless, when the study conducts a study of relation between the country's growth in market size and its inward FDI, the results of the study do not support the study's hypothesis. The correlation between the country's growth in GDI and the country's growth in inward FDI show a weak relation between the factors with the correlation coefficient of –0.48. Meanwhile, the growth of PCI of the country during 1991-1997 is –0.49 correlated to the country's growth in inward FDI during the same period.

The results of the study, hence, cannot bring to a strong conclusion that the study's market size hypothesis is supported in the case of the Philippines during 1991-2000. This should be explainable by other factors, which would be analyzed later on in the section of Cost Hypothesis, Export Hypothesis, and Other Determinants. Finally, a conclusion will be made.

Figure 32: The Philippines's Growth in inward FDI, GDP, Per Capita Income, and Population during 1991-2000



4.2 Cost Hypothesis

In terms of Cost hypothesis, the study reports a negative relationship between the country's inward FDI and its interest rate. The correlation coefficients is reported only at –0.85. Also, the relationship between the country's growth in cost of lending and its inward FDI growth reports a negative weak correlation with the coefficient of –0.42. This results supports the study hypothesis that the country's increasing cost of funding is negatively related to the country's inward FDI.

Nevertheless, the study's hypothesis that an increasing WPI of a recipient country should discourage investors is not supported. The hypothesis reports a weak correlation coefficient of 0.28 between the country's inward FDI and its WPI. Moreover, the correlation coefficient between the country's growth in inward FDI and the country's growth in WPI is reported only at –0.34.

Figure 33: The Philippines' growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

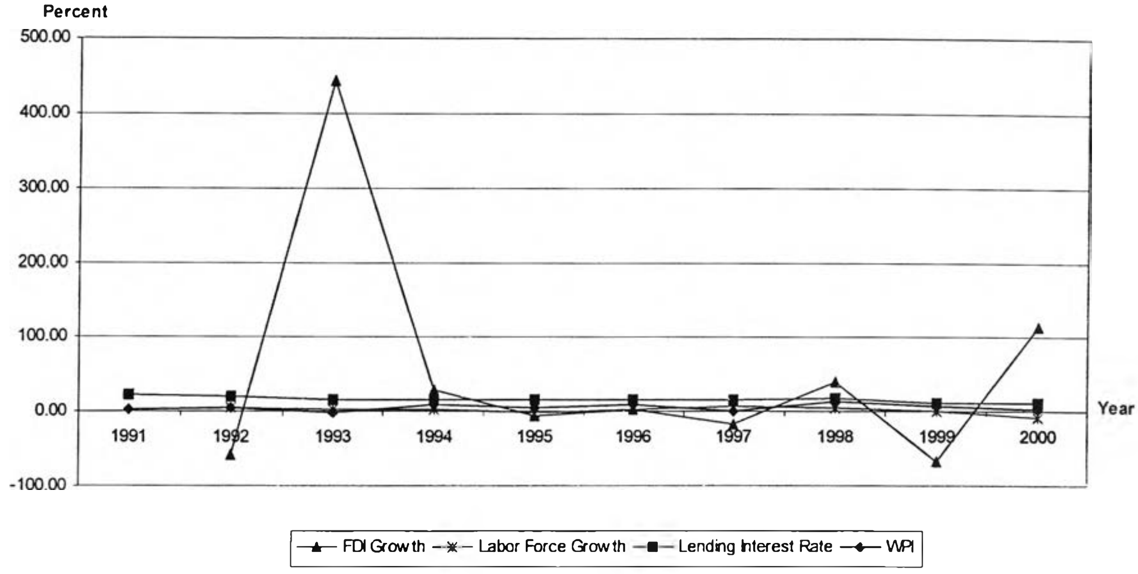
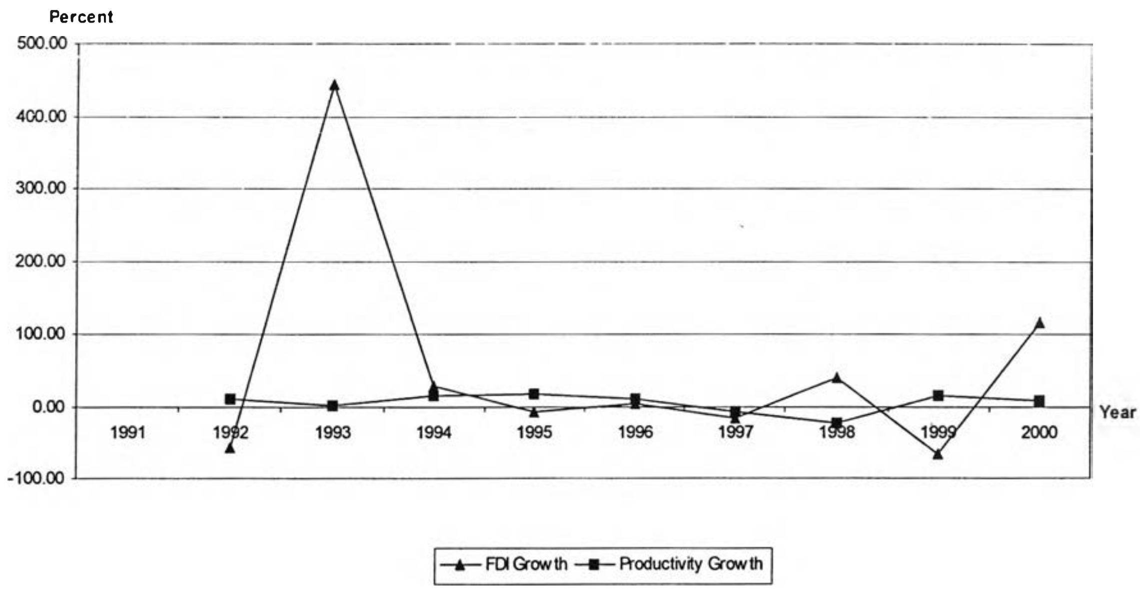


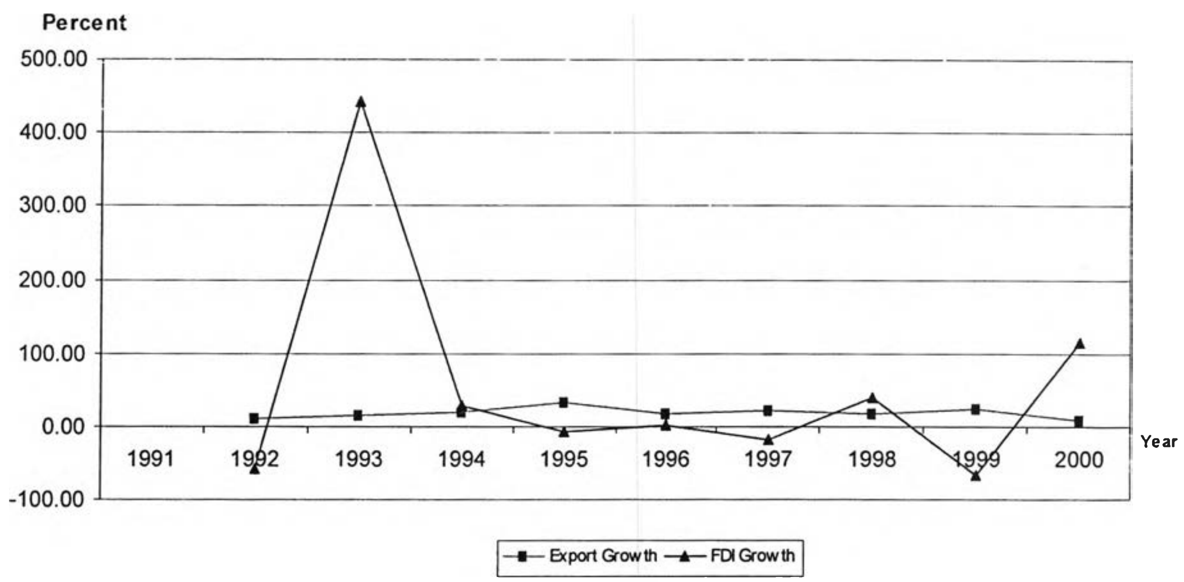
Figure 34: The Philippines' growth in inward FDI, and Productivity of Labor during 1991-2000



4.3 Export hypothesis

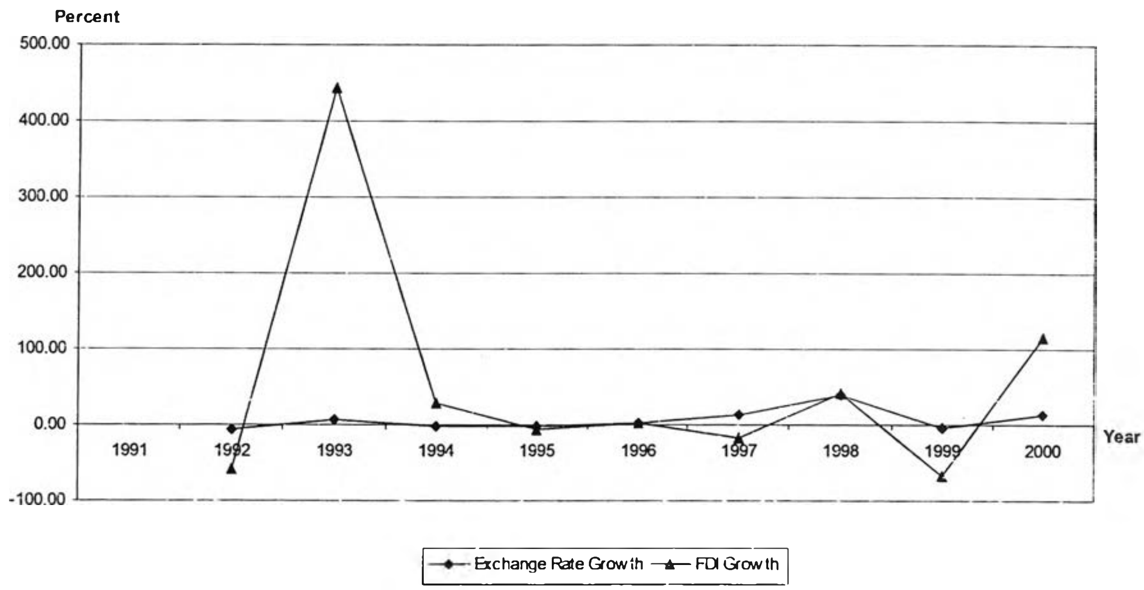
In terms of Export hypothesis, correlation coefficient reports the positive relationship between the country's inward FDI whilst the weak relationship between the Philippines' growth in inward FDI and its growth in exports is reported. The correlation coefficient between the country's inward FDI and its exports is reported at 0.59. Meanwhile, the correlation between the country's growth in inward FDI and growth in export is reported only at –0.24. By this, the study do not strongly support the study's hypothesis that an increasing export value of a country is a factor that takes part in encouraging the country's inward FDI.

Figure 35: The Philippines' inward FDI, and Export during 1991-2000



In addition, the study reports a weak, but positive, correlation between the country's exchange rate. The correlation coefficient between the country's inward FDI and it exchange rate is 0.08. Meanwhile, the country's depreciation rate is correlated with the country's growth in inward FDI with the correlation coefficient of 0.36. By this, the result of the study do not support the hypothesis that a depreciating exchange rate is positively related to the country inward FDI.

Figure 36: The Philippines' inward FDI, and Exchange Rate during 1991-2000



4.4 Other determining factors

The Philippines' government has eased number of laws and regulations to attract more foreign direct investment, aiming to lift the economic recession. However, numbers of industries are restricted for foreign ownership, while some, such as retail trade, security agencies, licensed professional are fully reserved for the Filipinos. (DOC, 1999) Sixty-per-cent foreign ownership is applicable in financial services, in particular for financing companies, and insurance industries.

Domestic market-oriented firms are foreign ownership restricted at 40% unless they engage in pioneer activities. Export-oriented firms are generally allowed for higher foreign ownership. They may also qualify for others incentives, provided by BOI, if at least 70% of their products are exported.

As a result of the 1997 crisis, the government has deregulated numbers of restrictions concerning FDI. The government established special economic zones to encourage foreign direct investment. Industries located in those zones will be considered for special custom duties, taxes and import restrictions. (DOC, 1999) Foreign enterprises established in less developed areas will be regarded as pioneers. The pioneer will also receive special fiscal incentives, such as corporate tax deduction, from the Filipino's Board of Investment. Hundred percent of foreign ownership will also applicable. (DOC, 1999)

The government of the Philippines has promised to reform and reduce its policy and regulations to help Philippines more attractive to foreign investors. Infrastructure is being developed. State-owned enterprises privatization is being reconsidered. The government also promises to increase the cooperation and trade integration with the region. (Committee on Statistics Economic and Social Commission for Asia and Pacific, 1998)

Filipino' labors are likely to be motivated and easy to train. (DOC, 1999) They are also ranked higher than the nearby neighbors in term of quality, cost, availability, and turnover. (DOC, 1999)

The country's financial market is quite sound and open. Foreigners can invest in private securities and money market instruments according to the government's foreign ownership regulations where banking system is also generally sound. Foreign exchange market, foreign-financing, and fund transfer are applicable with no government restrictions. (DOC, 1999)

For international trade, the country has signed number of bilateral agreements with countries in all region; namely, Australia, Bangladesh, Burma, Canada, Chile, China, Denmark, Iran, Italy, Egypt, Peru, Poland, South Africa, etc.

However, it was founded that the government does not succeed in countering corruption. Corruption remains as a problem for investors. (DOC, 1999) Beside, the country needs to develop more suitable infrastructure. Meanwhile, Political stability and social security must be managed to ensure investor's confidence.

5. Conclusion

In conclusion, the study does not strongly support the market size hypothesis, cost hypothesis, and export hypothesis in the case of the Philippines during 1991-1997. However, the study reports that the country's market size is positively correlated to its inward FDI value. Also, the study reports that an increasing interest rate of the country negatively related to its attractiveness to international investors, leading to a decreasing in inward foreign direct investment to the country.

In addition, the study reports that high labor's quality of the country and its nourish natural resource are another factors that induce a number of investment projects to the country. Hence, it is suggested that the country should strengthen these advantages in order to attract higher FDI in the long run. Also, it is recommended that the government should be able to attract more FDI to the country by providing investors with higher confidence concerning social security and corruption countering.

Thailand

1. Historical Background

The Kingdom of Thailand was established in the mid-14th century. Firstly, it was known as Siam until 1939. Thailand is the only Southeast Asian country never to have been taken over by any European nation. A bloodless revolution in 1932 led to a constitutional monarchy. In alliance with Japan during World War II, Thailand became a US ally following the conflict.

The country has ruled in the form of constitutional monarchy, administrated by National Assembly. Multi-political party system is designed by the constitution, while communist party is prohibited. (DOC, 1999)

Thailand is such an active member in regional political and economic cooperation. The country is also well known for agriculture product -such as rice, rubber, corn; tourism, textiles, garments cement, and jewelry.

2. Economic Environment

After enjoying the world's highest growth rate from 1985 to 1995 - averaging almost 9% annually - increased speculative pressure on Thailand's currency in 1997 led to a crisis that uncovered financial sector weaknesses and forced the government to float the Baht.

In 1997, the long pegged currency at 25 to the dollar was cancelled and managed floated, the Baht fell to its lowest point of 56 to the dollar in January 1998 and the economy contracted by 10.2% that same year.

As results, Thailand economic stability and growth were deteriorated. The whole sale price index and unemployment rate shot up. Meanwhile the interest rate was pegged high according to IMF suggestion. Till 1999, the policy was change to stimulate consumer spending. Hence, the rate dropped sharply then.

Thailand entered a recovery stage in 1999, expanding 4.2% and grew about the same amount in 2000, largely due to strong exports - which increased about 20% in 2000. An ailing financial sector and the slow pace of corporate debt restructuring, combined with a softening of global demand, is likely to slow growth in 2001.

3. Investment Climate

Thailand has announced and followed its open, market oriented economy. The country has promoted its economy via exporting and investment inflows. Board of Investment was established to assist foreign investor to invest in Thailand, providing them numbers of incentives according to government policy.

The FDI inflows to Thailand had risen up continuously till 1998. However, as a result of contraction and world economic crisis, the flows dropped by 30% in 1999 and keep decreasing in 2000. However, the flows increased again in 2001.

Table 20: Thailand's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	25.52	25.40	25.32	25.15	24.92	25.34	31.36	41.36	37.81	40.11
Export (M. USD)	28,437.12	32,466.30	36,962.83	45,232.60	56,443.91	55,719.53	57,604.26	54,341.26	58,549.74	69,248.60
FDI (M. USD)	2,014	2,113	1,804	1,366	2,068	2,271	3,626	5,143	3,561	2,813
GDP (B. USD)	98.74	111.55	125.44	144.51	168.28	182.41	151.14	111.91	122.06	122.17
Labor Force (Thousands)	31,138	32,385	32,153	32,516	32,887	32,586	33,455	33,576	33,209	N/A
Lending Interest Rate	19.00	17.54	15.60	10.90	13.25	13.40	13.65	14.42	8.98	7.83
PCI (USD)	1,745.48	1,947.06	2,162.38	2,461.47	2,833.00	3,040.16	2,493.98	1,829.76	1,982.71	1,960.29
Population	56.57	57.29	58.01	58.71	59.40	60.00	60.60	61.16	61.56	62.32
Unemployment Rate	3.50	3.60	1.50	1.30	1.10	1.10	0.90	3.40	2.97	0.00
WPI	6.80	7.00	6.60	10.80	7.60	1.80	5.20	13.00	-5.70	4.50
Productivity of Labor (USD)	3,171.11	3,444.41	3,901.33	4,444.36	5,116.92	5,597.78	4,517.56	3,332.97	3,675.37	N/A

Source: IMF, International Financial Statistics, Various Editions

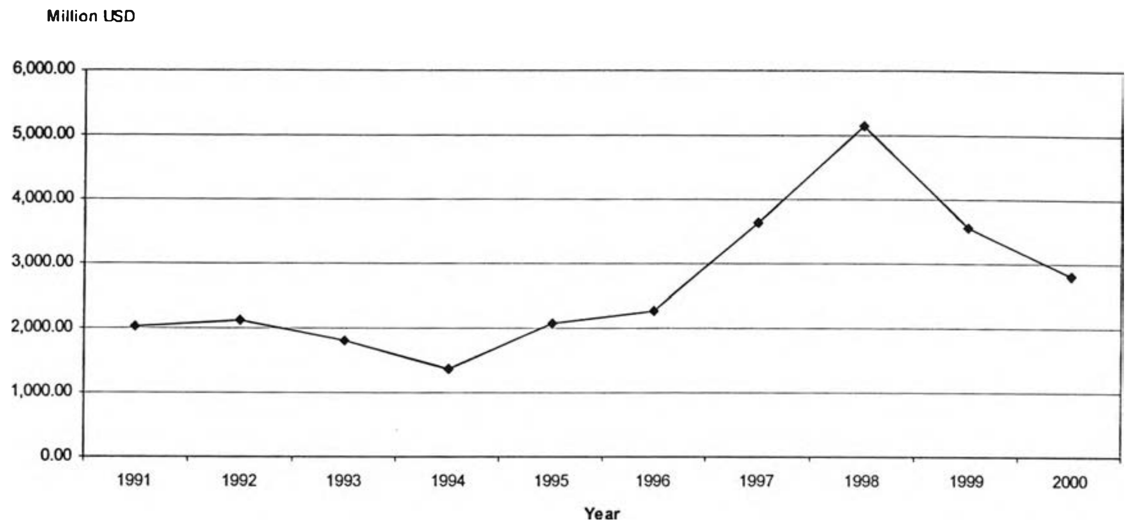
In 2002, Japan takes the highest share for foreign direct investment approved by BOI. Singapore takes the second seat. Later are United Kingdom, United States, Switzerland, Korea, and Hong Kong respectively.

Table 21: List of Application Approved by BOI, in 2002

COUNTRY	2002 APPLICATION APPROVED	
	No.	Total Invest
Asia		
Japan	215	38,398
Asian NIEs		
Taiwan	41	2,706
Hong Kong	5	1,585
Korea	33	3,213
Singapore	40	13,103
P.R.C.	7	379
Malaysia	23	1,676
Indonesia	2	139
Philippines	1	20
India	5	92
North America		
U.S.A.	37	11,113
Canada	2	93
Australia		
Australia	11	726
Europe		
EU	65	16,259
All Europe	78	20,437
-UK	15	11,237
-Germany	19	2,140
-Switzerland	12	3,727
-France	9	543
-Belgium	3	73
-Italy	2	633
-Netherlands	10	858
Total For. Projects	483	99,617

Source: BOI, 2002

Figure 37: Foreign Direct Investment in Thailand during 1991-2000



Source: UNCTAD, World Investment Reports

4. <u>FDI and Major Economic Factors Relationship</u>

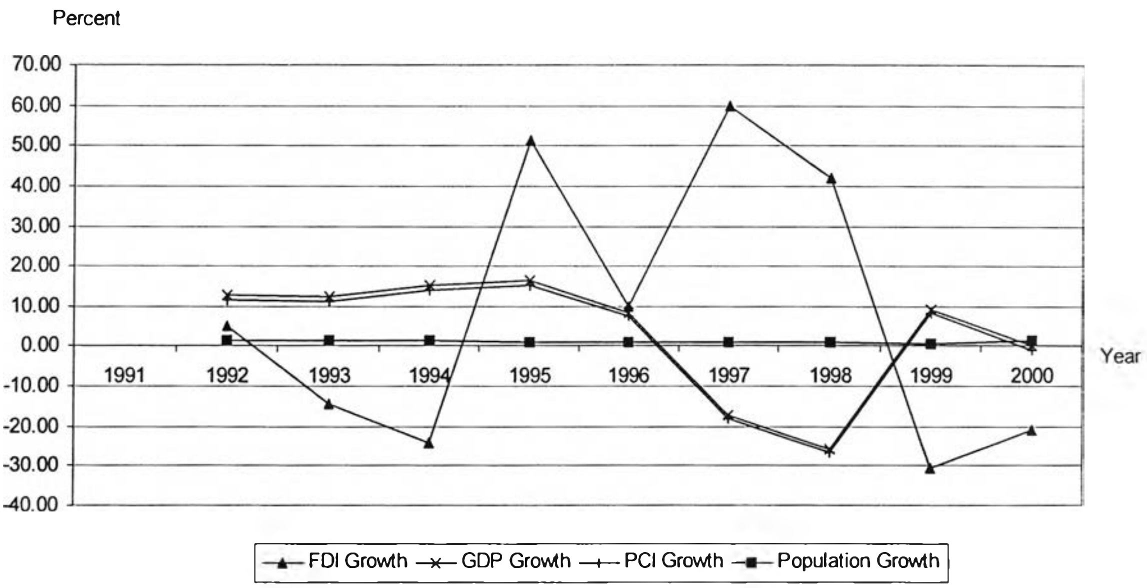
4.1 Market Size Hypothesis

By studying Thailand's performance on FDI during 1991-2000, the study reports a weak relationship between the country's market size and its inward foreign direct investment. The correlation coefficients between the country's inward FDI and its GDP are -0.22 during 1991-2000, and 0.22 during 1991-1997. Meanwhile, the correlation coefficients between the country's FDI and its PCI are -0.32 during 1991-2000, and 0.17 during 1991-1997.

In addition, the study reports negative relation between the country's growth in inward FDI and its growth in market size. The correlation coefficients between the country's growth in inward FDI and its GDP growth are -0.53 during 1991-2000, and –0.59 during 1991-1997. Meanwhile, the study reports the same correlation coefficients between the country's FDI growth and PCI growth, either during 1991-2000, or during 1991-1997.

From the statistics, the study cannot accept the hypothesis that an increasing size of the economy positively determines the value of inward FDI to the country. In contrast, the study reports that a high expansion rate of the economy discourages the growth of foreign direct investment. This can be a result of the rapid expansion that induces higher cost of labor, cost of funding, and destroy the country's competitiveness in exports. These factors, hence, would be studied later on in this session if they are determinants of Thailand's inward foreign direct investment.

Figure 38: Thailand's Growth in inward FDI, GDP, Per Capita Income, and Population during 1991-2000



4.2 Cost Hypothesis

The study reports a negative relation between the country's cost of production and the country's inward foreign direct investment. The correlation coefficient between the country's cost of product, measured by WPI, and the country's inward FDI is reported at –0.02 for the period of 1991-2000, and –0.53 for 1991-1997. Meanwhile, the growth of inward FDI during 1991-2000 is 0.39 correlated, and 0.34 during 1991-1997, to its inflation rate.

In addition, the study reports a weak correlation between the country's inward FDI and its lending interest rate. The correlation coefficient between inward FDI and one-year lending interest rate is -0.18 during 1991-2000. Meanwhile, the country's inward FDI growth and one-year lending interest rate growth is correlated to each other with the correlation coefficient of 0.46.

By these coefficients, the study does not strongly support the cost hypothesis. This means the relation between the country costs, either lending interest rate and inflation rate, and its inward foreign direct investment during 1991-2000 does not support the assumption that an increasing cost negatively determines the value of inward FDI to the country and its growth.

4.3 Export hypothesis

In terms of export hypothesis, the study also reports a similarly weak relation between the country's exports and the country's inward FDI with the correlation coefficient of 0.47. Meanwhile, the country's growth in exports is correlated with the country's inward foreign direct investment with the correlation coefficient of –0.31.

Figure 39: Thailand's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000

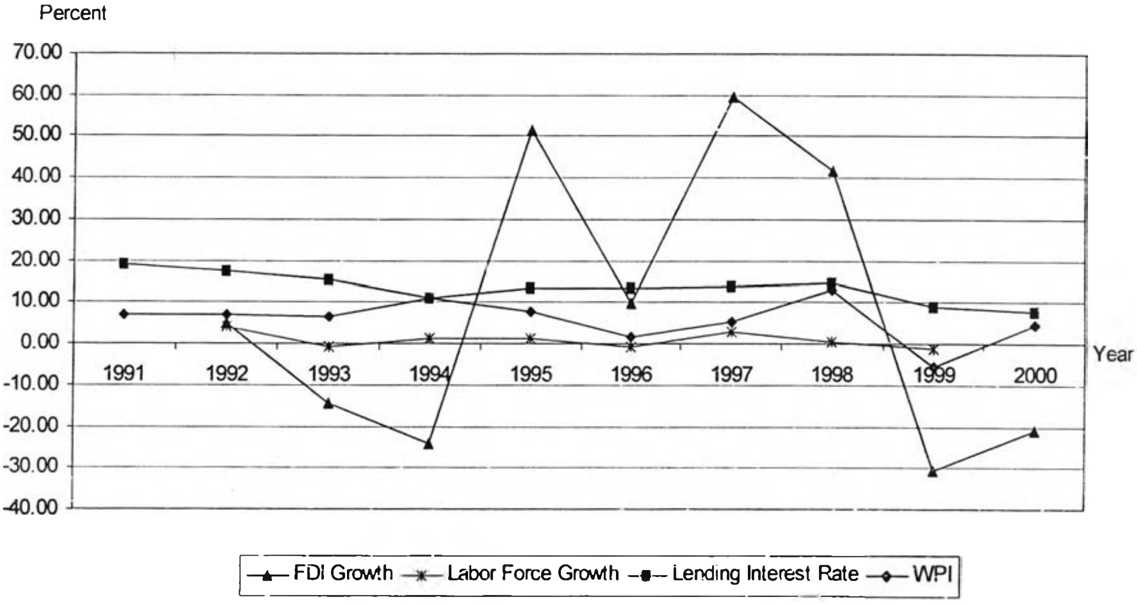
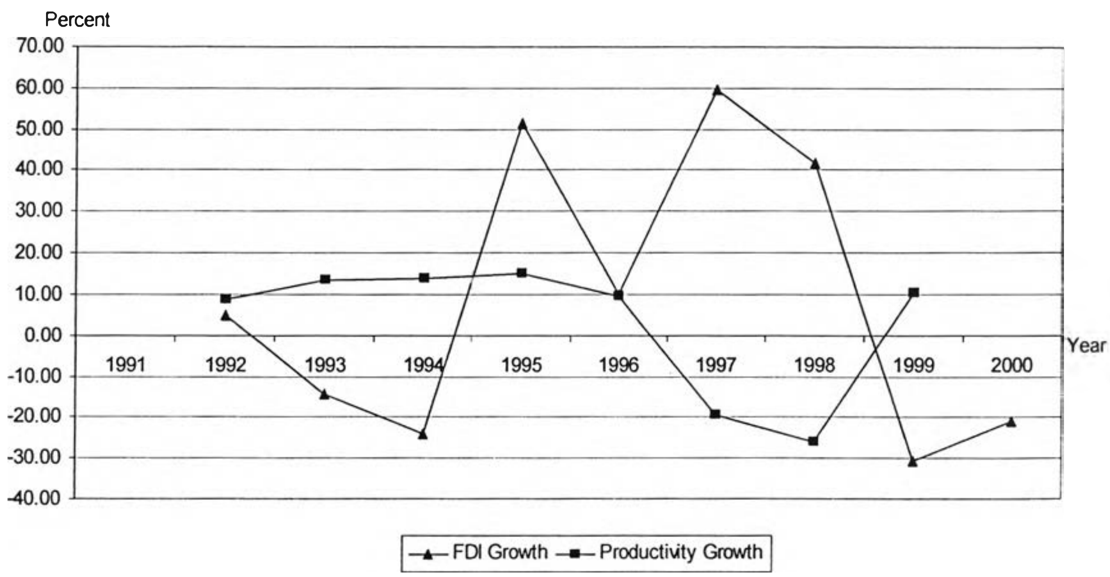


Figure 40: Thailand's growth in inward FDI, and Productivity of Labor during 1991-2000



In addition, the study supports the hypothesis that a depreciating exchange rate of Thai Baht is a positive determinant of the country's inward FDI. The correlation coefficient is 0.83. The coefficient is even higher to 0.91 when the data during the crisis period, 1998-2000, is excluded. Meanwhile, the correlation between the growth in depreciation rate and its inward FDI is similarly strong with the correlation coefficient of 0.66.

From the above statistics, the study cannot reaffirm that an increasing export value of the country positively, or negatively, determines the country's inward FDI. However, the study reaffirms that a depreciating exchange rate of the country is a factor that encourages the country's inward foreign direct investment.

Figure 41: Thailand's inward FDI, and Export during 1991-2000

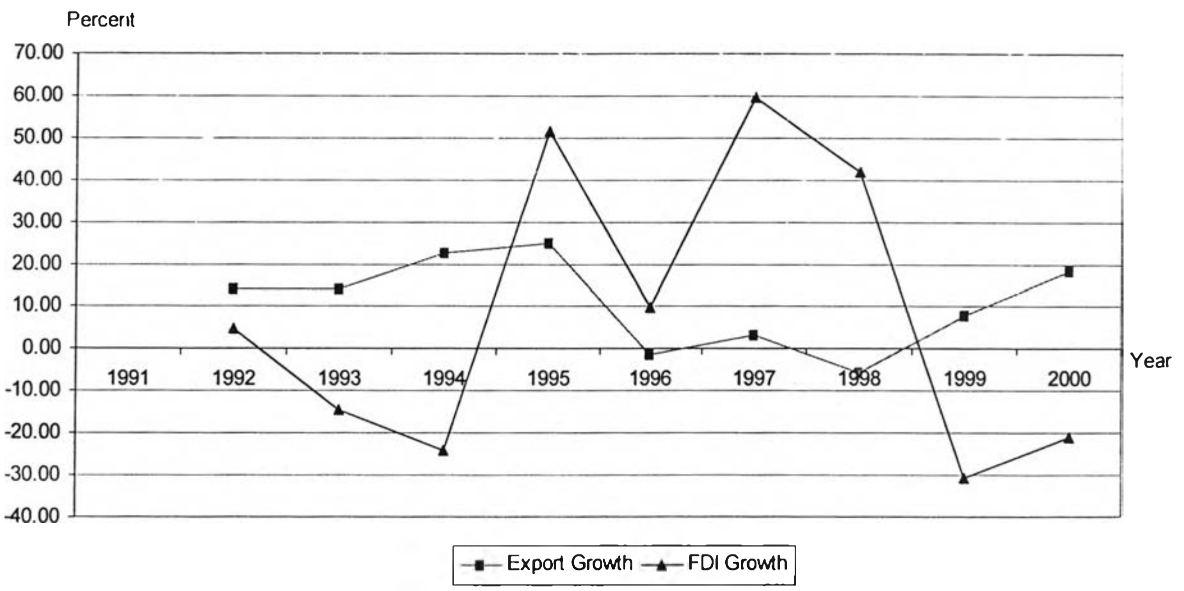
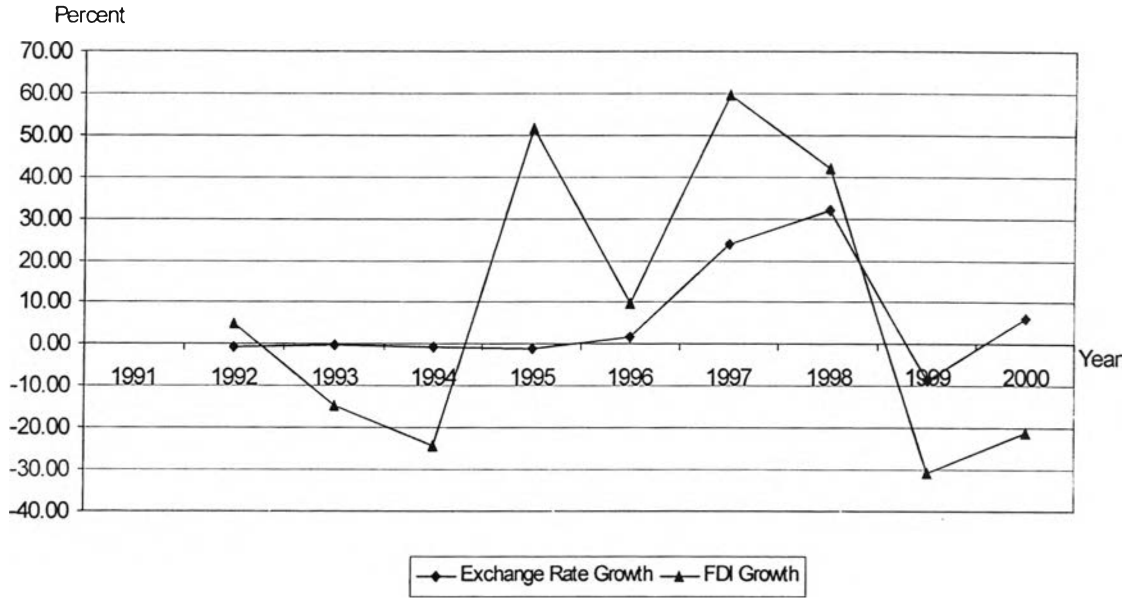


Figure 42: Thailand's inward FDI, and Exchange Rate during 1991-2000



4.4 Other determining factors

During 1990s, Thailand was successful in attracting inward investment flows. Manufacturing sector attracts the majority of flows. The automobile component manufacturing sector and electronic/electrical component sectors have attracted significant foreign investment. Delays in the financial restructuring and in the privatization are such obstacles for inward FDI.

Most of FDI inflows toward Thailand are labor-intensive and directed to either domestic market oriented or export oriented. However, the trend is about to change as the country start losing its international competitive from the raising wage and other production costs. (USTR, 2000)

FDI has been distributed into a few rural areas, particularly in the north. Low labor costs and flexible labor laws are Thailand's attractions for foreign investors. (Thailand Board of Investment [TBOI], -) Since 1997, the crisis period, a lot of restrictions have been removed. The regulatory environment has also been improved. The depreciation of Bath and local firms' bankruptcies provide foreign investors lower cost in M&A typed investment.

Ten export processing zones were established to encourage FDI. Numbers of incentives will be applied for investment in those areas, which would be varied according to type of investment, size, and location. (TBOI, 2002)

Financial system in Thailand is progressing through the though crisis. Non-performing loan and non-functional banking sector distort investor's modes of financing. (DOI, 1999) However, Thailand does not restrict foreign currency conversion and transfer.

For export-oriented investments, Thailand's numbers of bilateral agreement encourages the investors. Thailand has signed agreements with more than 25 countries, such as Germany, the Netherlands, the United Kingdom, China, and especially with the ASEAN countries. (DOC, 1999)

Nevertheless, Thailand still prohibits foreigners from holding a range of occupations. The reasons are accused as a protection of natural resources or national security concerns and as a barrier for those low income people who cannot easily compete with foreigners or wish to protect, such as telecommunications, constructions, handicrafts, transportation, farming, etc. (TBOI,-)

Besides, the country's laws for copyright and intellectual property protection were report to the U.S. State Department as "need of much improvement and enforcement". (DOC, 1999) Meanwhile, corruption and bribing are generally found in many levels of government branched. (DOC, 1999)

5. Conclusion

In the case of Thailand, the study does not strongly support either market size hypothesis or cost hypothesis as the weak correlation between the studied factors. However, the study's export hypothesis is partly support by the strong correlation coefficient between the country's exchange rate and its inward FDI.

Besides the major factors, Thailand was successful in attracting inward investment as it can provide investors with cheap labor, either skilled or unskilled. Also, comparing to other Asian countries, Thailand is one in of hi-technology country that has developed its financial markets and industrial infrastructure to serve investment projects.

However, foreign investment is still obstructed by political problems concerning corruption and intellectual properties. (DOC, 1999) Also, a rapid growth of the economy, leading to a bubble economy and high wages can distort the country's attractiveness to international investors.

Vietnam

1. Historical Background

France occupied all of Vietnam by 1884. Independence was declared after World War II, but the French continued to rule until 1954 when they were defeated by communist forces under Ho Chi MINH, who took control of the north. US economic and military aid to South Vietnam grew through the 1960s in an attempt to bolster the government, but US armed forces were withdrawn following a cease-fire agreement in 1973. Two years later North Vietnamese forces overran the south. Economic reconstruction of the reunited country has proven difficult as aging Communist Party leaders have only grudgingly initiated reforms necessary for a free market.

As a result of communist governed, Vietnamese business and production had been dominated by the government since the reunion till 1986, when Doi Moi policy was introduced.

Doi Moi policy has changed Vietnamese economy significantly and sustainably. The major missions of the Vietnamese government according to the policy are to release the government domination and restriction on private business, follow market mechanism, diverse types of business, reduce government intervention and subsidies, and to open the country for international business.

2. Economic Environment

Vietnam is a relatively low income, densely populated country that has had to recover from the ravages of war, the loss of financial support from the old Soviet Bloc, and the rigidities of a centrally planned economy. Substantial progress was achieved since the year 1986 when the government implemented it revolutive policy called "Doi Moi".

Doi Moi policy has helped the country to develop and enhanced its capability in production and productivity of business, particularly in agricultural sector. Before the policy had been implemented, the country faced difficulty in producing food and grains for its people. However after the time, the country can turn its status as a major exporter for rice. Meanwhile, more than fifty percent of state-owned enterprises has been privatized while the rest has been pushed hardly to increase their efficiency and productivity. Also, during 1986-1995, the country has economically grown by merely 9% in average.

In addition, since the policy has been into practice, the country has been opened and deregulated for international relations. Number of tourist travel to the country had grown by 20,000% in ten years. Value of exports has been expanded by 25% each year while import value has grown by 15% in average. Major export product of the country has still been agricultural product. However, the portion of industrial exports has been raised up dramatically from 8% in 1986 to 33% in 1991. After the period, the shares of agricultural product and industrial product to the total export value have stayed in the similar level of 30-35%.

In terms of international investment, the country's first international investment law was approved in the year 1986 as a result of Doi Moi policy. The law has been developed and rewritten regularly. In 1996, the new law has major aims to promote the country's export, particularly in agricultural sector and labor intensive industrial sector. Also, the country encourages environment-friendly hi-tech industry, infrastructure development, technology-transferred productions, and research and development activities. Meanwhile, the law provides investors huge tax incentives, low corporate tax.

The law also supports investment decentralization as today approximately 50% of international investments are concentrated in Ho Chi Mihn City and Hanoi. In addition, the investment also concentrated in industrial and service sectors. Major investors are Taiwan, Japan, Hong Kong, Singapore, and south Korea.

In 1994, the US. Government has allows privates and the government to trade with Vietnam, which was banned as a result of political reasons. This make Vietnam become more attractive for international investors, particularly for American business.

In 1997, when Asian financial crisis challenged the new market oriented economy to cope with the situation. From statistics, it is noticeable that the Dong's exchange rate is quite stable during the years of crisis (1996-2000). The standard Deviation of the movement lied at only 0.14. Meanwhile, the interest rate and whole sale price index did not shoot up as its neighbors, but decrease constantly.

In term of growth and export, Vietnam has performed very well during the period of study. It seems like the country did not suffer from the Asian crisis. Its GDP and Export value keep growing strong, contradict to neighbors.

GDP growth of 8.5% in 1997 fell to 6% in 1998 and 5% in 1999. Growth continued at the moderately strong level of 5.5%, a level that should be matched in 2001. These numbers mask some major difficulties in economic performance. Many domestic industries, including coal, cement, steel, and paper, have reported large stockpiles of inventory and tough competition from more efficient foreign producers; this problem apparently eased in 2000. Foreign direct investment fell dramatically, from $8.3 billion in 1996 to about $1.6 billion in 1999. Meanwhile, Vietnamese authorities have moved slowly in implementing the structural reforms needed to revitalize the economy and produce more competitive, export-driven industries. (IMF, 2000)

Vietnam's economy depends largely on export. Its major export products are rice, coffee, cashews, and rubber. (DOC, 1999)

Table 22: Vietnam's Economic Indicators

Category	Year									
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Exchange Rate	N/A	N/A	N/A	10,966	11,038	11,033	11,683	13,268	13,943	14,168
Export (M. USD)	N/A	N/A	N/A	5,537.57	6,804.31	10,076.77	11,570.66	12,203.04	14,332.35	17,038.47
FDI (M. USD)	N/A	N/A	N/A	N/A	N/A	1,803	2,587	1,700	1,484	1,289
GDP (B. USD)	N/A	N/A	N/A	16.28	20.74	24.66	26.84	27.21	28.68	31.35
Labor Force (Thousands)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Lending Interest Rate	N/A	N/A	N/A	N/A	N/A	20.10	14.42	14.40	12.70	10.55
PCI (USD)	N/A	N/A	N/A	224.53	280.38	327.19	357.54	357.50	371.94	403.50
Population	N/A	N/A	N/A	72.51	73.96	75.36	75.08	76.11	77.12	77.69
Unemployment Rate	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
WPI	N/A	N/A	N/A	N/A	N/A	5.70	3.40	7.90	4.80	-2.10
Productivity of Labor (USD)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

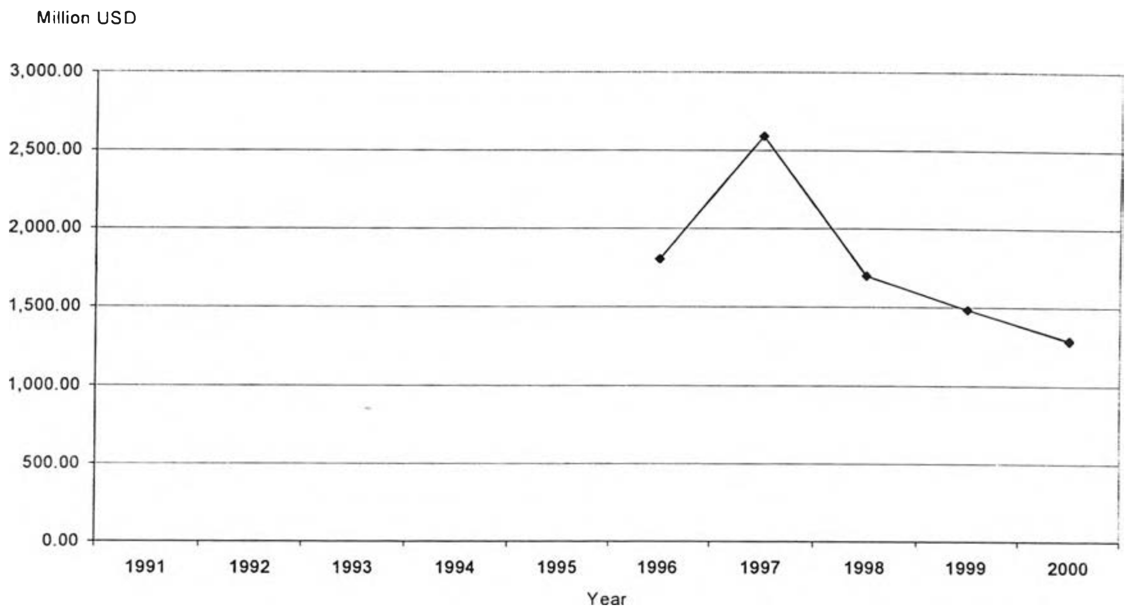
Source: IMF, International Financial Statistics, Various Editions

3. Investment Climate

An advantage characteristic of Vietnam on FDI attraction over its neighbors; like Myanmar, Laos, and Cambodia, is its openness – both economically and geographically. The country stated out very clearly that all investments in Vietnam are always welcome unless it infringes the nation's security, independence and sovereignty. Also, hundred per cent foreign-ownership is possible. Hence, the country can attract more FDI, compared to those countries.

By the end of 1997, the Vietnamese government has licensed more than 2,200 foreign investment projects, valued at 31.4 billion U.S. dollars. (DOC, 1999) By 1999, approximately 70 nations have invested in the country. More than 2,400 foreign firms have been licensed. Those licensed projects worth more than 35 billion dollars. (United Nation [U.N.], 2002) The important sources of FDI in Vietnam are Singapore, Taiwan, Hong Kong, Japan, and South Korea. (DOC, 1999)

Figure 43: Foreign Direct Investment in Vietnam during 1991-2000



Source: UNCTAD, World Investment Reports

4. <u>FDI and Major Economic Factors Relationship</u>

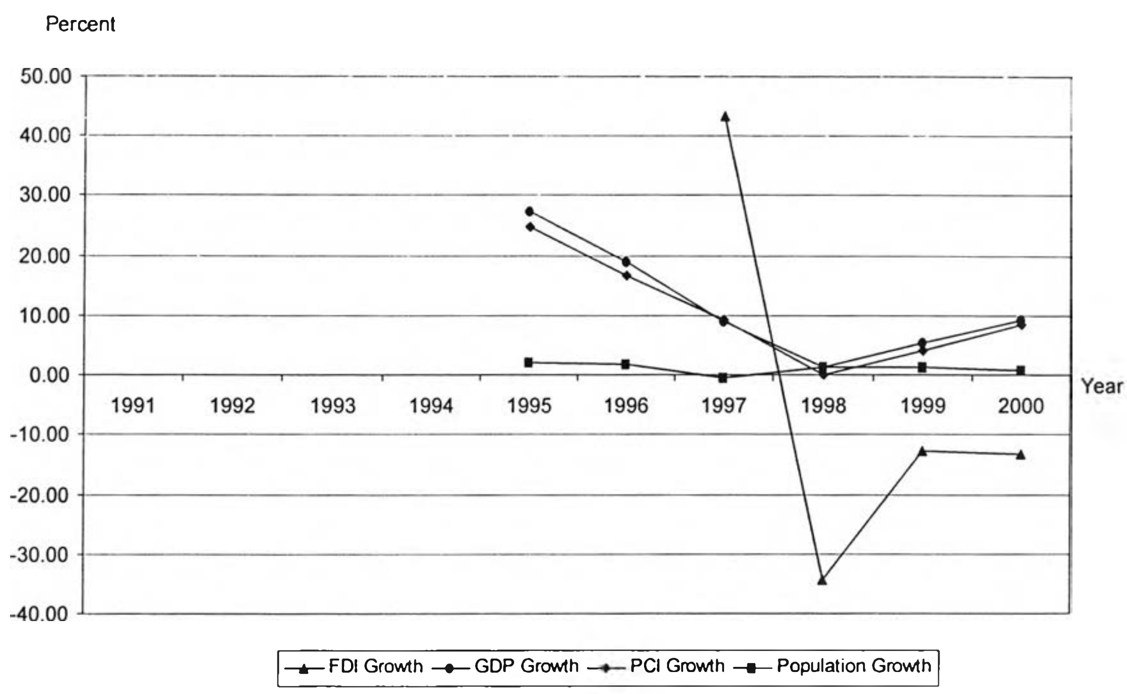
4.1 Market Size Hypothesis

Vietnam's economic data during 1996-2000 shows a contrast relationship between the country's market size and inward FDI to the study's hypothesis. The correlation coefficient between the country's inward foreign direct investment and its change in GDP is computed as –0.57. Meanwhile, that between FDI and the country's growth in per capita income is –0.50. This is similar to several other Asian countries that their increasing market size is negatively related to the amount of inward FDI to the countries.

However, the study reports that the growth of the country's market size is positively related to the country's inward FDI. This is supported by the correlation of 0.68 between the country's growth in GDP and the country's growth in inward FDI. Moreover, the country's PCI is correlated to its inward FDI with the correlation coefficient of 0.77.

By these coefficients, the study cannot reaffirm that an increasing market size of the country can encourage higher level of inward FDI to the country. This is because the data shows negative relations, which is contrast to the study's hypothesis and economics theories. However, the study reaffirms that a significant growth of the country is an encouraging factor toward FDI inflows.

Figure 44: Vietnam's Growth in inward FDI, GDP, Per Capita Income, and Population during 1994-2000



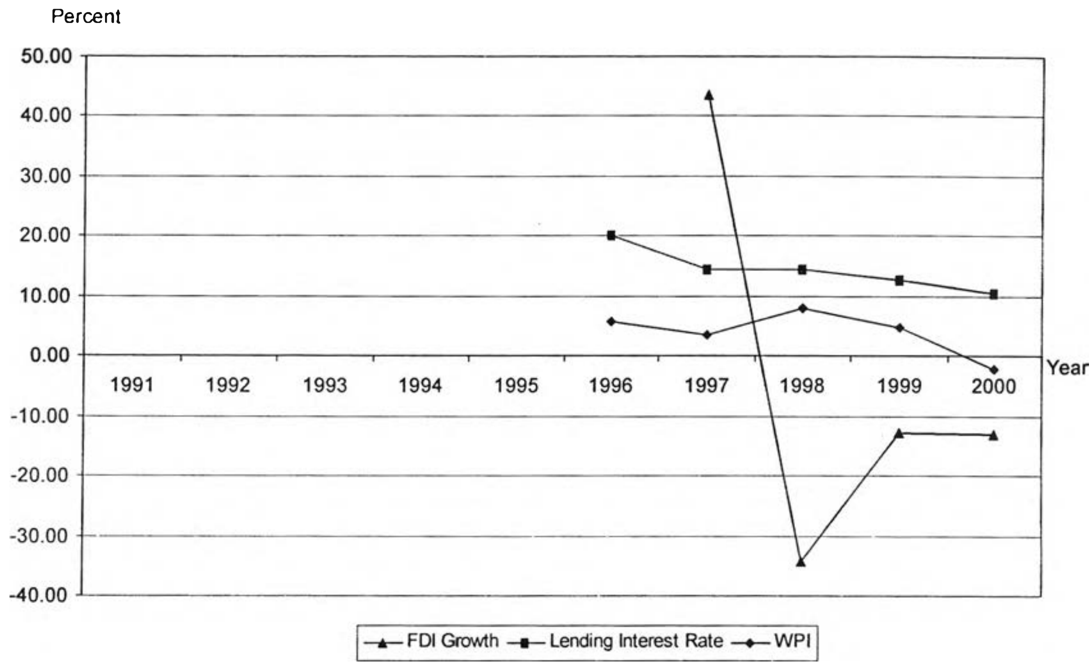
4.2 Cost Hypothesis

In addition, the study reports a weak relationship between the country's cost of lending and its inward foreign direct investment. The correlation coefficient between the country's inward FDI and the country's interest rate is reported as low as 0.36. Meanwhile, the growth of inward FDI to the country is correlated with the country's one-year lending interest rate with the correlation coefficient of only 0.27. This supports the hypothesis that the country cost of capital, measured by one-year interest rate is not a determinant of inward FDI to Vietnam during 1994-2000.

Besides the cost of investment, the study also reports a weak relation between the country's increasing cost of production, measured by WPI, and the country's inward FDI as the factors are correlated to each others with the correlation coefficient of only 0.27. Meanwhile, the study report that and increasing inflation rate of the country negatively related to the country's growth in inward FDI with the correlation coefficient of –0.23.

As a result, the study's results do not support the cost hypothesis in the case of Vietnam by employing the data during 1996-2000.

Figure 45: Vietnam's growth in inward FDI, labor force, Interest Rate, and WPI during 1991-2000



4.3 Export hypothesis

In terms of export hypothesis, the study found that Vietnam's export value is negatively correlated to its inward FDI with the correlation coefficient of –0.66. Meanwhile, the country's export growth is correlated to its inward FDI growth with the correlation coefficient of 0.37.

In addition, the country's depreciation in exchange rate discourages inward FDI with the strong correlation coefficient of - 0.72. Besides, the study reports that a high depreciation rate of the currency exchange rate induce to a lower growth in inward FDI with the correlation coefficient of –0.37.

As a result, the study does not support the export hypothesis in the case of Vietnam, by using the data during 1996-2000. This should be because of the Asian crisis and global trends that disfigures the relations between the factors.

4.4 Other determining factors

Regarding Vietnam's rapid economic growth in early 2000s, Vietnam has attracted a number of foreign investors. The investments are highly concentrated in Ho Chi Minh City and Hanoi, and are both directed to domestic market-oriented and export-oriented industries. FDI toward Vietnam are mostly labor intensive as the country has a very competitive labor cost. (Permanent Missions to the United Nations (PMUN), -)

Figure 46: Vietnam's inward FDI, and Export during 1991-2000

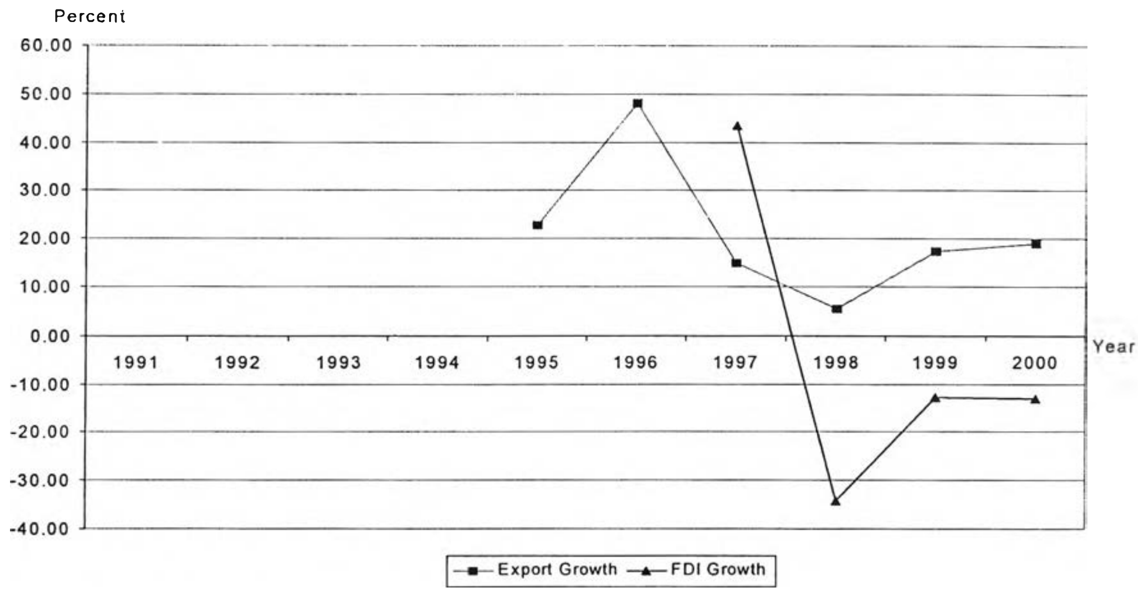
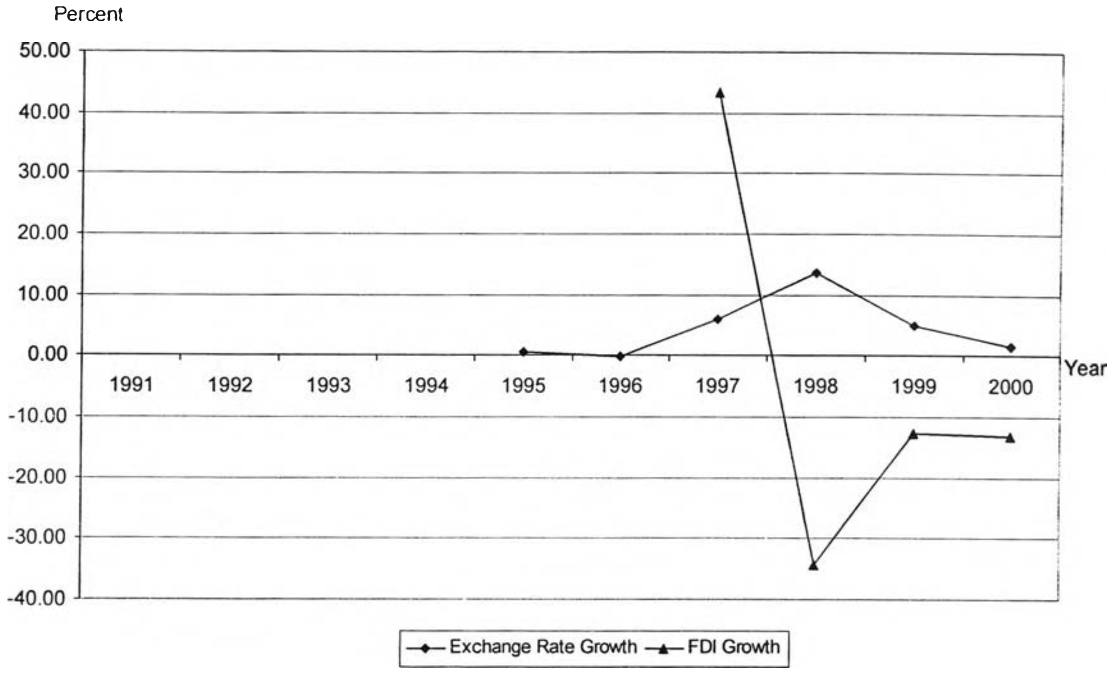


Figure 47: Vietnam's inward FDI, and Exchange Rate during 1991-2000



The Vietnamese government has a major goal to attract capital, advanced technology, and management skills from foreign firms. (U.N., 2002)

As a communist governed state, Vietnam tries to follow the Chinese way. Continuous reviews are made on policies, strategies. Reforms have been applied widely, in de-collectivization of agriculture, land reforms, price reforms, for example. (DOC, 1999)

Formerly, the country's policy was to attract heavy FDI into the nation. Later, the policy has changed towards agriculture, light industry, and export. (DOC, 1999) Vietnam is undertaking bilateral discussion to settle special trade agreement with the United States. Also, it is underway for WTO accession. (DOC, 1999)

However, it is discovered that the obstacle of FDI attraction are every level of government corruption, duel-pricing policy to discriminate foreigners, bureaucratic red tape, and lack of transparent foreign investment related laws, regulations, and procedures. (Vietnam Venture Group [VVG], 2001) The U.S. Bureau of East Asian and Pacific Affairs had reported to the Department of State that Vietnam's economy involves a great degree of political risk-taking. (DOC, 1999)

Reforms are not really complemented by the government for various political reasons and bureaucratic interests. (DOC, 1999) The government has such an urgent mission to reform and/or develop its financial sector, state-owned enterprises, and exchange rate system. IMF's Executive Board, 2000, stated that the ease of exchange rate control would provide more confidence to international investors. The directors encouraged the country to increase flexibility and simplify the country's exchange rate system. (IMF, 2000)

5. Conclusion

In conclusion, neither market-size hypothesis, cost hypothesis, nor export hypothesis are strongly supported by this study. The reason is subjected to the fact that the data is limited only during 1996-2000, when the global investment communities are passing through a structural change inducing by Asian crisis.

However, the study reports that a rapid economic development of the country during the decades shall make the country more attractive to international investors. However, the government may have to control the quality of growth and provide investors with price stability, either in terms of interest rate, inflation, cost of labor, or exchange rate.

Moreover, there are many other factors that make the country become more attractive to international investor than before. The study reports that a fresh and nourish natural resources of the country is one of the factors that attract investors' interest. Besides, the fact that Vietnam is located just next to China and the Vietnamese cultures and value are quite a similar that of Chinese is another encouraging factor for investors that aim to expand their investment to the Chinese economy. Also, a special bilateral trade agreement with the United States and its progress on WTO accession are encouraging foreign investment to flow into the country.

However, the study discovers that the obstacle of FDI attraction concern political corruption, duel-pricing policy to discriminate foreigners, bureaucratic red tape, and lack of transparent foreign investment related laws, regulations, and procedures.

Summary

In summary, the study's hypothesis, either market-size hypothesis, cost hypothesis, or export hypothesis, are partly supported. The study reports that market-size hypothesis and export hypothesis are supported in most of the cases. Meanwhile, export hypothesis is reaffirmed by several nations' evidence. However, cost hypothesis is rejected in most cases.

The first hypothesis, which is market size hypothesis, is supported by the positive relationship between the proxies and the value of inward FDI in several East Asian countries. The size of market, measured by GDP and PCI, is accepted as a positive determinant of inward FDI, in a half of the samples, which are China, Indonesia, Korea, and the Philippines. However, the proxy is not valid in the case of Hong Kong, Malaysia, and Thailand. Also, the study cannot accept the positive correlation between market-size and inward FDI in Vietnam, where the data is limited only in 1996-2000. Besides the GDP and PCI, the study reports a strong relation between inward FDI and population in the countries. The relation is reported by most of the countries, except Malaysia. In addition, the growth of market size is reported with the positive correlation with the inward FDI only in the case of Korea and Vietnam. However, in the case of Thailand, the study reports a negative relationship.

The second hypothesis, cost hypothesis, is weakly supported. The cost of lending is reported as a positive indicator of inward FDI only in the case of Korea and Malaysia, and as a negative indicator of inward FDI in the Philippines. Meanwhile, the relations are inconclusive in other nations. In terms of inflation, the study reports a negative relation between the proxy and the inward FDI in the case of Hong Kong, Korea, and Thailand. However, by studying the correlation between the growth of inward FDI and the cost, either interest rate or WPI, the study reports either weak or negative correlation between the factors.

The export hypothesis is lastly accepted as a strong indicator of inward FDI in most of the nations, except Malaysia and Thailand. The study reports a positive relation between the value of exports and inward FDI in five countries, out of eight, which are China Hong Kong, Indonesia, Korea, and the Philippines. Meanwhile, the growth of exports is also accepted as a positive indicator of inward FDI in Hong Kong, Indonesia, and Korea. Besides the exports, exchange rate is reported with a positive relationship to the value of inward FDI in four countries, which are China, Indonesia, Korea, Thailand, and Vietnam.All in all, the study concludes, by applying the correlation coefficient computed, that the market size hypothesis and the export hypothesis are supported by the study, whilst the relationship between inward FDI and the cost hypothesis is inconclusive. (Table 23, 24, 25)

Beside the hypothesis that are tested and reaffirmed, the study reports that there are several other factors that determine the value of inward FDI. In China, its accession to WTO is a major factor that encourages a higher investment in the country, leading to a high growth in inward FDI as well. In Hong Kong, the fact that the country can provide investors with market confidence, in price and exchange rate stability, and better infrastructures, concerning sound financial and capital markets and telecommunication network is an outstanding factor that influent inward FDI. Also, the country's location, next to the Chinese main land, the mixed cultures of British and

Chinese, and the bilingual labor are the factors that determine the huge amount of FDI to the country, compared to other countries as well. In Indonesia and the Philippines, the economic instability, civil unrest, and corruption practices are the factors that discourage inward FDI to the country. In Korea, the skilled labor of the country, the export promotion policies, and FDI deregulation of the government help encouraging more FDI to the country. In Malaysia, the shortage of skilled labor, the increasing cost of labor, and the restrictions on international activities are the major obstacles that kept the FDI value of the country remain low, compared to the others. In Thailand, it is reported that the increasing cost of labor and the corruption practices are the major obstacle of the country's inward FDI. Lastly, in the case of Vietnam, the fresh natural resources, the newly opened economy, and the country's specific economic relations with China and the United States are the major factors that encourage a large amount of FDI to flow into the country during the period. However, restrictions, regulations, and bureaucratic red tape are still the major obstacle on the country's inward FDI.

Table 23: Sign Reported by Correlation Coefficients between Countries' Inward FDI and the Proxies for Market Size Hypothesis and Cost Hypothesis

Country	GDP	PCI	Population	Interest Rate	WPI	Productivity
China	+	+	?	?	?	-
Hong Kong	?	?	+	?	-	?
Indonesia	+	+	+	?	+	+
Korea	+	+	+	+	-	+
Malaysia	?	?	?	+	?	?
The Philippines	+	+	+	-	?	+
Thailand	?	?	+	?	-	?
Vietnam	-	-	+	?	?	?

Table 24: Sign Reported by Correlation Coefficients between Countries' growth in Inward FDI and the Proxies for Market Size Hypothesis and Cost Hypothesis

Country	GDP Growth	PCI Growth	Population Growth	Interest Rate Growth	WPI Growth	Productivity Growth
China	?	?	?	?	+	?
Hong Kong	?	?	-	?	?	N/A
Indonesia	?	?	?	?	?	?
Korea	+	+	?	?	?	+
Malaysia	?	?	?	+	?	?
The Philippines	?	?	?	?	?	?
Thailand	-	-	-	?	?	-
Vietnam	+	+	+	?	?	?

Table 25: Sign Reported by Correlation Coefficients between Countries' Inward FDI and the Proxies for Export Hypothesis

Country	Export	Exchange Rate
China	+	+
Hong Kong	+	?
Indonesia	+	+
Korea	+	+
Malaysia	?	?
The Philippines	+	?
Thailand	?	+
Vietnam	-	-

Table 26: Sign Reported by Correlation Coefficients between Countries' Growth in Inward FDI and the Proxies for Export Hypothesis

Country	Export Growth	Exchange Rate Growth
China	+	+
Hong Kong	+	?
Indonesia	+	-
Korea	+	-
Malaysia	?	?
The Philippines	?	?
Thailand	?	+
Vietnam	?	?

Noted: 1. Signs are determined by the value of the correlation coefficient (r). ("+" is denoted when r ≥ 0.5, "-" is denoted when r ≤ -0.5, and "?" is denoted when – 0.5 ≤ r ≥ 0.5)

2. The signs are basically shown according to the correlation coefficient computed from the data during 1991-2000. However, if there is any significant difference between the sign and that during 1991-1997, the sign of 1991-1997 is presented instead.

3. The signs represent the value of correlation coefficient, but do not represent any cause and effect relationship.