The Economic Uncertainties among Asian Countries and Prospects for Increased Foreign Direct Investments to the Region

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Roundtable Discussion Sponsored by the Merrill Lynch Center
Wednesday, April 2, 2003

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❖ Introduction

- The Asian economic and financial crisis of 1997 left many of the countries in this part of the world economically paralyzed with devastating results.
- A postmortem of the crisis underscored the precarious nature of the economic foundation of many of the developing countries. Structural weakness combined with weak fiscal & monetary policies was the undoing of these economies. In addition, international and global financial markets through investor panic accelerated the downfall.
- Specifically:

1) Many of the Asian companies relied too much on bank debt to finance their growth.
2) Lack of development of bond and equity markets forced companies to rely on bank debt.

Introduction contd.

3) Many of the Asian banks borrowed dollars from international banks and lent the money to local companies.
4) Some of these companies were involved in less productive and speculative industries such as resorts, golf clubs, large commercial buildings with an expected downturn in the real estate markets.
5) Some of the Asian companies that borrowed dollars directly from foreign banks could not generate local currency to pay off the debt.
6) Many of the companies in Asia lacked the financial reporting transparency that is required by the regulators in the industrialized countries, and hence investors had no clue of the financial health of these companies.
7) The rampant cronyism that exists in many of the Asian countries between government agencies, banks and corporations further exacerbated the problem.
8) When many of the Asian currencies fell against the dollar, most of the banks could not service their loans and went into bankruptcy.

Why Invest in Asia?

- In spite of the problems faced by the countries of the region a few of them have rebounded and are again robust.
- Asia again is enjoying a year of growth. Of course, some countries like China, India, and Taiwan were not part of the countries such as Indonesia, South Korea, Singapore, and Thailand that felt the brunt of the 1977 crisis.
- Though Japan has flagged behind, China's rapidly evolving economy is soaring ahead.
- The old 'tiger' economies like Malaysia and Thailand have been posting strong export growth.
- The region is now the world's biggest factory floor. The region has become the global manufacturing center, producing everything from textiles and toys to sneakers and electronic products

Why Asia contd.?

- The International Monetary Fund has forecast a moderate growth for the region.
- It is the factor accumulation of the region that is impressive. Through high investment in both physical and human capital by the policy makers, the region has gained substantially in factor inputs compared to other regions of the world.
- The productivity performance [total factor productivity (TFP)] of the region has been stronger than expected.
- The population profile (demographics) of Asian countries provides a rising labor force.
- Economic development in many countries in this region has occurred rapidly from an initial position of economic backwardness and this has led to some useful financial institutions.
- The growth in this region is not uniform across countries. China, S. Korea, Singapore, and Taiwan are growing rapidly. India, Malaysia, and Thailand are growing moderately. Indonesia and the Philippines are still struggling.

Current Economic Conditions in Asia

- The current economic statistics for 9 of the Asian countries is presented in Table 1. The 9 countries that are analyzed here are:

1) India
2) Indonesia
3) Japan
4) Malaysia
5) Philippines
6) Singapore
7) South Korea
8) Taiwan
9) Thailand

Current Economic Conditions contd.

- India:
  - India's GDP grew 5% in 2001. This follows a robust rate of growth of 6.7% and 6.4% in the preceding 2 years. Between 1997 and 2001, the GDP grew by an average of 5.8%. Considerably higher than many of its neighbors.
  - The inflation rate declined to about 5% in 2001. India's inflation rate for the previous 5 years averaged about 7.3%.
  - The lending rate in India over the past 5 years has remained quite high. Average lending rate has hovered around 13%. This is causing some problems for the industrial sector. The industrial sector has slowed considerably in the last 5 years.
  - The FDI flows and the balance of payments (BOP), especially the current account balance is small relative to the size of the economy. India's BOP has been characterized by modest current account deficits and small financial account surpluses.

Current Economic Conditions contd.

- Indonesia
  - Indonesia's GDP grew by 3.3% in 2001, down from 4.8% in 2000. For the 5 year period, its GDP growth averaged 3.5%. Since the economic and financial crisis of Asia in mid 1997, Indonesia's standard of living has fallen precipitously. The value of the rupiah against the US dollar is about 25% of what it was at the beginning of 1997.
  - The inflation rate has decreased substantially from its 75% rate in 1998. For the 1997-2001 period the average inflation rate is 29.9%.
  - The lending rate in Indonesia is one of the highest in the region, it has averaged nearly 24%, depressing industrial output.
  - Prior to 1997, large international capital inflows financed the import of capital equipment and consumer goods for an expanding middle class. Since then, Indonesia is averaging a negative FDI of 6 billion US dollars.
  - Indonesia's unemployment rate is also one of the highest in the region at 15%.

Current Asian Economic Conditions contd.

- Japan

- Japan’s real GDP increased by 1.8% in 2001. Japan is only averaging GDP growth rates of less than 1%. The economy entered recession again in 2001. Japan’s economy has been in tailspin for some time now and this is causing some concerns to its investors and neighbors. Generally the anchor economy of the region, Japan has suffered through a long period of economic contraction.
- The deflation in prices across the range of consumer, investment and export sectors continued in 2001 as the price level declined by about 1%.
- With low interest rates of about 2.2%, the government is pushing for a renewed growth in its industrial sector.
- Even the large current account surpluses that Japan used to run up seemed to have slowed to just 107 billion US dollars.
- Japan’s unemployment once at about 3% is now over 5.5%.

Current Economic Conditions contd.

- Malaysia
  - The real GDP of Malaysia grew by just 0.4% in 2001. For the previous 5 years Malaysia’s GDP grew by an average of just 3%.
  - Malaysia’s lending rate has averaged about 8% helping the industrial sector to post a modest growth rate.
  - Since 1998 (after the Asian crisis) Malaysia has maintained a substantial current account surpluses. With the much weaker ringgit, Malaysia’s exports became much more attractive. In the year2001, Malaysia posted a trade surplus of US$18.4 billion.
  - Foreign direct investments that propelled the economy for years is now averaging only 3.5 billion US dollars.
  - With low levels of unemployment and with focus technology, Malaysia has the potential to post higher growth rates in years to come.

Current Economic Conditions contd.

- Philippines

- Philippine economy grew at a modest rate 3.2% in 2001. From a low growth rate of 0.6% in 1998, the economy has been averaging a growth rate of 3% over the past 4years.
- With lending rates at about 13%, Philippines is facing a slowdown in its industrial sector.
- Foreign Direct Investment flows to the Philippines has been modest in recent years averaging about 0.5 billion per year.
- Inflation rates have steadied in the past few years. The average inflation rate for the years 1997-2001is 6.5%.
- Unemployment in the Philippines has remained stubbornly high following the Asian crisis. During 2001, the average unemployment rate was 11.1%, about the same as it had been during 2000.

Current Economic Conditions contd.

- Singapore
  - In the last few years, Singapore has faced some challenges that is reflected in its GDP growth rates. Real GDP fell by 2.2% in 2001. Singapore's average GDP growth rate for the past 5 years is about 4.7%.
  - Singapore's economy is based on importation of raw materials and commodities for refining, reprocessing, and manufacturing for export markets. As the financial center for the region, Singapore is able to sustain positive trade balances with its neighbors.
  - Singapore had a modest inflow FDI's and runs a strong current account surplus. During 1998-200, the surpluses amounted to 25% of GDP and averaged in excess of US$21 billion per year.
  - Unemployment declined sharply from 3.2% in 1998 to 2.2% in 2000. For the 5 year period, Singapore's unemployment is only 2.7%.

Current Economic Conditions contd.

- South Korea
  - With a better mix of domestic consumption and investment than many of its neighbors, S. Korea has sustained very good growth rates. In 1999 and 2000, its economy grew by 9.35% and 10.9% respectively.
  - With an inflation rate of 4.0% and interest rates at about 10%, S. Korea's industrial production and overall consumption has remained healthy.
  - The current account balance has declined in recent years from a high of 40 billion US dollars that it achieved in 1998. For the years 1998-2001, the current account balance is about US$ 15.5 billion.
  - The unemployment rate has continued to decline and is at 3.7% now. For the 5 year period, the unemployment in S. Korea is averaging 4.7%.

Current Economic Conditions contd.

- Taiwan
  - In 2001, Taiwan had a negative growth rate. For the first time in 3 decades that has happened. One of the most successful economic models in this region, Taiwan has averaged about 8% real growth in GDP during the past 30 years.
  - Taiwan has very low inflation rate (1%) and reasonably low lending rate (5.8%).
  - Exports have been the primary engine for industrialization. With the 3rd largest foreign reserves and substantial trade surplus, Taiwan has one of the most dynamic economy in the region.
  - Unemployment rose slightly during 2001 to 4.5% compared to an average of 2.8% in the previous years.

Current Economic Conditions contd.

- Thailand
  - Thailand’s GDP growth has been a concern to its policy makers. For the 1997-2001 years, Thailand had a negative growth rate. In 2001, GDP grew by 1.8%.
  - Thailand has a sufficiently broad mix of export items that should enable the country to do well in the coming years.
  - From a net inflow of capital from abroad of close to US$20 billion in 1996, the financial account reversed during 1998-2000 and Thailand suffered a capital outflow of US$9billion per year.
  - Inflation rates (3.2%) and unemployment rates (2.6%) are under check and expected to remain low.
  - A significant problem continuing to plague Thailand’s economy is the large volume of non-performing loans which at present is over US$60 billion.

Prospects for Foreign Direct Investments to Asia

- The Asian economic crisis dealt a severe blow to the region's overall economy. Though the crisis only affected Indonesia, Malaysia, Singapore, South Korea, and Thailand the effects of the crisis was also felt in the neighboring countries.
- Slowly many of the countries have recovered from the crisis, but still remain mired with problems.
- The more industrialized economies of the region, countries like China, Singapore, South Korea, and Taiwan are expected to grow and attain stability. Others, such as India, Malaysia, and Thailand are expected to grow moderately. Indonesia and Philippines are struggling.
- Surprisingly, the second largest economy in the world, Japan, is struggling with negative growth rates and rising unemployment. Its banking system is struggling to recover from large non-performing loans and policy makers have yet to take any bold actions that conveys confidence in the system.

Prospects for FDI in Asia contd.

- Driven by the recent wave of cross-border mergers and acquisitions (M&A) global FDI outflows have been steadily rising. The effect of the FDI inflows into developing countries, especially in Asia as fueled these economies at a faster rate than ever anticipated.
- Given the economic importance of FDI, many developing countries have made their policies more favorable to investors.
- Even in Japan, a country that was regarded as extremely difficult to enter by foreign investors, M&As have flourished. This in spite of the traditional Japanese view that M&As are not suited to the business culture. In recent years both GE and Renault of France acquired Japanese companies at US$6.6 billion and US$5.4 billion respectively.
- Inflows of FDI Asian countries is on the rise. Some of the Asian countries have attracted more than some others countries.
- The countries that have attracted considerable amount of FDI in the region include Singapore, South Korea, and Taiwan.

Prospects for FDI Flows Into Asia contd.

❖ Countries that will attract most of the foreign investments in the region are:

1) China – stable economy, more liberal investment policies, skilled work force, low wages, and proximity to markets. China is already being labeled “The Manufacturing Floor Of the World.” Joining the WTO should further help China in drawing more FDI funds. <u>Will continue to attract FDI.</u>
2) Singapore – highly skilled labor force, excellent infrastructure, major financial center, sound policies, with one of the largest container ports in the world. <u>Will continue to attract FDI</u>.
3) Taiwan – has one of the strongest economies in the region. The country is also a heavy investor in China. Has drawn investments from a diverse group of countries. <u>Will remain attractive to foreign investors.</u>

Prospects of FDI Flows Into Asia contd.

4) South Korea – has enjoyed a FDI boom for the last 3 years. The country has completely repaid its IMF loan package that was used to rebuild the economy after the 1997 crisis. Its foreign currency debt rating has moved back to a solid investment grade fro 'junk' status. <u>South Korea is expected to be very attractive to foreign investors</u>.

5) India – deregulations of industries and the size of the market has enabled India to attain moderate economic success. The economy achieved very good growth rates on the strength of domestic consumption. The downturn in technology related companies in the US and Europe has hurt exports and may affect the economy. <u>The size of the market will attract FDI inflows to India</u>.

6) Malaysia – has recovered admirably from the 1997 crisis without much help from the IMF or other foreign institutions. By focusing more on manufacturing, the country has slowly moved away from its reliance on raw materials and exports of such commodities. The economic scene is stable, but the political environment is not. The long-term outlook for Malaysia is clouded by the political uncertainty over the succession plan for Prime Minister Mahathir and his state-controlled economic policies. <u>Malaysia may attract a modest amount of FDIs</u>.

Prospects for FDI Flows Into Asia contd.

7) Thailand – through the help of IMF and belt tightening, Thailand has recovered fully form its economic crisis. The government is sensitive to foreign investments and has developed a multifaceted economy embracing industries that employ latest technology. <u>Thailand should continue attracting substantial amounts of FDI in the next few years</u>.

8) Philippines – was marginally affected by the Asian crisis and still has remained one of the weak economies in the region. Political uncertainty, fragmented economic policies, corruption, and security issues have further damaged the confidence of foreign investors. Philippines is still at a crossroad and is not expected to fare well. <u>At the present time Philippines is not expected to be an attractive country for foreign investors</u>.

9) Indonesia – is one of the economically weakest countries in the region. Burdened with increasing debt, high inflation and unemployment and an unstable political environment, the country is expected to have difficulties reaching its economic targets. <u>The prospects of FDI inflows do not look good for Indonesia</u>.

Prospects for FDI Flows Into Asia contd.

10) Japan – is undergoing wrenching economic problems. The country's policy makers are not sure how to tackle the myriad of problems faced by the country. The traditional methods of stimulating the economy, such as public work projects and very low interest rates, have not worked. The rising yen has not helped either. It is crucial that the Japanese economy rebound to its earlier glory days to spur the economies of its neighbors. <u>In spite of its economic woes, Japan is considered an excellent candidate for FDI</u>.

- ✓ <u>War clouds</u>

- ✓ Asia which is expected to be a major driver of global economic growth this year, has been feeling the ill effects of the crisis in Iraq.

War Clouds

- The run-up in oil prices has raised the cost of producing goods and getting them to market.
- If the war in drags on for months, Asian economies may loose some the momentum that has been built over the last 3 years.
- A drawn out war could lead to declining exports that will further hurt a very tenuous economy.

- Conclusion

- Asian economies have attained stability after the 1997 economic crisis through sound policies, a shift in industrial output, lower inflation rate, and higher FDI flows.
- Some countries such as China, Singapore, South Korea, and Taiwan should be getting a disproportionately greater share of the FDI flows to the region. India, Malaysia, and Thailand have the potential to attract moderate amounts of FDI.

Conclusion contd.

- Indonesia and Philippines are two countries that may have difficulty attracting FDIs. These two countries need to drastically change their policies and establish political stability.
- Japan is problem in itself. Until its policy makers attack the banking and real estate loans crisis, Japan will have difficulties attaining even modest growth rates.

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Table 1
Asia – Current Economic Data (1997 -2001 average)

Factor	India	Indon.	Japan	Malay	Phillip	Singa	Korea	Taiwa	Thai
GDP/ Capita	1683	2722	22048	10308	3361	23095	12667	16280	6169
GDP Gr.r %	5.8	3.5	0.7	3.0	3.1	4.7	4.3	4.2	(1.1)
Infl. %	7.3	29.9	0.1	3.0	6.52	0.92	4.0	1.0	3.2
Int. rate %	13.0	23.7	2.2	8.2	13.6	6.2	10.6	5.8	10.4
FDI ($ Mil)	2630	(6251)	6736	3455	488	8591	6014	2887	3780
BOP C.acct ($bill)	(2.59)	19.88	107.5	6.1	4.5	17.6	15.5	9.2	7.8
Unem	4.4%	15%	4.4%	3.0%	9.5%	2.7%	4.7%	3.2%	2.6%