Chapter 43
What Attracts Foreign Direct Investments in Asian Economies?
An Institutional Approach to FDI

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ABSTRACT

This chapter focuses on institutional configurations in host economies and examines the configurations that had a high propensity for foreign direct investment (FDI) inflows in Asian economies. While many previous studies on the relationship between FDI and growth focus on institutions in host economies, they are apt to search for one and/or best institutions. They do not perceive heterogeneous sets of linked institutions. This chapter contributes to the existing literature in a twofold manner. First, this analysis, based on multiple factor analysis, demonstrates a substantial variation in institutional configurations across Asian economies in attracting FDI. These Asian economies can be categorized into three clusters. Second, the fuzzy-set quality comparative analysis shows that two of the institutional configurations have a high propensity for FDI. The one found in Singapore relies on institutional complementarities similar to liberal market economies, while the other one, which is characteristic to Thailand, focuses on human capital formation in Asian welfare capitalism.

INTRODUCTION

Foreign direct investment (FDI) has gained importance in increasingly globalized Asian economies since the 1990s. However, some Asian economies seem to have attracted more FDI than others. This chapter focuses on institutional configurations in host economies and examines those institutional configurations that created greater potential for FDI inflows in Asian economies in the 2000s. While many previous studies on the relationship between FDI and growth focus on institutions in host economies,

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they are apt to search for one and/or best institutions in order for host economies to attract FDI. They do not perceive the relationship between institutional configurations, i.e., heterogeneous set of linked institutions, and FDI inflows.

Our contribution to the existing literature is twofold. First, multiple factor analysis (MFA) demonstrates a substantial variation in institutional configurations across Asian economies that attract FDI. We categorize these Asian economies into three clusters based on institutional configurations. Second, fuzzy-set qualitative comparative analysis (fsQCA) shows that two of the institutional configurations create greater potential for FDI inflows. Of these, the one found in Singapore relies more on institutional complementarities similar to liberal market economies (Hall & Soskice, 2001), while the other one, which is characteristic to Thailand, focuses more on human capital formation typical in Asian welfare capitalism.

Our findings suggest that in order to attract FDI from multinational corporations (MNCs), governments in developing Asian countries should deregulate domestic product and labor markets, and create a well-functioning financial market. Alternatively, they should focus on human capital formation with relatively protected domestic markets.

OVERALL TRENDS IN FDI

Since the 1990s, foreign direct investment (FDI) has played a leading role in globalizing Asian economies. Today, most Asian economies have become important destinations for FDI from advanced economies. FDI has several advantages for these economies, in addition to its direct effect on economic growth. FDI is often associated with technological transfer or the introduction of new knowledge and skills, which in turn improves the economic environment for long-term growth. While domestic firms may benefit from the inflow of new knowledge associated with FDI, the increased competition in domestic markets induced by FDI may put pressure on local firms to enhance their productivity and promote human capital mobility among firms. A combination of these factors can create the conditions necessary for increased long-term economic growth. It is therefore believed that FDI inflows contribute to economic growth in Asian economies (Lee, Lee, & Kim, 2011).

Figure 1 shows the ratio of regional inward FDI to world inward FDI from 1990 to 2014. During the whole period, the ratio for the African region is steady at nearly 3 per cent. The ratio for South and Central America remained steady at roughly 5 per cent until 2010, when it increased to nearly 8 per cent.

North America, i.e., Developed economies: America, was the largest recipient of FDI, accounting for nearly 30 per cent of the total FDI in the 1980s. However, its share gradually declined and approached the share of the EU in the 1990s. In the early 2000s, the regional share of North America dropped rapidly, whereas there was a steep rise in the share of the EU region. Since then, the EU has been the largest recipient of FDI, accounting for roughly 40 per cent in the 2010s. However, the ratio of inward FDI to total FDI in the EU region gradually declined to 33.70 per cent in 2013.

It is clear from Figure 1 that economies in the Asian region have attracted an increasing share of global FDI since the mid-2000s. The ratio of inward FDI in this region was relatively stable at roughly 15 per cent in the 1990s while there was the dip in the ratio around the East Asian Crisis. However, it began to rise in the mid-2000s and has continued rising. The ratio approached the North American level in 2010 and has remained roughly equal to it since. Clearly, this region has become one of the most attractive destinations for MNCs making direct investments. The overall trend in FDI indicates that Asian

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