Volume Title: Financial Deregulation and Integration in East Asia, NBER-EASE Volume 5

Volume Author/Editor: Takatoshi Ito and Anne O. Krueger, Editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-38671-6

Volume URL: http://www.nber.org/books/ito_96-1

Conference Date: June 15, 1994

Publication Date: January 1996

Chapter Title: Interdependence through Capital Flows in Pacific Asia and the Role of Japan

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Chapter URL: http://www.nber.org/chapters/c8560

Chapter pages in book: (p. 107 - 146)

4 Interdependence through Capital Flows in Pacific Asia and the Role of Japan

Akira Kohsaka

Pacific Asia has been one of the most dynamic cases of outward-oriented development in the world in the past two decades. In light of the emerging trend toward "institutional" regional integration, as in Europe 1992 and NAFTA, it has been widely discussed whether Pacific Asia's development has enhanced regional economic interdependence or "natural" integration through trade flows (see, e.g., Eaton and Ho 1993; Frankel 1992; Frankel and Wei 1994; Petri 1993; Saxonhouse 1993).

It would be natural, then, to ask whether we can also find regional integration through capital, as through trade. Before discussing integration issues, however, we should realize what is going on in both inter- and intraregional capital flows in Pacific Asia. Nevertheless, there are fewer studies of capital flows than of trade (e.g., Yuan 1986; Frankel 1992; Kohsaka 1993). Thus we must first examine the changing patterns of capital flows and the degree of interdependence through capital in the region.

There is a vast literature on the general trend in capital flows to developing countries, provided by multilateral financial institutions (such as the International Monetary Fund [IMF] 1994; the World Bank 1993c; Bank for International Settlements [BIS] 1994; International Finance Corporation 1992). Based on these studies, this paper will review the changing pattern and nature of capital flows in Pacific Asia since the 1980s, to identify underlying fundamental factors that not only have contributed to these changes but also are unique to the region. We will then clarify intraregional interdependence through capital, and the role of Japan in it, by investigating multilateral aspects of these flows within the region.

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The author is grateful for helpful comments by Toshihiko Kinoshita, Anne O. Krueger, Ya-Hwei Yang, and other seminar participants.

Capital flows consist of such components as grants, official loans, suppliers and export credits, commercial bank loans, foreign direct investment, and portfolio investment. Significant changes in the pattern of external finance to developing countries during the last two decades can be found in table 4.1.

Table 4.1 shows that "the 1970s and 1980s were the boom-and-bust years of commercial bank finance to developing countries" (World Bank 1993b). In 1981 more than seven times as much long-term capital rushed into developing countries as a decade earlier, while the flow increased by less than 30 percent over the next decade. Accompanying shifts in the composition of flows were dominated by changes in the role of commercial bank loans. In 1981, commercial bank loans made up the largest share of total external finance to developing countries, followed by official loans and then by foreign direct investment; in 1991 commercial bank loans had fallen to second largest, far behind official loans and closely followed by foreign direct investment.

As will be shown below, external finance to Pacific Asia—comprising China, Hong Kong, Indonesia, Korea (South), Malaysia, the Philippines, Singapore, Taiwan, and Thailand—has also followed this trend, but to a limited degree. In addition, the region will be shown to have intensified natural integration through intraregional capital flows, as it had through trade flows in the late 1980s.

Previous studies found the following changing pattern of capital flows in the region up to the early 1980s: First, capital flows from developed economies in the Pacific Basin increased in importance. Second, the importance of Japan in particular was magnified across all components of capital flows. Third, private flows played a more significant role than official flows. The 1980s saw quite dynamic changes in the region, however, so it is not difficult to imagine that this pattern no longer holds.

Furthermore, the early 1990s is said to have seen a radical shift in the pattern of capital flows to developing countries "from debt to equity financing and

Table 4.1 **External Finance to Developing Countries: Gross Long-Term Flows (% of total)**

Component	1971	1981	1991
Official flows	39.9	33.3	45.3
Grants	9.0	7.3	14.5
Official loans	30.9	26.0	30.8
Suppliers and export credits	10.8	11.0	12.3
Commercial bank loans	35.7	46.1	17.4
Foreign direct investment	12.3	8.3	16.5
Portfolio investment	1.2	1.3	8.5
Total (billion $)	19.5	156.9	205.3

Source: World Bank (1993b).

from bank to nonbank sources" (World Bank 1993b). This shift partly reflects the improved economic climate in some Latin American countries. Can we find similar development in Pacific Asia?

This paper is organized as follows: Section 4.1 demonstrates differences in patterns of external finance between Asia and Latin America in order to show regional diversity of recent developments in capital flows. Recent changes in the structure of foreign capital inflow and local capital outflow, rather than of net flows, are examined in section 4.2 for both Pacific Asia as a whole and individual countries in the region. Since Pacific Asian countries have diverse structures of external finance, we suggest that regional aggregation may obscure or distort the size and direction of capital flows. Section 4.3 attempts to identify underlying factors that not only have helped realize these changes but also are unique to the region. We suggest that changes in macroeconomic balances provide the fundamental mechanism that has determined structural changes in net capital flows. In Section 4.4, we scrutinize changes in the geographical distribution of these capital flows and indicate that the changes suggest increasing regional interdependence through capital flows, resulting in a sophisticated network of multilateral flows in the region, which would magnify the "regional aggregation bias" mentioned above. Then, section 4.5 examines the role of Japan as one of the key players in the region with respect to capital flows and finds some important changes there. Some conclusive remarks will be made at the end of the paper.

4.1 Regional Patterns of External Finance

Recent trends in capital flows to developing countries contrast sharply with those of the mid-1980s with respect to not only amount but composition. Annual average net flows declined from $31 billion for the years 1977–82 to $9 billion for 1983–89 and then rebounded to $92 billion for 1990–93 (see table 4.2 below for the developing countries' total net flow). Among the components of capital flows, the dominant one has been foreign direct investment (FDI), with portfolio investment showing remarkable growth, while long-term loans were actually flowing *out*.

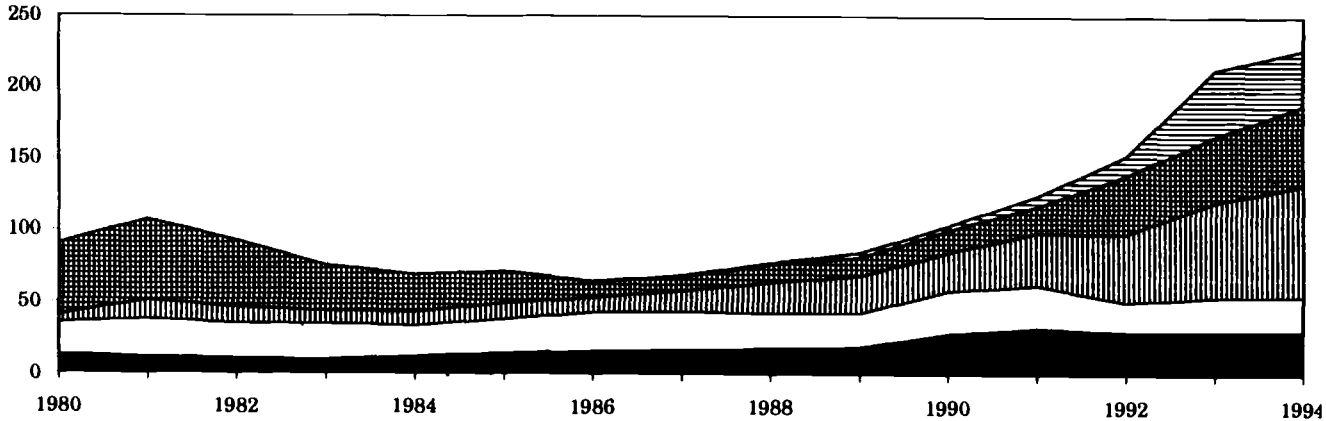
The amount of foreign capital inflow net of amortization is sometimes called "net resource flows."[1] Figure 4.1 shows the amount and composition of long-term net resource flows to all developing countries, to East Asia and the Pacific, and to Latin America and the Caribbean during the period 1982–94 (World Bank 1994).[2] It is obvious that the above-mentioned general trend in gross

1. Net resource flows here consist of the net flow of long-term debt excluding IMF credits, direct foreign investment (net), and grants (excluding technical cooperation). Net resource flows minus grants correspond to changes in liabilities in the long-term capital account of the balance of payments.

2. In addition to Pacific Asia, East Asia and the Pacific includes Fiji, Laos, Papua New Guinea, Solomon Islands, Tonga, Vanuatu, and Western Samoa.

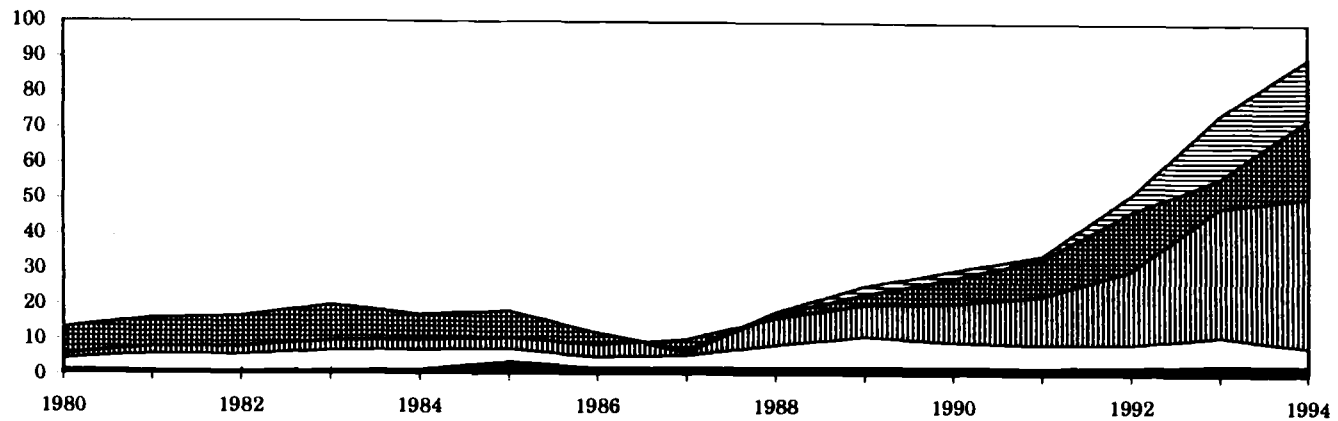
A

(current prices, US$ billion)



B

(current prices, US$ billion)



C

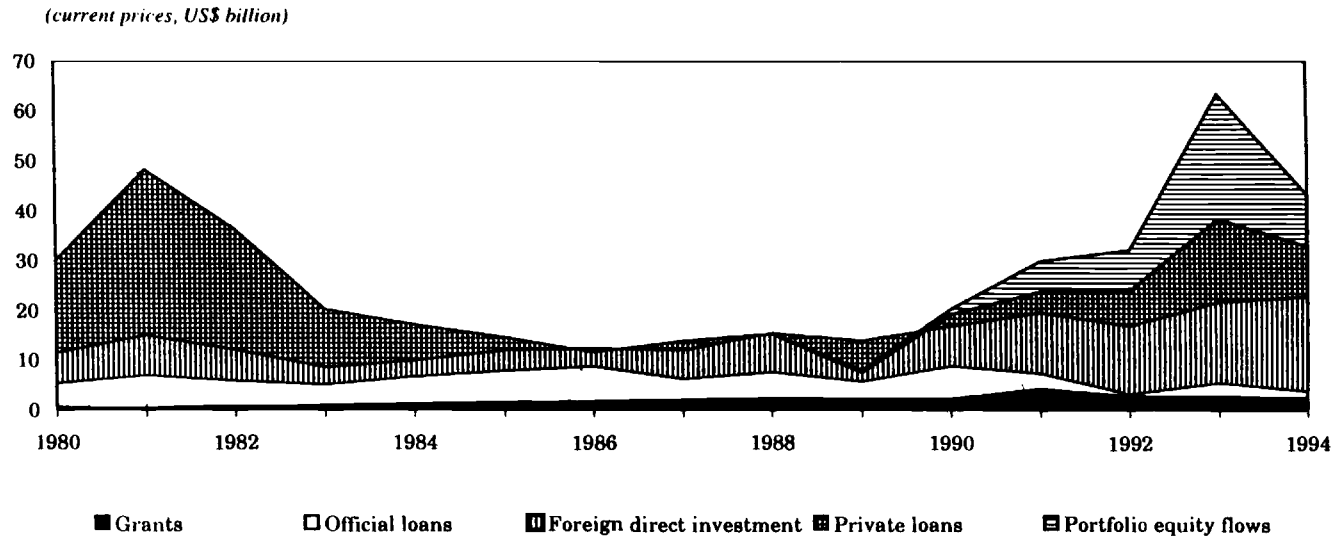


Fig. 4.1 Net resource flows by region: (*A*) all developing countries; (*B*) East Asia and the Pacific; (*C*) Latin America and the Caribbean

Source: World Bank (1995).

capital flows to developing countries as a whole is not necessarily identical to those of individual regions.

In Latin America and the Caribbean (fig. 4.1*C*), total net flows sharply declined from a peak of $50 billion in 1981, remained low at around $10-$20 billion during 1983–88, and then rebounded to eventually surpass the previous peak in 1993. During this process, the composition of capital flows changed dramatically. The flow of private loans (mostly commercial bank loans) disappeared and then turned negative (i.e., flowed out) in the mid-1980s. In its place, FDI became the most important form of capital flow, and in 1993, portfolio equity flows became the next most important form; private loans came back, not as bank loans, but as bond issues.

In contrast, East Asia and the Pacific never saw as significant a decline in net capital flows as Latin America, even in the early 1980s (fig. 4.1*B*). Total net flows remained stable during 1980–85 at around $15-$20 billion. The major form of capital was commercial bank loans, and the second was official loans. There then appeared a vigorous surge in total net capital flows, especially after 1986; this time, FDI was far more significant than in the early 1980s, while commercial bank loans resumed its growth as a major component, and portfolio equity flows surged starting in the early 1990s. Now, if we turn to the capital account figures of the balance of payments (see table 4.2), we can ascertain more striking contrasts between these two regions.

In the Western Hemisphere, foreign capital *outflow* in Other long-term flows (mainly commercial bank loans) continued not only in 1983–89 under the "debt overhang" but even in 1990–93, the most recent period listed. Note that this outflow forced the region to be a net capital exporter, instead of an importer, in the 1980s, which has been called the "lost decade." Under these circumstances, the surge of foreign capital inflow in the 1990s took, primarily, the form of portfolio investment (i.e. bonds and equities) and, then, the form of FDI.

On the other hand, Asia continued to receive a significant amount of foreign loans, although FDI caught up to and then exceeded this amount, and portfolio investment was catching up toward the 1990s.[3] More important, one notable fact is that local capital outflow (the assets flows in table 4.2) in Asia has become significant in each component of capital transactions, namely, FDI, portfolio investment, and loans. In fact, these annual average outflows amounted to about one-third of the corresponding foreign capital inflows for the period 1990–93. This will be shown to reflect increasing capital interdependence in Pacific Asia.

3. In addition to Pacific Asia, "Asia" includes Afghanistan, Bangladesh, Fiji, India, Kiribati, Laos, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Solomon Islands, Sri Lanka, Tonga, Vanuatu, Western Samoa, and "Asia not specified."

Table 4.2 **Capital Account: Asia and Western Hemisphere (annual averages)**

	Amount (billion U.S. $)				Share (%)			
Net Flow	1973–76	1977–82	1983–89	1990–93	1973–76	1977–82	1983–89	1990–93
Developing countries total								
FDI	3.7	11.3	13.3	34.1	24.2	26.4	94.3	63.3
Assets	−0.3	−0.9	−3.4	−10.2	3.5	5.2	100.0	34.8
Liabilities	4	12.2	16.7	44.3	16.7	20.3	95.4	53.2
Portfolio	−5.6	−10.5	6.5	26.8	−36.6	−24.5	46.1	49.7
Assets	−6.4	−13.1	3.6	−13	74.4	75.7	−105.9	44.4
Liabilities	0.8	2.6	2.9	39.8	3.3	4.3	16.6	47.8
Other LT	17.2	42	−5.7	−7	112.4	98.1	−40.4	−13.0
Assets	−1.9	−3.3	−3.5	−6.1	22.1	19.1	105.9	20.8
Liabilities	19.1	45.3	−2.1	−0.9	79.9	75.4	−12.0	−1.1
LT total	15.3	42.8	14.1	53.9	103.4	139.9	160.2	58.9
Assets	−8.6	−17.3	−3.4	−29.3	50.0	38.5	27.2	99.0
Liabilities	23.9	60.1	17.5	83.2	74.7	79.6	82.2	68.7
ST Capital	−0.5	−12.2	−5.3	37.6	−3.4	−39.9	−60.2	41.1
Assets	−8.6	−27.6	−9.1	−0.3	50.0	61.5	72.8	1.0
Liabilities	8.1	15.4	3.8	37.9	25.3	20.4	17.8	31.3
Total net	14.8	30.6	8.8	91.5	100.0	100.0	100.0	100.0
Assets	−17.2	−44.9	−12.5	−29.6	100.0	100.0	100.0	100.0
Liabilities	32	75.5	21.3	121.1	100.0	100.0	100.0	100.0
Asia								
FDI	1.3	2.7	5.2	19.8	23.2	20.3	36.4	53.5
Assets	−0.1	−0.2	−2.6	−7.0	50.0	28.6	46.4	45.1
Liabilities	1.4	2.9	7.8	27.7	24.1	20.7	39.2	50.8
Portfolio	0.2	0.6	1.4	7.2	3.6	4.5	9.8	19.5
Assets	0	−0.1	−0.9	−3.4	0.0	14.3	16.1	19.4
Liabilities	0.2	0.7	2.3	10.6	3.4	5.0	11.6	19.4
Other LT	4.1	10.0	7.7	10	73.2	75.2	53.8	27.0
Assets	−0.1	−0.4	−2.1	−6.2	50.0	57.1	37.5	35.4
Liabilities	4.2	10.4	9.8	16.2	72.4	74.3	49.2	29.7
LT total	5.6	13.3	14.3	37	82.4	84.2	85.6	79.4
Assets	−0.2	−0.7	−5.6	−17.5	20.0	20.6	52.8	62.3
Liabilities	5.8	14	19.9	54.5	74.4	72.9	72.9	73.0
ST Capital	1.2	2.5	2.4	9.6	17.6	15.8	14.4	20.6
Assets	−0.8	−2.7	−5	−10.6	80.0	79.4	47.2	37.7
Liabilities	2	5.2	7.4	20.2	25.6	27.1	27.1	27.0
Total	6.8	15.8	16.7	46.6	100.0	100.0	100.0	100.0
Assets	−1	−3.4	−10.6	−28.1	100.0	100.0	100.0	100.0
Liabilities	7.8	19.2	27.3	74.7	100.0	100.0	100.0	100.0
Western Hemisphere								
FDI	2.2	5.3	4.4	11.1	19.1	18.2	−40.7	58.7
Assets	−0.1	−0.2	−0.3	−1.2	12.5	14.3	75.0	17.9
Liabilities	2.3	5.5	4.7	12.3	18.7	18.0	−45.2	48.0
Portfolio	0.2	1.6	−1.2	17.6	1.7	5.5	11.1	93.1

(*continued*)

Table 4.2 (continued)

	Amount (billion U.S. $)				Share (%)			
Net Flow	1973–76	1977–82	1983–89	1990–93	1973–76	1977–82	1983–89	1990–93
Assets	−0.1	−0.2	−0.4	−7.4	12.5	14.3	100.0	110.4
Liabilities	0.3	1.8	−0.8	25	2.4	5.9	7.7	97.7
Other LT	9.1	22.2	−14	−9.8	79.1	76.3	129.6	−51.9
Assets	−0.6	−1	0.3	1.9	75.0	71.4	−75.0	−28.4
Liabilities	9.7	23.2	−14.3	−11.7	78.9	76.1	137.5	−45.7
LT total	11.5	29.1	−10.8	18.9	88.5	110.6	65.1	79.1
Assets	−0.8	−1.4	−0.4	−6.7	22.2	13.7	−66.7	51.9
Liabilities	12.3	30.5	−10.4	25.6	74.1	83.6	60.5	69.6
Other ST	1.5	−2.8	−5.8	5	11.5	−10.6	34.9	20.0
Assets	−2.8	−8.8	1	−6.2	77.8	86.3	166.7	48.1
Liabilities	4.3	6	−6.8	11.2	25.9	16.4	39.5	30.4
Total	13	26.3	−16.6	23.9	100.0	100.0	100.0	100.0
Assets	−3.6	−10.2	0.6	−12.9	100.0	100.0	100.0	100.0
Liabilities	16.6	36.5	−17.2	36.8	100.0	100.0	100.0	100.0

Source: IMF (1994).

4.2 Capital Flows in Pacific Asia

4.2.1 Individual Patterns of Capital Flow

We have seen some differences in regional patterns of capital flow by comparing Asia with Latin America. Regionally aggregated capital flows, however, may not be very useful in grasping the changing nature and pattern of these flows in individual economies within the region, or rather, may obscure important differences between these economies. This is true for the case of Pacific Asia. Table 4.3 shows capital accounts of the balance of payments in Pacific Asia in aggregate as well as for individual economies. Overall, there appears to be little difference between Asia in table 4.2 and Pacific Asia in table 4.3. However, if we look into individual economies, table 4.3 suggests two points. First, during the period 1986–89, both Korea and Malaysia had huge net outflows of foreign loans, of which a significant part was premature amortization. This was not an involuntary outflow due to the drying-up of new loans as in the case of Latin America, but a voluntary outflow due to these countries' remarkably improved external balances. In this case, it should be noted that regional aggregation tends to understate the significance of loan capital in the other economies in the region because Korea's and Malaysia's outflows offset other countries' "other" flows (liabilities) for the period 1986–89.

Second, the geographical distribution of local capital outflow shows high concentration in the Asian newly industrializing economies (ANIEs). That is, in Pacific Asia, there seem to have been broadly two types of economies in terms of

Table 4.3 **Long-Term Capital Account: Pacific Asia (annual averages)**

	Amount (million U.S. $)			Share (%)		
Net Flow	1982–85	1986–89	1990–92	1982–85	1986–89	1990–92
Pacific Asia						
Total	15,328	6,216	20,924	100.0	100.0	100.0
Assets	−5,795	−12,344	−19,889	100.0	100.0	100.0
Liabilities	21,123	18,560	40,813	100.0	100.0	100.0
FDI	3,665	5,425	13,889	23.9	87.3	66.4
Assets	−533	−4,237	−6,789	9.2	34.3	34.1
Liabilities	4,198	9,662	20,677	19.9	52.1	50.7
Portfolio	2,112	1,137	1,712	13.8	18.3	8.2
Assets	−227	−518	−1,943	3.9	4.2	9.8
Liabilities	2,339	1,655	3,655	11.1	8.9	9.0
Other	9,552	−346	5,323	62.3	−5.6	25.4
Assets	−5,035	−7,590	−11,157	86.9	61.5	56.1
Liabilities	14,587	7,244	16,480	69.1	39.0	40.4
China						
Total	2,020	5,700	3,679	100.0	100.0	100.0
Assets	−1,043	−1,205	−4,635	100.0	100.0	100.0
Liabilities	3,063	6,906	8,314	100.0	100.0	100.0
FDI	771	2,013	4,422	38.2	35.3	120.2
Assets	−225	−681	−1,914	21.6	56.5	41.3
Liabilities	996	2,694	6,336	32.5	39.0	76.2
Portfolio	0	829	−21	0.0	14.5	−0.6
Assets	−30	−210	−340	2.9	17.4	7.3
Liabilities	227	1,039	319	7.4	15.0	3.8
Other	1,052	2,859	−722	52.1	50.2	−19.6
Assets	−789	−314	−2,380	75.6	26.1	51.4
Liabilities	1,841	3,173	1,658	60.1	45.9	19.9
Indonesia						
Total	4,229	3,198	5,495	100.0	100.0	100.0
Assets	0	0	0	0.0	0.0	0.0
Liabilities	4,229	3,198	5,495	100.0	100.0	100.0
FDI	262	475	1,450	6.2	14.9	26.4
Assets	0	0	0	0.0	0.0	0.0
Liabilities	262	475	1,450	6.2	14.9	26.4
Portfolio	160	−23	−64	3.8	−0.7	−1.2
Assets	0	0	0	0.0	0.0	0.0
Liabilities	160	−23	−64	3.8	−0.7	−1.2
Other	3,807	2,746	4,109	90.0	85.9	74.8
Assets	0	0	0	0.0	0.0	0.0
Liabilities	3,807	2,746	4,109	90.0	85.9	74.8
Korea						
Total	2,764	−4,952	5,649	100.0	100.0	100.0
Assets	−755	−1,799	−4,985	100.0	100.0	100.0
Liabilities	3,519	−3,153	10,634	100.0	100.0	100.0
FDI	35	479	−281	1.3	−9.7	−5.0
Assets	−86	−187	−1,075	11.3	10.4	21.6
Liabilities	121	666	794	3.4	−21.1	7.5

(*continued*)

Table 4.3 (continued)

	Amount (million U.S. $)			Share (%)		
Net Flow	1982–85	1986–89	1990–92	1982–85	1986–89	1990–92
Portfolio	380	−81	3,223	13.7	1.6	57.1
Assets	0	−20	−48	0.0	1.1	1.0
Liabilities	380	−61	3,271	10.8	1.9	30.8
Other	2,350	−5,350	2,707	85.0	108.0	47.9
Assets	−670	−1,592	−3,862	88.7	88.5	77.5
Liabilities	3,019	−3,759	6,569	85.8	119.2	61.8
Malaysia						
Total	3,138	−306	4,695	100.0	100.0	100.0
Assets	−279	−483	168	100.0	100.0	100.0
Liabilities	3,418	178	4,527	100.0	100.0	100.0
FDI	1,038	825	3,508	33.1	−270.0	74.7
Assets	0	0	0	0.0	0.0	0.0
Liabilities	1,038	825	3,508	30.4	464.0	77.5
Portfolio	1,080	−96	−398	34.4	31.5	−8.5
Assets	0	0	0	0.0	0.0	0.0
Liabilities	1,080	−96	−398	31.6	−54.1	−8.8
Other	1,021	−1,034	1,585	32.5	338.5	33.8
Assets	−279	−483	168	100.0	100.0	100.0
Liabilities	1,300	−551	1,417	38.0	−309.8	31.3
Philippines						
Total	1,179	597	2,700	100.0	100.0	100.0
Assets	−4	−4	−43	100.0	100.0	100.0
Liabilities	1,183	602	2,743	100.0	100.0	100.0
FDI	36	483	434	3.0	80.9	16.1
Assets	0	0	0	0.0	0.0	0.0
Liabilities	36	483	434	3.0	80.3	15.8
Portfolio	3	91	33	0.2	15.2	1.2
Assets	−4	−4	−43	100.0	100.0	100.0
Liabilities	6	95	77	0.5	15.8	2.8
Other	1,141	24	2,233	96.8	3.9	82.7
Assets	0	0	0	0.0	0.0	0.0
Liabilities	1,141	24	2,233	96.5	3.9	81.4
Singapore						
Total	1,763	340	4,197	100.0	100.0	100.0
Assets	−1,855	−4,627	−2,925	100.0	100.0	100.0
Liabilities	3,618	4,967	7,122	100.0	100.0	100.0
FDI	1,101	2,397	3,811	62.4	705.0	90.8
Assets	−171	−347	−1,286	9.2	7.5	44.0
Liabilities	1,271	2,744	5,098	35.1	55.2	71.6
Portfolio	−14	−166	−1,103	−0.8	−48.8	−26.3
Assets	−194	−284	−1,511	10.4	6.1	51.7
Liabilities	180	118	409	5.0	2.4	5.7
Other	676	−1,891	1,488	38.3	−556.2	35.5
Assets	−1,490	−3,997	−128	80.4	86.4	4.4
Liabilities	2,166	2,106	1,616	59.9	42.4	22.7

Table 4.3 (continued)

	Amount (million U.S. $)			Share (%)		
Net Flow	1982–85	1986–89	1990–92	1982–85	1986–89	1990–92
Taiwan						
Total	−1,686	−1,204	−5,364	100.0	100.0	100.0
Assets	−1,730	−4,151	−7,342	100.0	100.0	100.0
Liabilities	45	2,947	1,978	100.0	100.0	100.0
FDI	148	−2,059	−1,499	−8.8	171.0	27.9
Assets	−51	−2,960	−2,366	2.9	71.3	32.2
Liabilities	199	901	867	443.6	30.6	43.8
Portfolio	0	0	0	0.0	0.0	0.0
Assets	0	0	0	0.0	0.0	0.0
Liabilities	0	0	0	0.0	0.0	0.0
Other	−1,834	855	−3,866	108.8	−71.0	72.1
Assets	−1,680	−1,191	−4,976	97.1	28.7	67.8
Liabilities	−154	2,046	1,111	−343.6	69.4	56.2
Thailand						
Total	1,920	2,842	9,995	100.0	100.0	100.0
Assets	−129	−75	−126	100.0	100.0	100.0
Liabilities	2,049	2,917	10,121	100.0	100.0	100.0
FDI	275	813	2,044	14.3	28.6	20.4
Assets	−1	−61	−148	1.0	81.7	116.9
Liabilities	276	874	2,191	13.5	30.0	21.7
Portfolio	307	583	41	16.0	20.5	0.4
Assets	0	0	0	0.0	0.0	0.0
Liabilities	307	583	41	15.0	20.0	0.4
Other	1,339	1,446	7,910	69.7	50.9	79.1
Assets	−128	−14	121	99.0	18.3	−16.9
Liabilities	1,466	1,460	7,888	71.6	50.0	77.9

Source: IMF (various years [a]).

capital flows since the latter half of the 1980s: one type with not insignificant two-way flows and the other type with mostly foreign capital inflow. Korea, Singapore, and Taiwan (and, probably, Hong Kong, for which balance of payments data are not available) are the former, and Indonesia and the Philippines are the latter; Malaysia and Thailand appear to be joining the former group.

For individual countries in Pacific Asia, the local and foreign flows in the main components of capital since the 1980s can be summarized as follows (see table 4.3). In three ANIEs, Korea, Singapore, and Taiwan, either current accounts have tended to run a surplus or local outflow has exceeded foreign inflow at least in some components of capital. Taiwan has been an extreme case in that, since the latter half of the 1980s, local capital outflow has overwhelmed foreign capital inflow in direct investment, portfolio investment, and other long-term capital. Singapore has become a net overseas portfolio investor since the late 1980s while remaining a net host country in terms of direct investment.

Korea has become a net overseas direct investor since the late 1980s while having been an important portfolio "investee" since the early 1990s.

In complete contrast to Taiwan, Indonesia and the Philippines have both remained one-way capital absorbers. Between these two groups, Malaysia, Thailand, and China have begun to send capital abroad as either direct investment (in the cases of Thailand and China) or portfolio investment (in the cases of Malaysia and China), while all three countries have been important destinations for the recent explosion of FDI from Japan and the Asian NIEs.

4.2.2 Individual Patterns of Foreign Capital Inflow

The most recent developments in foreign capital inflow are shown in table 4.4. The steadily increasing share of FDI in foreign capital inflow has been the most salient feature. In China, Malaysia, and Singapore, FDI has been the most important component of capital inflow. FDI literally rushed into China; the average share of FDI in total net long-term flows exceeded 50 percent over 1990–93.

The growing prominence of FDI reflects increased intraregional trade and intraregional division of labor under the global production, sourcing, and marketing strategies pursued by international businesses, as well as local market growth and deregulation. Indeed, we note that there is not only geographical concentration of FDI but also shifts in FDI even within Pacific Asia, which seems to result at least somewhat from "regulatory arbitrage" on the part of international businesses.

Meanwhile, in Korea, Malaysia, and Thailand, portfolio investment has grown rapidly very recently. In particular, in Korea more than 80 percent of net resource inflow in 1990–93 was portfolio investment.

Foreign investment in bonds includes both international issues, such as Eurodollar bonds, and direct purchases of local securities, which virtually started to expand in 1993 in Pacific Asia (see OECD, various issues); Hong Kong, Korea, Malaysia, and Thailand have been main recipients. Portfolio equity investment, on the other hand, includes international issues (including depository receipts) and direct purchases in local markets; China, Korea, Malaysia, and Thailand are the main recipients.

Finally, "official debt," or official loans, remained significant, though relatively smaller, in China, Indonesia, and the Philippines. Its role was reduced sharply in Malaysia and Thailand, however. This will be discussed in section 4.4 in more detail.

4.3 Macroeconomic Development in Pacific Asia

4.3.1 Factors in the Recent Developments in Capital Flows

We have observed that significant changes have occurred in capital flows to developing countries in general, as well as to Pacific Asia. What drove these

Table 4.4 **Capital Inflow: Pacific Asia (annual averages)**

Flow	Amount (million U.S. $)		Share (%)	
	1986–89	1990–93	1986–89	1990–93
China				
Net resource flow	8,855	21,211	98.6	92.7
Net LT debt flow	5,933	8,683	67.0	40.9
Official debt	1,356	2,682	15.3	12.6
Private bonds	896	400	10.1	1.9
Other loans	3,681	5,601	41.6	26.4
FDI	2,694	11,952	30.4	56.3
Portfolio equity	0	1,031	0.0	4.9
Grants	229	−456	2.6	−2.1
ST debt flow	122	1,660	1.4	7.3
Net total flow	8,977	22,871	100.0	100.0
Indonesia				
Net resource flow	3,301	6,185	91.4	78.8
Net LT debt flow	2,590	3,748	78.4	60.6
Official debt	2,342	2,788	70.9	45.1
Private bonds	−42	143	−1.3	2.3
Other loans	290	818	8.8	13.2
FDI	475	1,589	14.4	25.7
Portfolio equity	50	730	1.5	11.8
Grants	187	117	5.6	1.9
ST debt flow	312	1,660	8.6	21.2
Net total flow	3,613	7,844	100.0	100.0
Korea				
Net resource flow	−3,299	5,556	93.4	90.3
Net LT debt flow	−3,996	2,343	121.1	42.2
Official debt	−907	−61	27.5	−1.1
Private bonds	−16	2,483	0.5	44.7
Other loans	−3,074	−80	93.2	−1.4
FDI	666	724	−20.2	13.0
Portfolio equity	29	2,484	−0.9	44.7
Grants	2	5	−0.1	0.1
ST debt flow	−233	600	6.6	9.7
Net total flow	−3,532	6,156	100.0	100.0
Malaysia				
Net resource flow	−308	4,877	74.9	80.7
Net LT debt flow	−1,243	−55	403.5	−1.1
Official debt	−205	52	66.6	1.1
Private bonds	−74	−101	24.0	−2.1
Other loans	−964	−5	312.8	−0.1
FDI	825	3,788	−267.8	77.7
Portfolio equity	71	1,095	−22.9	22.4
Grants	40	49	−12.8	1.0
ST debt flow	−103	1,170	25.1	19.3
Net total flow	−411	6,046	100.0	100.0

(*continued*)

Table 4.4 (continued)

Flow	Amount (million U.S. $)		Share (%)	
	1986–89	1990–93	1986–89	1990–93
Philippines				
Net resource flow	1,196	1,913	100.7	87.6
Net LT debt flow	317	766	26.5	40.0
Official debt	634	1,035	53.0	54.1
Private bonds	−149	289	−12.4	15.1
Other loans	−168	−558	−14.0	−29.2
FDI	483	516	40.4	27.0
Portfolio equity	63	354	5.3	18.5
Grants	332	278	27.8	14.5
ST debt flow	−8	271	−0.7	12.4
Net total flow	1,188	2,185	100.0	100.0
Thailand				
Net resource flow	1,897	4,976	72.3	59.4
Net LT debt flow	370	1,652	19.5	33.2
Official debt	−2	113	−0.1	2.3
Private bonds	−13	533	−0.7	10.7
Other loans	385	1,007	20.3	20.2
FDI	874	2,244	46.1	45.1
Portfolio equity	515	903	27.1	18.1
Grants	139	177	7.3	3.6
ST debt flow	728	3,407	27.7	40.6
Net total flow	2,625	8,383	100.0	100.0

Source: World Bank (1994).

developments? Both domestic and international influences must have been at work (see, e.g., Fernandez-Arias 1994; Ghosh and Ostry 1993; Gooptu 1994).

The increasing share of FDI in both foreign capital inflow and local capital outflow has been the most salient feature of Pacific Asia. Consensus, however, has not yet been achieved on what exactly determines FDI. Such factors as low labor cost and product life cycle have become relatively less important because of technological changes. Taxation and other policy measures in the home country of multinational firms have become more crucial in determining FDI.

Nevertheless, changes in the international economic environment do play a crucial role in determining the size and direction of FDI. Remember that the FDI boom of the 1980s, mentioned above, was triggered by the major currency realignment due to the Plaza Accord in 1985, which brought drastic changes in international competitiveness among manufacturing exporters. The growing protectionist atmosphere in developed countries is another factor that could explain the relocation of production sites from developed to developing countries.

In contrast to FDI, portfolio investment requires a rather well arranged do-

mestic capital market, which rarely exists in developing countries. Furthermore, although portfolio investment to some developing economies has expanded sharply in recent years, it may reflect only temporary favorable international economic conditions. Accordingly, it is not yet clear whether portfolio investment could be a sustainable source of external finance to developing countries.

International influences consist of both cyclical and structural factors. As with an upsurge in banking capital inflow to developing countries in the latter half of the 1970s, a cyclical downturn in industrial countries and a resulting decline in their interest rates played a significant role in the surge of portfolio investment in "emerging markets" in the early 1990s—as well as its recent reversal due to higher interest rates. Structural factors include institutional and technological developments in investor countries, which have enhanced competition in capital markets, increased capital mobility by lowering the transaction costs of market access, and widened the range of both investors and financial instruments. It has recently been observed that there has been increased international diversification of portfolio investment along with an broadened investor base.[4]

For host countries, the basic determinants of foreign investment include sound macroeconomic management, a well-qualified labor force, an efficient private sector, and an adequate regulatory system and policy framework. These factors are not necessarily sufficient but are crucial preconditions for attracting foreign capital that are well within the control of developing countries.

Now, supposing that developing economies share international developments in common, we will focus on domestic developments in Pacific Asia, which has attained remarkable results as distinct from other regions. More specifically, remembering that one of the key roles of capital flows is as investment finance, we will concentrate on the macroeconomic development of the Pacific Asian countries. As for regulatory and policy frameworks, all these countries significantly opened up their capital accounts during the mid-1980s, though it is beyond the scope of this paper to discuss the changing regulatory systems and policy frameworks for foreign capital flows and to assess their impact.[5]

4. In the 1990s we have seen a wider range of financial assets and a greater weight of institutional investors. These are both a cause and a result of increased global capital market integration. Technological advances and financial deregulation in developed countries, as well as financial asset accumulation, also constitute fundamental factors explaining these developments.

5. We give a cursory review of policy changes toward capital flows: Taiwan has been relatively generous to foreign capital in the manufacturing sector, but restrictive on overseas investment. In the 1980s, Taiwan worried about a persistent external surplus and eroded international competitiveness in export sectors, so it opened sectors further and allowed overseas portfolio and direct investment in the 1980s. FDI in Taiwan and Taiwanese overseas investment have both shown remarkable growth since 1987.

In contrast to Taiwan, Korea restricted incoming FDI in the 1970s and, instead, introduced commercial loans and allocated them at government discretion. But, once a medium-term external surplus was achieved in the mid-1980s, Korea seriously began trying to open capital transactions

4.3.2 Structural Changes in Macroeconomic Balances

Macroeconomic stability has often been regarded as one of the conditions necessary to attract foreign capital by demonstrating the manageability and creditworthiness of host countries. In this context, table 4.5 compares several macroeconomic indicators for "high-inflow" countries in Asia and in Latin America—those countries that attracted relatively high foreign capital inflow during 1990–93.

One of the interesting findings from table 4.5 is that there appears to be no association between macroeconomic stability and net capital inflow. By any measure of macroeconomic performance—real economic growth, domestic inflation, current account imbalance, or external debt indicators—the high-inflow economies in Asia were superior to those in Latin America. Openness as measured by the ratio of exports to GDP was also higher in Asia than in Latin America, and became more so, which naturally led to lower debt service ratios in Asia than in Latin America. In fact, high-inflow countries in Asia attracted foreign capital inflow through the three most recent periods, while those in Latin America all but lost access to the international capital market during 1983–89.

Of course, we could say that the macroeconomic performance during 1977–82 was the *cause* of the "debt crisis" and that during 1983–89 was the *result*, so that these periods could be regarded as a learning process for both international investors and host countries over their reckless behaviors in the past. But how then can we reconcile this with developments in the recent period?

More striking differences between the two country groups can be found in such structural measures as ratios of private investment and consumption to GDP. First, the average investment ratio in the Asian group was significantly higher than in the Latin American group, and became more so over the years. In fact, the ratio for 1990–93 was more than 1.5 times higher in Asia than in Latin America. Second, in Asia the investment ratio increased and the consumption ratio decreased through the three most recent periods, while in Latin America the consumption ratio showed significantly larger increases than the investment ratio from 1973–76 to 1977–82 and again from 1983–89 to 1990–93. In other words, we can see that, as is often observed, positive net foreign capital inflow was used for investment finance in Asia and for consumption finance in Latin America. Put differently, capital inflow *augmented* domestic

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both inward and outward in a gradual manner. Increasing overseas direct investment and portfolio investment in the domestic market reflect the accelerated pace of this recent development.

The ASEAN4 nations—Indonesia, Malaysia, the Philippines, and Thailand—made efforts in the early 1980s to attract export-oriented foreign manufacturing corporations; these efforts were fully realized in the late 1980s. Recently, however, the rapid increase in FDI has led to bottlenecks of infrastructure so that, for example, preferential policies for FDI were partly "retrenched" in Malaysia in 1991.

Table 4.5 **Macroeconomic Indicators: High-Inflow (1990–93) Asia and Western Hemisphere (annual averages; % of GDP unless otherwise noted)**

Indicators	1973–76	1977–82	1983–89	1990–93
Asia high inflows (1990–93)				
Real GDP[a]	4.7	6.2	7.9	7.5
Consumer prices[a]	8.8	7.7	7.5	7.4
Private investment	27.3	27.9	31.4	33.5
Private consumption	73.8	73.6	69.1	66.4
Exports	12.7	15.2	16.6	21.8
Imports	13.3	16.2	18.1	22.9
Current account balance	−0.3	−1.2	−0.9	−1.2
Fiscal deficit	−1.1	−3.0	−3.1	−2.2
Debt	12.1	15.8	24.1	26.8
Debt service	9.0	11.7	17.0	12.8
Real effective exchange rate[a,b]	–	0.7	−6.3	−6.8
Total net capital inflow	1.6	2.1	1.8	3.6
Western Hemisphere high inflows (1990–93)				
Real GDP[a]	6.2	4.3	2.4	2.1
Consumer prices[a]	30.0	43.6	143.7	250.3
Private investment	22.7	23.5	20.0	20.5
Private consumption	73.1	77.5	76.2	78.8
Exports	9.3	10.4	14.7	12.1
Imports	9.9	10.9	10.3	11.2
Current account balance	−3.0	−4.6	−0.6	−2.0
Fiscal deficit	−2.4	−4.3	−5.3	−0.1
Debt	19.9	31.8	50.2	35.4
Debt service	30.5	47.9	42.5	30.9
Real effective exchange rate[a,b]	–	3.2	−2.2	2.2
Total net capital inflow	4.0	4.2	−2.4	2.9

Source: IMF (1994).

Note: To define high- and low-inflow groups, countries within each region were ranked on the basis of average net capital inflow during 1990–93. Small countries with purchasing-power-parity (PPP) shares less than 0.1 percent in each region were excluded.

[a]Annual percentage change. Entry for 1973–76 reflects 1974–76.

[b]Data available only from 1979 onward. Entry for 1977–82 reflects 1980–82.

savings to finance investment in Asia, while it *substituted* for them in Latin America.

If we look at individual countries in Pacific Asia, we can find more dramatic structural changes in macroeconomic balances from the 1980s onward. Developing economies are generally thought of as being short of domestic savings and, as a result, likely to run a persistent external deficit. This is no longer the case in Pacific Asia. Table 4.6 shows domestic investment, national savings, the ratio of the saving-investment gap to GDP, and real economic growth in Pacific Asia since 1978.

In the ANIEs—Hong Kong, Korea, Singapore, and Taiwan—savings ratios

Table 4.6 **Macroeconomic Balances: Pacific Asia (% of GDP and % growth rates)**

Balance	1978–81	1982–85	1986–89	1990–93
Indonesia				
Investment (I)	23.0	27.7	31.6	34.9
Savings (S)	25.3	25.0	28.3	31.8
S-I gap	2.2	−2.7	−3.3	−3.1
GDP growth	8.0	4.0	6.1	6.6
Korea				
Investment (I)	32.6	29.1	31.0	36.7
Savings (S)	23.6	25.1	35.0	34.8
S-I gap	−9.0	−4.0	4.1	−1.9
GDP growth	5.5	8.9	10.5	7.0
Malaysia				
Investment (I)	30.2	34.1	26.0	34.4
Savings (S)	28.9	26.0	28.8	29.4
S-I gap	−1.3	−8.0	2.8	−5.1
GDP growth	7.6	4.7	6.0	8.7
Philippines				
Investment (I)	29.1	23.7	18.5	22.5
Savings (S)	25.2	21.7	19.1	18.2
S-I gap	−3.9	−2.0	0.6	−4.2
GDP growth	5.0	−2.4	5.1	0.9
Singapore				
Investment (I)	43.8	46.7	37.3	40.4
Savings (S)	34.9	43.9	42.0	48.3
S-I gap	−8.3	−2.8	4.7	7.9
GDP growth	9.3	5.4	8.0	7.7
Thailand				
Investment (I)	27.0	24.5	29.6	41.1
Savings (S)	21.4	19.6	27.2	33.4
S-I gap	−5.6	−4.9	−2.4	−7.7
GDP growth	6.7	5.5	9.9	8.9
Taiwan				
Investment (I)	31.1	22.5	21.0	23.7
Savings (S)	33.1	32.9	37.4	29.5
S-I gap	2.0	10.5	16.4	5.8
GDP growth	11.8	6.9	9.7	6.2
Hong Kong				
Investment (I)	34.0	26.3	26.6	28.3
Savings (S)	29.8	27.4	32.6	31.7
S-I gap	−4.2	1.1	6.0	3.4
GDP growth	10.4	4.7	9.0	4.7
China				
Investment (I)	35.3	38.1	43.8	35.2
Savings (S)	35.5	37.4	41.2	38.0
S-I gap	0.2	−0.7	−2.6	2.3
GDP growth	7.7	11.4	8.2	10.0

Sources: International Financial Statistics Yearbook (Washington, D.C.: IMF, 1994); *Key Indicators of Developing Asian and Pacific Countries* (Manila: Asian Development Bank, 1994).

have shown a steady upward trend in the last two decades and remained or become high enough that saving-investment differences have been positive or close to positive since the mid-1980s. Now, capital flows in the NIEs can increase on both the asset and liability sides, which makes the picture of capital flows in the region more complex than before; this situation will be discussed in section 4.4.

Unless the NIEs accumulate official foreign reserves indefinitely, their positive saving-investment differences imply negative net capital inflows or positive outflows, which may or may not be directed toward Pacific Asia. Of course, this does not mean that the ANIEs have become immune to external deficits. The point here is that some economies in the region have already "graduated" from the savings-shortage situation that is typical of developing economies so that financing the saving-investment gap is no longer their first priority for capital flows.

While this is not yet the case in the other economies in the region, savings ratios in Indonesia, Thailand, and China have also been relatively high and/or showing steady upward trends (the Philippines has been under economic stress since the debt crisis). Indeed, we should note that domestic savings have played a far more important role in investment finance than foreign savings and will do so in the future. These high and growing domestic savings reflect macroeconomic discipline and could support self-sustained growth through internal investment finance.[6] This growth would help maintain foreign capital inflow to augment domestic savings, even when these countries suffer from cyclical downturns. Here we see the major difference between Latin America and Pacific Asia. As far as domestic factors are concerned, the sustainability of external finance depends not only on short-term macroeconomic stability but also on longer-term macroeconomic-balance structures.

4.4 Interdependence through Capital Flows

From the analysis in section 4.3, we learned that both the financing needs of saving-investment gaps and the components of capital flows have changed and diversified over time and across economies in Pacific Asia since the 1980s. Until now, however, our observations have been limited to bilateral aspects of capital flows in countries and/or regions. Here we will try to extend our discussion to a multilateral network of capital flows in the region. We will discuss official capital flows, direct investment, and bank loans, in turn.

4.4.1 Official Capital Flows

Net official flows had been or turned negative in several rapidly growing economies (the ANIEs, Malaysia, and Thailand) in the late 1980s, while the other economies (China, Indonesia, and the Philippines) are still more or less

6. Causality appears to go from income growth to savings ratio (see World Bank 1993a).

dependent on official flows as a major financial source (table 4.4). But, note that these official flows did not change evenly across their components.

Official capital flows are divided into two components—official development assistance (ODA) and other official flows (OOF)—according to their "grant elements." OOF is likely to be "retrenched" faster than ODA in rapidly growing economies because it is rational to obtain and hold less costly loans and to repay more costly ones first. Table 4.7 shows net official flows of Pacific Asian economies by component and by creditor in dollar terms and in percentage shares.

Table 4.7 shows that Korea, Malaysia, and Thailand seemed to enter the net repayment "phase" of relatively costly OOF in the latter half of the 1980s. However, Malaysia and Thailand still depend on less costly ODA to a significant degree, while Korea has "graduated" and ceased to depend on official financial resources.

The relative contributions of some major creditors are also found in table 4.7. Regarding ODA, Japan's role remains dominant (with a greater than 50 percent share) and is still increasing in Malaysia. But this is no longer the case with respect to OOF. The role of the United States in ODA was modest and has diminished (with a less than 5 percent share). Multilateral institutions as a whole have been more important than the United States, but far less so than Japan.

On the other hand, table 4.7 gives a different picture of official flows to Indonesia, the Philippines, and China. All three have been receiving still-increasing amounts of ODA *as well as OOF.* For Indonesia and the Philippines, Japan's contribution was significant (with a greater than 50 percent share of ODA) and even expanded. For the Philippines, the United States has been a more important official creditor than multilateral institutions as a whole. For China, though, in both ODA and OOF, Japan's share is declining relative to that of multilateral institutions.

In keeping with the recent global trend, the importance of official flows as a source of external finance has somewhat declined in Pacific Asia. But this should be attributed to the "graduation" of several high-growth members in the region, rather than to the geographical redistribution of official development finance after the end of the Cold War as is generally claimed (e.g., see World Bank 1993b).

As for official capital flows, Japan has played a key role in enhancing regional interdependence in capital flows, but its role has changed significantly with the dynamic growth in the region. Japan's contribution to both ODA and OOF to the ANIEs has become modest, and this is also the case at least for OOF to the higher-income ASEAN4. But, for the rest of the region, Japan's role not only has remained significant but has grown.[7]

7. Most recently, ANIEs and some ASEAN members began to provide official financial assistance to neighboring low-income countries. We are going to observe two-way flows not only in FDI but in official flows in this region.

Table 4.7 **Net Official Flows: Pacific Asia (annual averages)**

	Amount (million U.S. $)				Share (%)			
Net Flow	Japan	United States	Multi-national	Total	Japan	United States	Multi-national	Total
China								
ODA								
1981–85	304.8	0.0	244.5	681.8	44.7	0.0	35.9	100.0
1986–90	655.8	0.0	627.8	1,762.8	37.2	0.0	35.6	100.0
1990–92	786.4	0.0	789.2	2,379.8	33.0	0.0	33.2	100.0
OOF								
1981–85	60.2	9.4	81.6	177.0	34.0	5.3	46.1	100.0
1986–90	124.7	30.6	419.8	688.3	18.1	4.4	61.0	100.0
1990–92	105.5	34.0	552.6	1,008.1	10.5	3.4	54.8	100.0
Indonesia								
ODA								
1981–85	231.8	71.8	126.8	780.4	29.7	9.2	16.2	100.0
1986–90	773.2	33.2	127.8	1,435.0	53.9	2.3	8.9	100.0
1990–92	1,096.7	16.0	132.7	1,908.7	57.5	0.8	7.0	100.0
OOF								
1981–85	13.8	30.4	610.6	709.0	2.0	4.3	86.1	100.0
1986–90	407.4	−10.2	1,214.4	1,666.0	24.5	−0.6	72.9	100.0
1990–92	327.5	40.7	1,023.3	1,609.9	20.3	2.5	63.6	100.0
Korea								
ODA								
1981–85	48.1	−9.6	7.6	65.5	73.4	−14.7	11.6	100.0
1986–90	19.4	−27.2	3.5	21.5	90.1	−126.4	16.4	100.0
1990–92	36.1	−33.3	1.6	36.8	98.3	−90.7	4.4	100.0
OOF								
1981–85	1.8	232.2	417.7	671.4	0.3	34.6	62.2	100.0
1986–90	−1.2	−314.4	−462.1	−786.8	0.2	40.0	58.7	100.0
1990–92	−2.0	−64.3	−266.8	−399.1	0.5	16.1	66.9	100.0
Malaysia								
ODA								
1981–85	120.6	0.4	14.6	202.2	59.6	0.2	7.2	100.0
1986–90	158.2	−0.6	12.0	253.8	62.4	−0.2	4.7	100.0
1990–92	243.2	0.0	16.7	322.3	75.4	0.0	5.2	100.0
OOF								
1981–85	10.5	7.4	86.5	140.8	7.4	5.3	61.4	100.0
1986–90	−23.5	−12.0	18.6	−17.8	131.8	67.4	−104.3	100.0
1990–92	40.3	0.0	49.7	65.4	61.6	0.0	76.0	100.0
Philippines								
ODA								
1981–85	178.7	102.2	52.5	404.3	44.2	25.3	13.0	100.0
1986–90	480.7	231.6	88.2	936.6	51.3	24.7	9.4	100.0
1990–92	712.4	233.7	180.8	1,349.5	52.8	17.3	13.4	100.0
OOF								
1981–85	44.0	13.8	401.1	484.3	9.1	2.8	82.8	100.0
1986–90	117.3	101.4	190.0	473.0	24.8	21.4	40.2	100.0

(*continued*)

Table 4.7 (continued)

Net Flow	Amount (million U.S. $)				Share (%)			
	Japan	United States	Multi-national	Total	Japan	United States	Multi-national	Total
1990–92	140.3	116.7	396.0	751.4	18.7	15.5	52.7	100.0
Thailand								
ODA								
1981–85	225.8	24.6	86.3	436.4	51.7	5.6	19.8	100.0
1986–90	366.2	27.6	73.3	616.4	59.4	4.5	11.9	100.0
1990–92	412.9	23.7	79.4	763.8	54.1	3.1	10.4	100.0
OOF								
1981–85	22.4	−13.4	364.9	425.8	5.3	−3.1	85.7	100.0
1986–90	83.8	−9.6	−125.9	−40.7	−205.8	23.6	309.2	100.0
1990–92	218.8	15.0	−244.0	93.8	233.2	16.0	−260.1	100.0

Source: Geographical Distribution of Financial Flows to Developing Countries (Paris: OECD, various issues).

4.4.2 Foreign Direct Investment

There are no reliable comprehensive data available on the geographical distribution of private capital flows within Pacific Asia. But, for direct investment, we can make a good conjecture about the general tendency of its movement by compiling figures on individual host economies for stocks of direct investment by investor country as shown in table 4.8.

Note that each economy's figures for FDI are not exactly comparable (see Japan External Trade Organization 1993). Some are on approval basis, and others are on disbursement basis. Benchmark years for the accumulation of investment figures are different across the economies. Some figures are totals of all industries; others cover only manufacturing. And FDI from the ANIEs and other developing economies are often unavailable separately, which would lead to an underestimation of FDI by the ANIEs and the ASEAN4 countries here.

Despite these shortcomings, we can safely obtain a general picture of changes in the amount, pace, and direction of FDI in the region from table 4.8 as follows:

First, throughout the period 1982–93, FDI increased vigorously in the region. Total FDI in the region increased by 1.7 times during 1982–86, 2.5 times during 1986–90, and 1.9 times during 1990–93 (see the bottom three rows in table 4.8). Especially since the latter half of the 1980s, the rate of increase has accelerated.

Second, this acceleration in FDI increase was mainly because of FDI to China and the ASEAN4 excluding the Philippines. FDI to the ANIEs grew rapidly, but without much acceleration. (FDI to China and the ASEAN4 increased by 3.1 and 2.7 times, respectively, during 1986–90 and by 3.1 and 1.9 times during 1990–93, as against a 1.4 times increase in FDI to the ASEAN4

Table 4.8 **FDI Stocks: Pacific Asia (% share of total stock in each host country)**

Source	Destination											
	Hong Kong	Singapore	Taiwan	Korea	NIEs	Indonesia	Malaysia	Philippines	Thailand	ASEAN4	China	Total
United States												
1982	46.7	32.3	30.3	29.1	32.9	5.6	9.9	48.3	8.5	11.1	n.a.	18.1
1986	41.2	36.7	29.2	29.5	33.5	7.7	8.7	57.0	19.1	15.5	15.6	21.5
1990	30.6	37.4	24.9	28.7	30.3	5.7	5.6	53.6	11.6	9.4	11.2	15.1
1993	28.1	39.2	24.7	29.3	30.8	5.5	11.2	50.2	14.0	10.9	8.1	13.9
European Community												
1982	14.2	36.7	9.2	13.1	21.9	11.7	18.1	9.8	23.2	15.5	n.a.	17.6
1986	10.9	30.0	12.9	9.5	17.9	12.0	24.9	12.2	15.8	14.5	7.2	14.8
1990	10.9	27.2	15.6	15.5	18.8	12.3	15.2	11.1	7.4	11.3	5.0	12.3
1993	12.4	25.7	14.8	23.1	19.9	13.0	17.6	17.7	10.1	13.0	3.2	12.0
Japan												
1982	30.1	16.8	20.9	47.1	23.8	36.9	21.8	18.0	23.4	29.8	n.a.	27.9
1986	20.5	24.0	25.2	52.3	29.5	33.2	19.4	13.7	20.5	26.3	15.1	26.0
1990	31.5	28.2	29.3	48.2	33.2	24.9	25.2	15.2	35.4	27.8	13.6	27.2
1993	34.1	28.2	28.9	41.0	31.8	20.6	22.3	15.5	23.8	21.9	8.6	20.6
Hong Kong												
1982		n.a.	8.3	0.0	2.7	10.1	3.2	5.9	3.4	7.2	n.a.	5.7
1986		n.a.	5.8	3.6	2.6	11.9	3.7	6.0	3.2	8.0	53.6	11.5
1990		n.a.	4.6	2.9	2.3	9.6	3.4	6.8	5.9	7.2	59.7	13.6
1993		n.a.	6.3	0.0	2.2	8.4	2.6	5.2	15.2	9.5	63.6	20.9
Singapore												
1982	1.7		0.0	n.a.	0.2	0.0	6.6	n.a.	3.6	1.6	n.a.	1.1
1986	1.4		0.0	n.a.	0.2	2.0	9.0	n.a.	2.8	2.8	0.4	1.7
1990	1.0		1.0	n.a.	0.6	2.6	7.8	n.a.	3.7	3.8	1.1	2.6
1993	2.3		2.6	n.a.	1.1	5.8	6.4	1.9	4.2	5.2	1.4	3.6

(*continued*)

Table 4.8 (continued)

Source	Destination											
	Hong Kong	Singapore	Taiwan	Korea	NIEs	Indonesia	Malaysia	Philippines	Thailand	ASEAN4	China	Total
Taiwan												
1982	1.3	n.a.		n.a.	0.1	0.0	1.4	n.a.	6.8	2.2	n.a.	1.5
1986	0.0	n.a.		n.a.	0.0	0.9	1.8	n.a.	6.2	2.5	n.a.	1.4
1990	n.a.	n.a.	n.a.		n.a.	4.8	2.3	n.a.	0.6	2.9	n.a.	1.7
1993	n.a.	n.a.	n.a.		n.a.	5.4	3.5	1.9	0.0	3.0	n.a.	1.8
NIEs												
1982	3.0	0.0	8.3	0.0	3.1	10.1	11.6	5.9	14.0	11.0	n.a.	8.4
1986	1.4	0.0	5.8	3.7	2.8	16.2	15.4	6.0	12.3	14.0	54.0	15.0
1990	1.7	0.0	5.6	3.6	3.0	23.0	36.7	6.8	17.2	23.1	60.7	23.3
1993	2.6	0.0	8.9	3.0	4.0	25.5	31.3	9.3	24.9	25.9	65.0	31.1
ASEAN4												
1982	0.0	0.0	0.0	0.0	0.0	2.5	8.0	0.0	2.0	2.5	n.a.	1.7
1986	0.0	0.0	0.0	0.0	0.0	0.0	4.4	0.0	2.3	1.1	0.5	0.7
1990	0.9	0.0	0.0	0.0	0.1	0.0	4.0	0.0	0.9	1.0	0.4	0.7
1993	1.8	0.0	0.0	0.0	0.2	0.0	4.4	0.0	0.0	0.9	0.9	0.8
Total (million $)												
1982	1,245	4,492	3,495	1,436	10,668	11,777	1,600	2,228	6,819	22,424	n.a.	33,092
1986	2,506	6,421	5,893	3,633	18,453	15,809	3,217	2,722	9,076	30,824	6,538	55,815
1990	3,971	11,547	13,215	7,873	36,606	38,678	15,610	3,303	25,687	83,278	20,452	140,336
1993	5,287	16,607	17,667	10,552	50,113	67,625	31,233	4,897	54,738	158,493	64,180	272,786
Ratio of year-end stocks												
86/82	2.01	1.43	1.69	2.53	1.73	1.34	2.01	1.22	1.33	1.37	n.a.	1.69
90/86	1.58	1.80	2.24	2.17	1.98	2.45	4.85	1.21	2.83	2.70	3.13	2.51
93/90	1.33	1.44	1.34	1.34	1.37	1.75	2.00	1.48	2.13	1.90	3.14	1.94

Source: Calculated from national statistics.

during 1982–86.) Recall that FDI from the ANIEs is likely to be underestimated.

Third, with increasing FDI in the region, Japan's share as an investor was larger than the U.S. and EC shares and stayed almost constant throughout the 1980s (26–28 percent), unlike the declining shares of the United States and European Community. Japan's share rose slightly in 1986–90 but fell to 21 percent in 1990–93, mainly because of its cyclical downturn.

Fourth, the share of the ANIEs as investors has dramatically expanded throughout the entire period covered, from 8 percent (1982) to 31 percent (1993), the most remarkable new development in the region since the early 1980s. This is particularly the case for the ASEAN4 in the late 1980s as well as in China since then. Two movements are notable: one is Hong Kong's investment in China, and the other is, to a lesser degree, Taiwan's in the ASEAN4.[8]

Fifth, FDI in the region grew rapidly and accelerated, and during the process, the share of intraregional FDI (from Japan plus the NIEs) increased from less than 40 percent (1982) to more than 50 percent (1990). A notable point is that the increased intraregional direct investment proceeded hand in hand with increased intraregional trade.

The developments in FDI in Pacific Asia, outlined above, undoubtedly have some structural factors in common with FDI in the global context, though somewhat magnified. First, there is a general trend of expansion in worldwide production, sourcing, and marketing strategies by international businesses. This "globalization" trend of international business has been shared and strengthened by those in rapidly growing developing economies in the region. We can confirm this by noting the accelerating intraregional trade and proliferating horizontal and/or vertical international division of labor found in manufacturing industries. Second, other domestic factors must have contributed—for example, local economic growth and deregulation of capital movements in the region, both of which have been, again, particularly salient in Pacific Asia.

4.4.3 International Banking Flows

Finally, we will deal with banking flows, that is, the cross-border claims and liabilities of banks, a component of private capital flows whose geographical distribution is most difficult to trace. We note that, outside the BIS reporting area, Asia was the only region during 1985–93 in which cross-border lending by BIS-reporting banks continued to grow (see table 4.9). The distribution of

8. Hong Kong's FDI to China includes Chinese domestic investment via Hong Kong in pursuit of the preferential treatment of FDI in China, called "round-tripping" of Chinese capital. Thus, note that Hong Kong's FDI to China is to some extent inflated by this round-tripping. See World Bank (1993c).

Table 4.9 **Distribution of International Bank Lending outside the Reporting Area by BIS-Reporting Banks (end of year)**

	Positions (billion U.S. $)				Share (%)			
Country	1985	1990	1992	1993[a]	1985	1990	1992	1993[a]
All countries	583.6	664.8	689.7	687.7	100.0	100.0	100.0	100.0
Developed countries	112.3	161.2	149.1	142.7	19.2	24.2	21.6	20.8
Latin America	236.5	184.8	187.4	189.8	40.5	27.8	27.2	27.6
Asia	94.3	135.4	167.7	183.5	16.2	20.4	24.3	26.7

Source: The Maturity, Sectoral and Nationality Distribution of International Bank Lending, Second Half 1993 (Basel: BIS, 1993).

[a]Preliminary figures for 1993.

Table 4.10 **International Claims outside the Reporting Area by Nationality of BIS-Reporting Banks**

		Share (%)			
Claims on:	Total (million U.S. $)	Japan	United States	United Kingdom	Germany
All countries	687,720	20.5	12.9	10.6	15.9
Pacific Asia	165,247	40.9	9.6	8.1	6.3
China	32,538	39.7	2.2	6.7	5.5
Indonesia	29,866	54.9	8.1	5.9	5.4
Korea	40,295	29.9	10.4	10	7
Malaysia	12,607	41.1	9.8	13.8	7.4
Philippines	5,633	16.6	44.1	10.3	2.7
Taiwan	15,185	26.8	16.1	9.7	8.5
Thailand	29,123	55.2	7.9	5.7	6.2
Offshore centers	338,214	62.8	3.1	6	8.3
Hong Kong	186,856	66.1	3	4.9	7.3
Singapore	151,358	58.8	3.3	7.3	9.6

Source: The Maturity, Sectoral and Nationality Distribution of International Bank Lending, Second Half 1993 (Basel: BIS, 1993).

bank lending by the nationality of the reporting banks indicates the dominance of Japanese banks in Pacific Asia, particularly in its offshore financial centers, Hong Kong and Singapore (table 4.10).[9] In the case of Japanese banks, despite Japanese boom and bust, their long-term foreign-currency external lending increased solely in Asia during 1990–93 (Ministry of Finance 1994).

9. Similar geographical concentration could be found in the case of U.S. banks lending to Latin America and German banks to Eastern Europe, but their degrees of dominance are not as great as Japan's.

One could correctly point out that it is impossible and useless to try too hard to trace multilateral banking flows. In fact, the existence of growing offshore financial markets makes simply infeasible the construction of a matrixlike table for bank loans within the region. Also, international financial transactions can no longer be regional because of developments in telecommunications and other technical innovations.

When we look at the cross-border claims and liabilities of banks and nonbanks, we recognize how widely and how deeply each economy is linked to the international financial market. The claims and liabilities of the two international financial centers, Hong Kong and Singapore, grew remarkably during the 1980s, and those of Japan started to expand vigorously in 1985. In fact, Japan, Hong Kong, and Singapore increased cross-border claims and liabilities as a ratio to GDP two to four times during the 1980s.[10] Note that growth has been mainly in interbank transactions.[11]

Table 4.11 illustrates the key role of Hong Kong in international financial transactions by reporting external bank claims and liabilities. The most conspicuous fact is, of course, that the position of Japanese banks as financial intermediaries has become paramount. Table 4.11 also indicates that, aside from the financial giant, Japan, a financial network through interbank transactions has steadily widened and deepened in Pacific Asia by such players as China, Taiwan, and Singapore vis-à-vis Hong Kong.

Financial interrelation has been promoted vigorously through three financial centers in the region, Tokyo, Hong Kong, and Singapore. Their market sizes as ratios to GDP increased by two to four times during the 1980s. Unlike the cases of official flows and FDI, Japan's role in banking flows has become huge since the 1980s. In fact, in the Hong Kong market, intraregional claims and liabilities amounted to 80 percent of the total. Although the other two ANIEs, Taiwan and Korea, are still cautious in opening up, their liberalizations of capital transactions are now on the time table. Closer interdependence through capital has been also found in cross-border banking.

10. Cross-border claims by banks are (as a percentage of GDP)

Country	1981	1990
Japan	7	32
Hong Kong	161	662
Singapore	549	1,058

Source: IMF (various years [b]).

11. Malaysia and then Thailand became more closely linked with the international arena in the latter half of the 1980s in terms of cross-border claims and liabilities. Although the liberalization of their capital accounts will change the situations in Taiwan and Korea, this has not happened yet. A relatively thin link to the international market is also found in Indonesia and the Philippines.

Table 4.11 **External Bank Liabilities and Claims: Hong Kong**

	Amount (million U.S. $)				Share (%)			
Country	1980	1985	1990	1993	1980	1985	1990	1993
Liabilities								
United States	2,156	6,593	12,792	11,990	6.6	7.9	3.2	2.7
Japan	1,797	10,731	258,273	286,679	5.5	12.9	64.1	65.4
China	191	2,821	14,939	20,056	0.6	3.4	3.7	4.6
Korea	414	1,364	1,039	1,525	1.3	1.6	0.3	0.3
Taiwan	104	1,215	951	827	0.3	1.5	0.2	0.2
Singapore	8,223	20,162	29,881	34,967	25.2	24.2	7.4	8.0
Indonesia	531	906	660	1,505	1.6	1.1	0.2	0.3
Malaysia	171	139	185	223	0.5	0.2	0.0	0.1
Thailand	138	155	402	1,267	0.4	0.2	0.1	0.3
Philippines	682	646	870	680	2.1	0.8	0.2	0.2
European Community	12,019	24,368	55,666	59,635	36.8	29.2	13.8	13.6
Grand total	32,658	83,399	402,952	438,632	100.0	100.0	100.0	100.0
Claims								
United States	2,035	6,655	14,558	15,722	5.9	6.6	3.1	3.0
Japan	1,984	13,320	309,419	334,326	5.7	13.2	66.7	64.5
China	1,490	3,919	15,486	25,221	4.3	3.9	3.3	4.9
Korea	2,726	8,286	6,642	9,062	7.9	8.2	1.4	1.7
Taiwan	1,274	1,268	3,591	7,661	3.7	1.3	0.8	1.5
Singapore	3,528	14,462	28,192	22,569	10.2	14.3	6.1	4.4
Indonesia	1,364	1,725	2,832	4,063	3.9	1.7	0.6	0.8
Malaysia	466	938	830	1,717	1.3	0.9	0.2	0.3
Thailand	810	1,583	3,510	8,596	2.3	1.6	0.8	1.7
Philippines	2,408	2,934	1,551	639	7.0	2.9	0.3	0.1
European Community	6,440	24,628	36,836	38,160	18.6	24.3	7.9	7.4
Grand total	34,585	101,262	464,087	518,022	100.0	100.0	100.0	100.0

Source: Monthly Digest of Statistics (Hong Kong: Census and Statistics Department, Hong Kong Monetary Authority, various issues).

4.5 The Role of Japan in the Region

Finally, we examine the role of Japan as a major capital supplier as well as a financial intermediary in Pacific Asia. Japan's total long-term capital outflow reached its peak of $192 billion in 1989, which coincided with the peak of its "bubble economy," or financially inflated boom. After the bubble burst, along with the economic downturn, its capital outflow declined sharply and hit the bottom at $58 billion in 1992. Among the components of capital, portfolio investment, the most significant since the mid-1980s, makes up more than 50 percent of the total outflow, FDI 20 percent, and loans 10 percent. After 1992, FDI and loans shrank more than portfolio investment (see table 4.12).

Although data on bilateral capital flows between Japan and Pacific Asia are

Table 4.12 **Long-Term Capital Account by Region: Japan (annual averages)**

A. World

	Amount (million U.S. $)				Share (%)			
Net Flow	1983–85	1986–88	1989–91	1992–94	1983–85	1986–88	1989–91	1992–94
Total	−43,958	−132,974	−31,925	−62,884	100.0	100.0	100.0	100.0
Assets	−57,010	−138,269	−144,777	−80,517	100.0	100.0	100.0	100.0
Liabilities	13,052	5,295	112,852	17,633	100.0	100.0	100.0	100.0
FDI	−4,994	−22,434	−40,271	−15,002	11.4	16.9	126.1	23.9
Assets	−5,343	−22,736	−40,960	−16,216	9.4	16.4	28.3	20.1
Liabilities	349	302	689	1,213	2.7	5.7	0.6	6.9
Trade credits	−3,434	−3,123	195	4,867	7.8	2.3	−0.6	−7.7
Assets	−3,448	−3,103	202	4,873	6.0	2.2	−0.1	−6.1
Liabilities	13	−20	−7	−7	0.1	−0.4	0.0	0.0
Loans	−10,321	−13,639	12,425	−4,311	23.5	10.3	−38.9	6.9
Assets	−10,258	−13,561	−19,258	−7,845	18.0	9.8	13.3	9.7
Liabilities	−63	−78	31,683	3,535	−0.5	−1.5	28.1	20.0
Securities investment[a]	−24,724	−87,307	2,639	−45,932	56.2	65.7	−8.3	73.0
Assets	−35,531	−92,228	−75,722	−56,546	62.3	66.7	52.3	70.2
Liabilities	10,807	4,921	78,360	10,614	82.8	92.9	69.4	60.2
Other	−485	−6,471	−6,913	−2,505	1.1	4.9	21.7	4.0
Assets	−2,430	−6,641	−9,039	−4,783	4.3	4.8	6.2	5.9
Liabilities	1,946	170	2,126	2,277	14.9	3.2	1.9	12.9

B. ANIEs

	Amount (million U.S. $)			Share (%)		
Net Flow	1988–89	1990–91	1992–93	1988–89	1990–91	1992–93
Total	−2,739	36,219	8,585	100.0	100.0	100.0
Assets	−3,616	−3,907	1,217	100.0	100.0	100.0
Liabilities	878	40,126	7,368	100.0	100.0	100.0
FDI	−2,689	−1,774	−272	98.2	−4.9	−3.2
Assets	−2,749	−1,820	−455	76.0	46.6	−37.4
Liabilities	61	46	183	6.9	0.1	2.5
Trade credits	−189	2	1,142	6.9	0.0	13.3
Assets	−189	2	1,144	5.2	0.0	94.0
Liabilities	−1	0	−2	−0.1	0.0	0.0
Loans	5,535	33,169	9,548	−202.1	91.6	111.2
Assets	−190	−1,886	473	5.3	48.3	38.9
Liabilities	5,725	35,054	9,075	652.4	87.4	123.2
Securities investment[a]	−5,121	4,701	−2,089	187.0	13.0	−24.3
Assets	−213	−309	−166	5.9	7.9	−13.6
Liabilities	−4,909	5,010	−1,924	−559.4	12.5	−26.1
Other	−275	122	256	10.0	0.3	3.0
Assets	−276	107	221	7.6	−2.7	18.1
Liabilities	2	16	36	0.2	0.0	0.5

(*continued*)

Table 4.12 (continued)

	C. Other Asia					
	Amount (million U.S. $)			Share (%)		
Net Flow	1988–89	1990–91	1992–93	1988–89	1990–91	1992–93
Total	−6,020	−5,534	−2,987	100.0	100.0	100.0
Assets	−6,324	−6,212	−5,782	100.0	100.0	100.0
Liabilities	304	678	2,795	100.0	100.0	100.0
FDI	−1,720	−2,346	−1,982	28.6	42.2	66.3
Assets	−1,697	−2,343	−1,985	26.8	37.7	34.3
Liabilities	−23	−4	3	−7.4	−0.5	0.1
Trade credits	19	−29	682	−0.3	0.5	−22.8
Assets	19	−29	688	−0.3	0.5	−11.9
Liabilities	0	0	−6	0.0	0.0	−0.2
Loans	−5,236	−3,830	−3,475	87.0	69.2	116.3
Assets	−5,236	−3,832	−3,482	82.8	61.7	60.2
Liabilities	0	2	8	0.0	0.2	0.3
Securities investment[a]	549	751	2,565	−9.1	−13.6	−85.9
Assets	189	−82	−224	−3.0	1.3	3.9
Liabilities	361	833	2,789	118.6	122.9	99.8
Other	368	−80	−778	−6.1	1.4	26.0
Assets	402	74	−779	−6.4	−1.2	13.5
Liabilities	−34	−153	1	−11.2	−22.6	0.0

Source: Bank of Japan (various issues).

[a]Securities investment is identical to portfolio investment.

not available, table 4.12 shows long-term capital flows between Japan and two subregions in Asia, namely, the ANIEs and "other Asia," the latter dominated by the ASEAN4 and China with respect to capital flows.[12] According to table 4.12, parallel with the general trend of flows, Japan's capital outflow to the ANIEs fell sharply after 1990, while its outflow to "other Asia" remained relatively steady and significant.

For the ANIEs, the main declining components were loans and trade credits, and then direct investment. In fact, in 1992–93 loans flew *back into* Japan from Hong Kong, Korea, and Singapore partly because of a "stock adjustment" after the Japanese bubble burst.[13] The focus of Japanese FDI shifted away from the ANIEs after 1990 because these countries have lost their major advantages of cheap labor costs and undervalued exchange rates. On the other hand, loan inflow from the ANIEs to Japan was significant throughout 1988–93, in partic-

12. "Other Asia" includes, in addition to Pacific Asia, Afghanistan, Bangladesh, Bhutan, Brunei, East Timor, India, Macao, Maldives, Myanmar, Nepal, Pakistan, and Sri Lanka.

13. Long-term loans by Japanese banks and insurance companies to Asian countries, particularly to Hong Kong, Korea, Singapore, and Thailand, once again expanded, reaching $13 billion in 1994 (Bank of Japan, various issues).

ular during 1990–91 mainly vis-à-vis Hong Kong and Singapore. Note also that there was significant ANIE portfolio investment in Japan in 1990–91, again mainly through Hong Kong and Singapore.

For "other Asia," the recent retrenchment in Japan's capital flows, described above, has hardly been felt (table 4.12). In fact, total net capital outflow declined, but only slightly from $6.3 billion (1988–89) to $5.8 billion (1992–93). As for the composition of capital, loans and direct investment have remained the largest and second largest components (60 and 35 percent shares, respectively). Meanwhile, long-term capital inflow from "other Asia" to Japan has been negligible.

This is not the whole story about capital flows between Japan and Asia, however, because we have not yet examined short-term capital flows and these flows are crucially important in discussing Japan's role in capital flows in Pacific Asia. Because of data unavailability on multilateral flows from short-term monetary transactions, however, we cannot deal directly with their intraregional flows. Instead, we can only make some conjectures based on investment income data. Figure 4.2 shows Japan's investment income flows by region since 1983. Investment income includes not only direct investment income but loan interest and other income accrued to Japan's total external assets and liabilities.[14]

Figure 4.2 shows that investment income flows between Japan and the ANIEs have been huge compared with those between Japan and the United States and the European Community. Note in particular that Japan paid more investment income to the ANIEs than to the United States during 1988–92. This may seem puzzling because the United States has invested longer and more in Japan than have the ANIEs and capital flows between Japan and the ANIEs have declined significantly recently. The answer is given by figure 4.3, which illustrates Japan's total external assets and liabilities outstanding by capital flow component.

Figure 4.3 shows that Japan's external assets consist mainly of securities investment and short-term monetary assets, plus some direct investment and loans, and that its external liabilities are constituted primarily by short-term monetary liabilities and then by securities investment. Thus, we see the significance of short-term monetary transactions, which appeared, not in long-term capital flows, but in investment income by region.

In other words, the hidden factor in the puzzle is short-term monetary flows between Japan and the ANIEs, in particular Hong Kong and Singapore. Although international bank loans relatively declined on a net basis in Pacific Asia, as elsewhere, international interbank claims and liabilities expanded on a gross basis rather rapidly through international financial centers, and this general trend enhanced and deepened international banking flows within the region. Japan's role in intraregional capital flows appears to reside in its key relationship with Hong Kong and Singapore.

14. Investment income comprises direct investment income, interest on trade credit, loans, bank loans and deposits, and external bonds, and interest and dividends on securities.

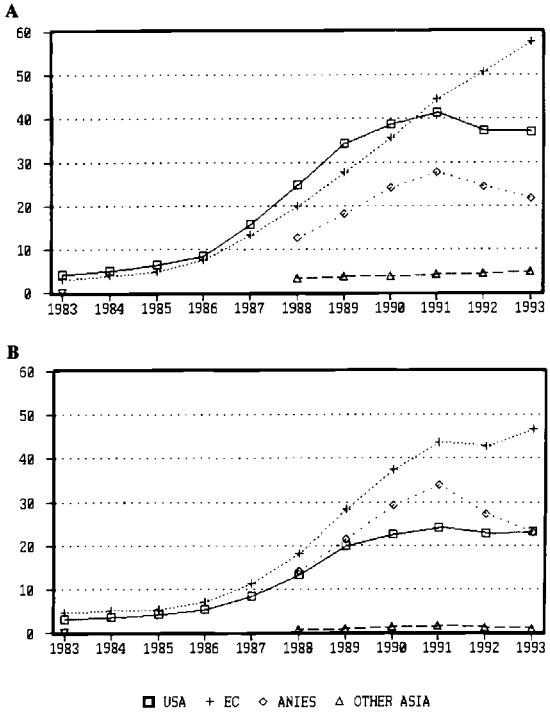

Fig. 4.2 Japanese investment income by region, 1983–93: (*A*) credit (billion U.S.$); (*B*) debit (billion U.S.$)
Source: Bank of Japan (various issues).

4.6 Concluding Remarks

We have examined developments in capital flows in Pacific Asia since the early 1980s. The regional pattern of external finance has been different from those of other developing regions. First, Pacific Asia did not suffer from such a severe decline in foreign capital inflow in the 1980s as did other developing regions. Second, some countries in Pacific Asia became "source countries" of capital either overall or of a specific component of capital.

However, Pacific Asia also displays some features in its changing pattern of external finance in common with other developing countries. FDI has begun to play a more significant role in capital flows. Portfolio investment has shown steady growth as an important new form of capital flows, though its sustainability remains in question.[15]

15. On the recent upsurge in portfolio investment flows to developing countries and its macroeconomic impact, see Claessens (1995a, 1995b), IMF (1994), World Bank (1993c), Calvo, Leiderman, and Reinhart (1993), Frankel (1994), Corbo and Hernandez (1994), Schadler et al. (1993), and Mathieson and Rojas-Suarez (1993).

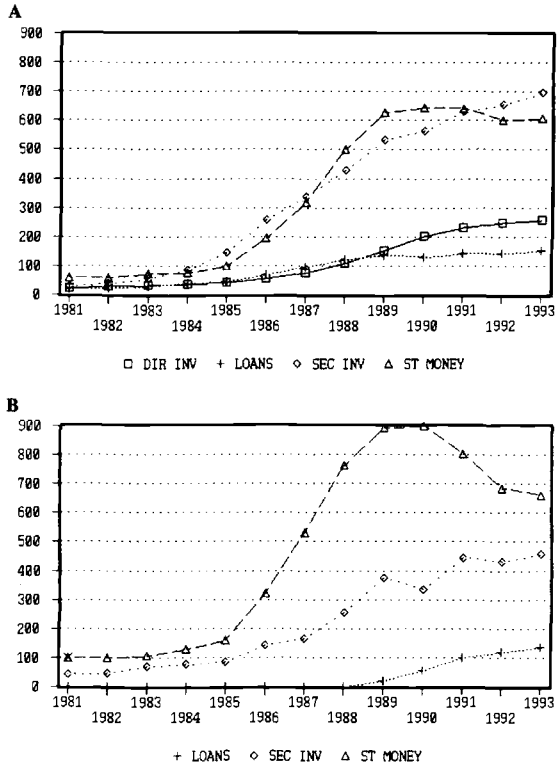

Fig. 4.3 Japan: (*A*) external assets (billion U.S.$); (*B*) external liabilities (billion U.S.$)
Source: Bank of Japan (various issues).

The ANIEs have appeared as far more important capital suppliers in the region since the 1980s. This has generated a greatly diversified and sophisticated network of capital flows in Pacific Asia. This is obviously one of the reasons for the relative decline of EC and U.S. capital in the region during that period.

One of the fundamental factors in this change in capital flows was the structural development in macroeconomic balances of these economies in the process of their dynamic growth in the 1980s. Indeed, some of them "graduated" from the stage of persistent domestic saving shortages typical of developing countries; this "graduation" in turn caused a significant change in the size and direction of capital flows.

Even though long-term international bank loans have appeared to shrink on a net basis, cross-border bank claims and liabilities have shown a great increase relative to domestic economic activities, especially through the international

financial centers. This has widened and deepened international capital transactions among economies in the region.[16]

As a result, Japan's role as a capital supplier has remained large, although not larger than in the early 1980s. Its role has become limited to a specific category of lower-income countries in the region. In fact, Japan's role in capital flows in Pacific Asia has been changing across various components of capital flows. It is no longer the dominant capital supplier in the region, though it has become the most important financial intermediary.

After realizing the importance of structural changes in macroeconomic balances and enhanced regional interdependence through capital flows, we should be more cautious in using regional aggregation. In such a dynamic region as Pacific Asia, aggregation across diverse economies sometimes gives misleading information about amounts as well as directions of those flows that may cancel one another within the region. This may not only be the case for capital flows.

Finally, we should note that, in the background of these shared developments, various preconditions for foreign investment were provided by host countries in Pacific Asia. They created the conditions necessary for increasing capital flows in order to help finance macroeconomic imbalances on one hand and tap technological spillovers on the other, while changes in the international economic climate as well as in the source countries may have created sufficient conditions.

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16. In fact, there is evidence that capital mobility and interest rate linkage among the economies has increased (see Glick and Hutchison 1990; Frankel 1992; Haque and Montiel 1990; Montiel 1994).

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Comment Toshihiko Kinoshita

Kohsaka's paper gives an updated and well-balanced overview of capital flows both into and out of Pacific Asia and will no doubt benefit those who are interested in this subject. Its coverage of all types of capital flows in this area is quite informative. Features of capital flow in Pacific Asia are made quite understandable through the comparison with Latin America. In that sense, it is a good paper. However, it seems to me that the description dwells too much on the phenomenon—though the analysis of savings-investment gaps as related to capital flow is well written.

Broadly speaking, capital flows can be classified in two categories. One is determined by the market. The other—official development finance (ODA plus OOF except export credit)—is determined by the policies of donor governments. The rise and fall of private capital flows, or the first category of flow, may well be explained by factors influencing the market. Kohsaka stresses in his paper the significance of vigorously growing foreign direct investment (FDI) in this region. Then, the logic of the recent rise and fall of FDI from Japan and elsewhere must be further explained. Such explanation is necessary in order to have a better idea of what might happen in the future.

There must be factors both in host countries and on the investors' side that influence the rise and fall of FDI. On the host country side in this region, we can easily find such factors: deregulation policies, such as the open door and reform policies of China and Vietnam; a growing domestic (or regional) market; and competition among host countries to induce more FDI, in particular, export-oriented FDI. On the investors' side, let me illustrate my interpretation

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of the mechanism that expanded Japan's FDI in the 1980s and the reverse mechanism that decreased it in the early 1990s (see figs. 4C.1 to 4C.4). The increase in FDI by Taiwan and Korea could be explained by the appreciation of their currencies vis-à-vis the U.S. dollar, a domestic labor shortage, and a fast-growing technological backlog.

Now, let me return to officially supported capital flow. As Kohsaka contends, it comprises ODA and OOF. Japan's ODA, for instance, has shown fast growth. That of the United States has not in the past decade. This difference reflects the differing policies of the two countries. It may be worth mentioning.

As for OOF, there exist two basic flows—one multilateral, the other bilateral. Let me add some facts. The former comprises the capital flows of the World Bank and the Asian Development Bank (ADB). The ADB will be more sensitive to a country-to-country balance in the region and the World Bank to a region-to-region balance (e.g., Asia vs. Africa). Bilateral OOF flows consist of officially supported suppliers' and buyers' credit and untied loans, which is more prevalent in this region, or such loans as have been massively supplied by the Export-Import Bank of Japan. Export credit as a whole is relatively less policy-based. It can be regarded as rather passive finance, particularly when the recipient is very creditworthy. Should exporters of country A fail in an international tender on a specific project, country A's export credit agency is not requested to provide financing.

The above-mentioned officially supported untied loans are one of the financial menus used in the new policy of the Japanese government, since 1987, to flow more Japanese capital to developing countries in a harmonious way. The main borrowers have been governments or governmental agencies, which sometimes relend to local private banks. These are my comments. Now let me ask one question.

Kohsaka classifies countries in the region into three groups. China is classified as a country that outflows capital somewhat and inflows capital at the same time. Will China's pattern of two-way capital flow continue into the twenty-first century?

Comment Ya-Hwei Yang

Kohsaka's paper gives an overview of the recent trend of capital flows both into and out of the Pacific Asia. Kohsaka finds that some countries in the region have become source countries of capital. Foreign direct investment has come to play a more significant role. Portfolio investment appears to have shown steady growth. The author mentions that the fundamental factors which have

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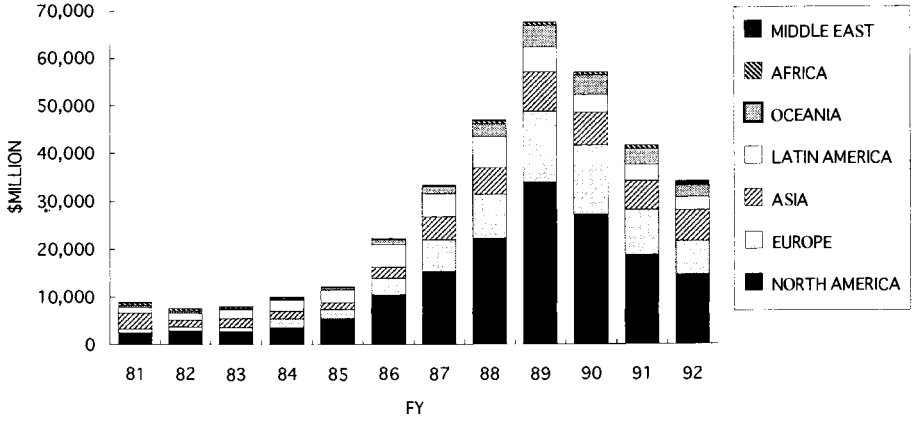

Fig. 4C.1 Trends in Japan's outward FDI by region
Source: Prepared by Export-Import Bank of Japan with statistics from Ministry of Finance.

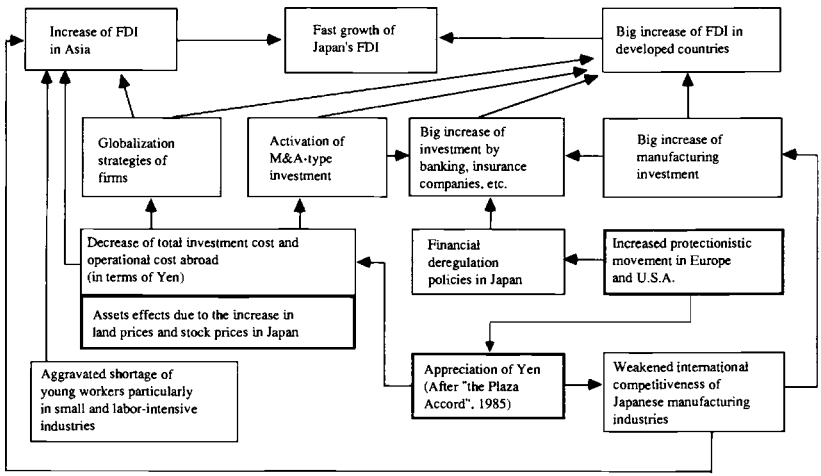

Fig. 4C.2 Expansion mechanism of Japan's outward FDI in the latter half of the 1980s

generated this change in capital flow are structural developments. Some of the countries have graduated from the stage of persistent domestic savings shortage. In addition, the role of Japan as a capital supplier has remained important, but not so dominant as before.

I have learned a great deal from this paper. It provides valuable information on the above-mentioned issues. I would like to add some complementary points here. Some of the issues need further study, if enough data are available. First, if this paper were able to give more explanation for each important phe-

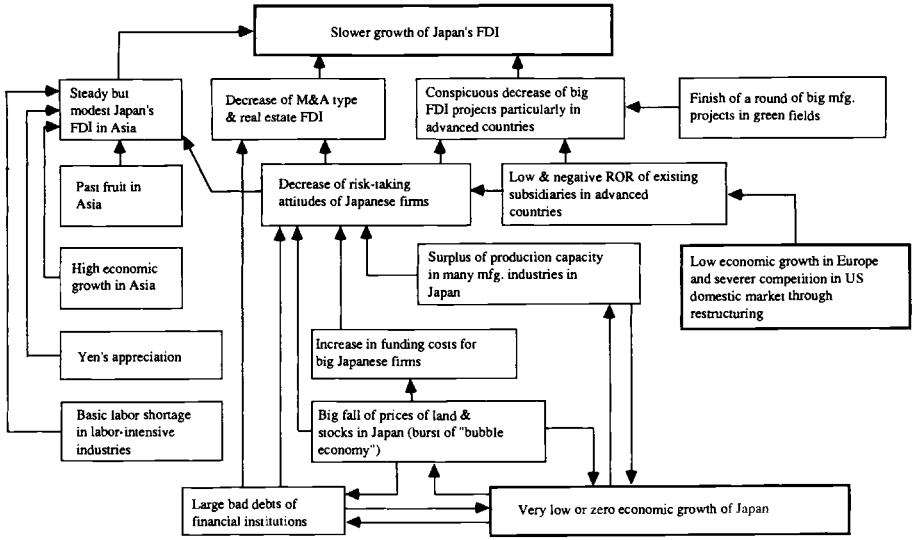

Fig. 4C.3 Change in expansion mechanism of Japan's outward FDI since the early 1990s

nomenon, it would be more comprehensive. For example, why have the net capital flows in the relationship between Japan and the NIEs changed? In addition, if the capital movement between any two countries were identified, it would be more informative. I understand that data availability is a problem that cannot be solved at present.

Because I am from Taiwan, I will give a brief synopsis of the case of Taiwan in related issues. Taiwan is one of the NIEs, also one of the four "tigers" in Asia. It has maintained a high growth rate and stable price levels. In recent years, many Taiwanese businesses have moved to other countries, especially to mainland China and Southeast Asia. The reason for this phenomenon is that traditional labor-intensive goods made in Taiwan are not as competitive as before. Labor in Taiwan has become more expensive because labor shortage is a serious problem. Land prices are increasing greatly, as well. Therefore, these traditional industries must invest abroad to search for cheaper labor and cheaper land, instead of staying in Taiwan. In the past five years, much Taiwanese capital has gone to mainland China. In the past three years, some Southeast Asian countries, such as Vietnam, seem to be more attractive to Taiwanese investments. In each of these Southeast Asian countries, Taiwan is usually ranked among the top three investor countries. When Taiwanese firms move outward, their primary capital fund sources are their head offices in Taiwan. Capital outflows generally follow the direction of overseas investment. Therefore, there is a large amount of capital flowing out of Taiwan. However, the offshore banking center of Taiwan is not yet matured and advanced. Therefore,

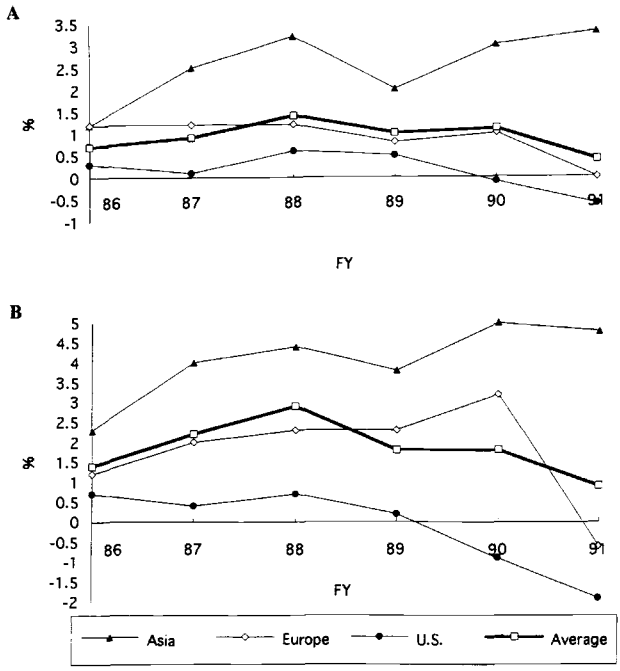

Fig. 4C.4 Operational profit ratio of Japanese affiliates vis-à-vis total sales: (*A*) all industries; (*B*) manufacturing sector

Source: Wagakuni Kigyo No Kaigai Jigyo Katsudo (Ministry of International Trade and Industry), no. 22 (1993).

much of this capital movement passes through the underground economy, instead of through official financial channels. In addition, the trade and capital flow patterns between Japan and Taiwan have not changed much so far. Although Taiwan has been an export-oriented country, it still has the same big trade deficit with Japan that it has had for decades. Most machines and key parts of manufactured goods are imported from Japan to Taiwan. Therefore, the capital flow relationship between the two has not changed much.

Different countries have different stories, and I have provided Taiwan's case as a reference for Kohsaka's paper.