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Flying Geese Theory and Japanese Foreign Direct Investments in South Asia :

Trends, Explanations and Future Prospects

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Abstract

Japan has emerged as a major source of FDI outflows especially since the mid-1980s. Japanese corporations have also set up production bases in many countries in East and Southeast Asia which feed back to their home market or third countries. The export-platform production by Japanese MNEs has moved over time from East Asian countries to Southeast Asia in a 'flying geese pattern'. South Asian countries, however, despite their large markets, manpower pool and liberal policies have not received the attention of Japanese corporations in a desirable manner. This paper reviews the trends in Japanese FDI inflows in the South Asian countries in the perspective of patterns of global FDI flows. It then explores the reasons for the relative neglect of South Asia by Japanese MNEs. It also examines the export-orientation of Japanese FDI in the South Asian countries and explores their prospects of serving as bases for export-oriented production.

1. Introduction

Japan has emerged as a major source of FDI outflows especially since the mid-1980s. Japanese corporations have become major players in a number of industrialised, newly industrialising and developing countries and dominate a growing number of market segments. Japanese corporations have also set up production bases in a large number of countries particularly in East and Southeast Asia which feed back to their home market in Japan or are used to serve as regional or global production centres. These production bases have been relocated by Japanese MNEs to access cheaper supplies of abundant labour or raw materials in their host countries as Japan lost its comparative advantage due to rising wages and appreciating yen since the Plaza Accord. These production bases have thus helped their host countries not only to enter new lines of manufacturing but have also assisted them to expand manufac-

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tured exports. The export-platform production by Japanese MNEs, however, has moved over time from East Asian countries to Southeast Asian countries as the competitive advantages of the original locations diminished. Flying geese theory has been advanced to explain the footloose nature of Japanese export-platform FDI (see Akamatsu, 1962; Ozawa, 1990). South Asian countries on the other hand, despite their large and growing markets, large pools of trained and cheap manpower, and reforms undertaken to liberalize their policies, have not received attention of Japanese corporations in a desirable manner. Furthermore, the Japanese MNEs have not yet begun to tap the potential of these countries for setting up export bases either for their home market-oriented consumption or for third country exports.

This paper reviews the patterns and trends in Japanese FDI inflows in the South Asian countries and contrasts them to those concerning the global flows of FDI. It then explores into the reasons for the relative neglect of South Asia by Japanese MNEs. It also reviews the patterns with respect to the export-orientation of Japanese FDI in the South Asian countries and explores the prospects of South Asia becoming a base for Japanese MNEs for export-oriented production.

2. Trends in Japanese FDI and the Place of South Asia

Japanese FDI outflows have grown substantially since the mid-1980s. The stock of Japanese outward FDI has grown from US $ 44 billion in 1985 to $ 293 billion by 1999 (UNCTAD, 2000). Of the Japanese FDI outflows over the 1990s, typically two thirds have been directed to industrialised countries, mainly the US and a few European countries particularly the UK. Of the inflows directed to developing countries, over 60 per cent are concentrated in Asian countries, with a high concentration in the East and Southeast Asian countries (Table 1). The South Asian countries have received a marginal, if not negligible, share of Japanese FDI outflows. The share of South Asian countries in Japanese FDI inflows going to developing countries has fluctuated between 0.37 per cent and 1.71 per cent between the 1990-96 period with an upward trend on the whole. In 1997, it showed a rather sharp rise to 3.95 per cent before falling again to 1.49 per cent in 1999. India has received the bulk of Japanese FDI in South Asia followed by Sri Lanka and Pakistan.

To put the relative importance of South Asian countries as destinations of Japanese FDI in perspective, we have also computed their share in global FDI inflows (viz. outflows from all the sources of FDI). South Asian countries have received a very small proportion of global FDI inflows. However, as shown in Table 2 and Figure 1, the South Asian countries have received a more respectable share of global FDI inflows among developing countries than their share in Japanese FDI inflows. Only in 1992, 1997, and 1998 does their share of Japanese inflows surpass their share in global inflows on a comparable basis. The share of South Asian countries showed a rising trend in both the cases during the 1991–97 period although the upward trend is more pronounced in the case of global inflows than Japanese inflows. Since 1997, share of South Asia has declined in both the cases and the decline has been sharper for its share in global inflows since 1997 is partly due to the crisis in the East Asian countries some of which like South Korea have emerged as important sources of FDI in the region.

Table 1 Japanese Direct Investment by Key Regions, 1991–99

(Million US $)

Fiscal Year	1991	1992	1993	1994	1995	1996	1997	1998	1999
World	41584	34138	36025	43071	51392	48020	53976	45127	72788
Developed Countries	30980	23850	25165	26665	34554	31197	34389	30040	56149
% share	74.5	69.863	69.854	61.909	67.236	64.967	63.712	66.567	77.141
North America	18823	14572	15287	18639	23218	23021	21391	12119	27033
Europe	9371	7061	7940	6565	8586	7372	11205	15517	28161
Australia and NZ	2786	2217	1938	1461	2750	804	1793	2404	955
Developing Countries	10603	10286	10860	16407	16839	16822	19588	15086	16638
% share	25.498	30.131	30.146	38.093	32.766	35.031	36.29	33.43	22.858
Latin America	3337	2726	3370	5533	3879	4446	6337	7156	8116
Middle East	90	709	217	305	153	238	471	162	123
Africa	748	238	539	368	381	431	332	492	562
Oceania	492	188	97	55	66	93	265	47	19
Asia	5936	6425	6637	10146	12360	11614	12183	7229	4818
NIEs I	2203	1922	2419	3011	3236	3538	3412	1954	3480
NIEs II	3083	3197	2398	4037	4137	4949	5695	4878	3959
China	579	1070	1691	2699	4478	2510	1987	1179	819
South Asia	40	219	80	198	232	287	774	338	248
% share in Developing Countries	0.377	2.129	0.737	1.207	1.378	1.706	3.951	2.24	1.491
% share in Asia	0.674	3.409	1.205	1.952	1.877	2.471	6.353	4.675	3.172
India	14	122	35	102	130	219	434	285	227
Pakistan	14	18	12	84	43	30	62	10	0
Bangladesh	8	60	16	2	1	11	7	3	0
Sri Lanka	4	19	17	10	58	27	271	40	21

Source: Complied from Japan, MITI (1994, 1996, 1998, 2000) quoting the Ministry of Finance.

Table 2 Global Foreign Direct Investment Inflows 1991–99

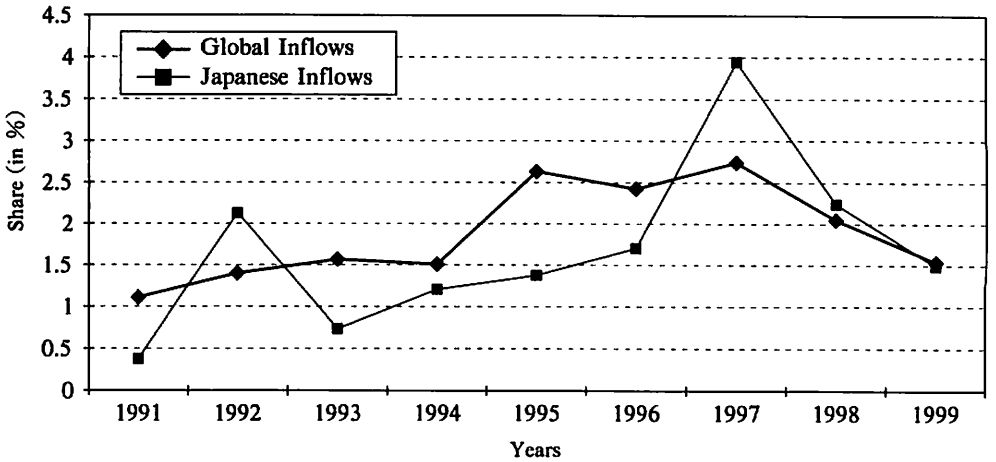
(Million US $)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
World	158936	175841	217559	255988	331844	377516	473052	680082	865487
Developing Countries	41696	51108	72528	104920	111884	145030	178789	179481	207619
Asia	23129	29651	51218	68606	73324	92434	101575	96504	105621
South Asia	463	717	1137	1581	2945	3519	4900	3680	3193
% share in Developing Countries	1.11	1.403	1.568	1.511	2.632	2.426	2.741	2.05	1.538
% share in Asia (Developing)	2.002	2.418	2.22	2.31	4.016	3.807	4.824	3.813	3.023
Bangladesh	1	18	10	11	2	14	141	308	150
India	155	233	574	973	2144	2426	3577	2635	2168
Maldives	n.a.	7	7	9	7	9	11	12	10
Nepal	2	1	4	7	8	19	23	12	132
Pakistan	257	335	347	419	719	918	713	507	531
Sri Lanka	48	123	195	166	65	133	435	206	202

Source: On the basis of UNCTAD, *World Investment Reports*, Various years.

Figure 1a South Asia's Share of Global and Japanese FDI Inflows received by Developing Countries, 1991-99, %

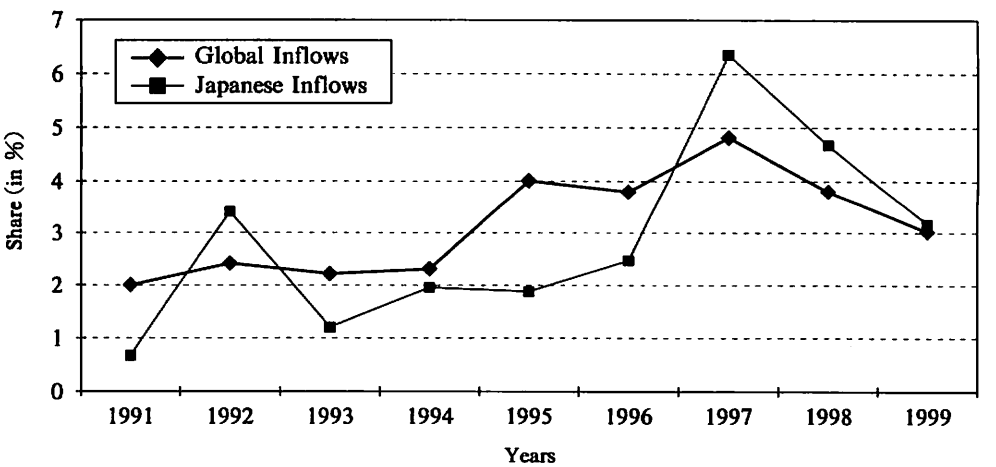
Year	1991	1992	1993	1994	1995	1996	1997	1998	1999
Of Global Inflows	1.110	1.403	1.568	1.511	2.632	2.426	2.741	2.05	1.538
Of Japanese Inflows	0.377	2.129	0.737	1.207	1.378	1.706	3.951	2.24	1.491



Sources: Based on Tables 1 and 2.

Figure 1b South Asia's Share of Global and Japanese FDI Inflows received by Asian Developing Countries, 1991-99, %

Year	1991	1992	1993	1994	1995	1996	1997	1998	1999
Global Inflows	2.002	2.418	2.22	2.31	4.016	3.807	4.824	3.813	3.023
Japanese Inflows	0.674	3.408	1.205	1.952	1.877	2.471	6.353	4.675	3.172



Sources: Based on Tables 1 and 2.

The relative neglect of South Asian countries by Japanese MNEs is also not consistent with their potential as assessed by Japanese agencies either. For instance, in EXIM Bank of Japan's recent Surveys, India has been put as the second most promising destination for investment in the long term among developing countries after China consistently in the past three Surveys. In respect of the medium term prospects too, India's ranking has moved up from 6th among developing countries in the 1996 Survey, to 4th in the 1997 and 1998 Surveys. In terms of actual flows, the FDI inflows in India or South Asia from Japan hardly match their potential as reflected in the EXIM Surveys.

What explains the relative neglect of South Asian countries by Japanese MNEs as hosts of their investments? Are Japanese FDI flows determined by different factors than those from other sources of FDI? To find answers to these questions, we turned to our recent analysis of determinants of affiliate sales of Japanese and US MNEs in a sample of host countries with the help of an exclusive three dimensional data set [see Kumar, 2000, for more details]. The data set covers 74 host countries, 7 branches of manufacturing and three points of time over the 1982–1994 period. A comparison of determinants of Japanese and US investments may reveal if the former are driven by different factors. In what follows, a brief description of the quantitative exercise is presented.

Factors Explaining the Location of Investments of Japanese and US MNEs

The inter-country variation in sales (as a measure of intensity of operation) of affiliates of Japanese and US MNEs in a particular country, in a particular sector and at a particular point of time is sought to be explained in the framework of an Extended Model of Location of Foreign Production formulated by us drawing upon the complementary approaches of gravity model of international trade and the theory of international operations of firms. This model explains the affiliate sales in terms of some demand (or gravity factors) in the host country captured by population, per capita national income, the geographical distance between the home and the host country, the extent of cultural affinity (proxied by linguistic homogeneity) between the home and host country, and the extent of urbanization. The model also includes a few variables in tune with the theory of foreign operation of firms that make local production preferable to exporting. These include wage rates, an index of quality of infrastructure and a vector of variables capturing different elements of the host country's policy framework. The policy factors included the relative openness of the country's trade regime, performance requirements imposed by host countries on foreign affiliates, the extent of investment incentives provided by host governments, the extent of tax incentives extended by host governments and the tax rates [see Kumar, 2000, for more details of the analytical framework and hypotheses].

This model, therefore, combines the demand factors in the host countries that act to pull MNEs towards them as well as factors that make affiliate sales rather than exporting as the mode of market servicing. Some of these factors are structural in the nature in the sense that they are given in a short period such as population, income levels, urbanization, infrastructure, wages and geographical and cultural distance as well as factors that are subject to host government policy and can be changed in short run such as trade, investment and technology regimes.

The model explains the patterns of location of MNEs' operations quite well for both Japanese and US companies. In general the findings for Japanese and US affiliates tend to converge. Yet some differences in the performance of individual variables are noticeable. We would summarize here the main findings specially those that point to a possible divergence in the patterns of Japanese and US MNEs. This may help to understand the relative neglect of South Asia by Japanese MNEs as observed earlier. Population is with significant positive coefficient throughout. Hence, holding other factors constant, countries with larger population are more attractive for MNE operation. However, the population elasticity of foreign penetration is greater than one for US MNEs but is less than one for Japanese MNEs. It would appear, therefore, that US MNEs are more than proportionately attracted to larger countries while the attraction of larger countries for Japanese MNEs is less than proportionate.

Income exerts a strong positive effect on foreign affiliate sales for both US and Japanese cases. The income elasticity of affiliate sales works out to 1.35 for US MNEs and 1.06 for Japanese MNEs. Thus income elasticity for US MNEs is much higher than that for Japanese MNEs for corresponding samples suggesting that US MNEs are particularly responsive to income levels for their investment decisions. Holding other factors constant, countries with higher income levels are disproportionately more attractive for MNEs whether originating in the West or East, although more so for the former. Conversely, lower income countries are disproportionately less attractive for MNE activity.

The differences in elasticities of Japanese MNEs with respect to poplation and income of host countries do not explain the neglect of South Asia by Japanese MNEs. The lower income elasticity should actually have favoured a greater proportion of Japanese FDI outflows compared to the Western outflows coming to South Asia!

The geographical distance between home and host countries plays a significant negative role throughout. Distance in the case of Japanese MNEs comes up with a much stronger significance of the coefficient than for US MNEs. Hence holding other factors constant, Japanese MNEs prefer to invest in the neighbouring countries more than their US counterparts.

Similarly, the countries sharing cultural or linguistic similarities with the home country are found to be more likely hosts of operations of a country's MNEs, controlling for other advantages. The importance of the cultural factor in guiding FDI patterns has been highlighted by the emergence of China as one of the largest hosts of FDI inflows over the past few years. The bulk of FDI inflows directed to China have been associated with ethnic Chinese enterprises. The quantitative literature, however, has been rather slow to recognize the role of cultural factors in shaping the global patterns of FDI flows. The effect of cultural proximity is also much stronger in the case of Japanese affiliates than in the case of US affiliates. This suggests that holding other factors constant, Japanese MNEs are more sensitive to cultural proximity in their overseas expansion than their US counterparts. The geographical and cultural distance between Japan and the South Asian countries may explain a part of the lack of their interest in the region.

Japanese MNEs appear to be more sensitive to the quality of infrastructure than US MNEs as the effect of the variable is stronger in the former case than the latter.

The variables capturing the host country trade, investment and technology policy regimes behave in a predicted manner and no significant divergence between response

of Japanese and US MNEs is notable.

Finally, two variables were included to examine any special advantages enjoyed by East and Southeast Asian newly industrialising economies (NIEs) viz., *ASNIE 1* and *ASNIE 2* do exert some effect. Both the variables are significant with a positive sign in the case of Japanese MNEs. However, only the second group of countries has a significant positive effect for US MNEs. That would imply that Southeast Asian and East Asian countries have enjoyed some special attractions for hosting operations of Japanese MNEs beyond those covered by our models such as demand patterns, geographical and cultural proximity and aspects of policy framework. In the presence of these regional dummies, the coefficient of geographical distance in the case of Japanese MNEs expectedly loses its statistical significance as the Asian NIEs are Japan's most immediate neighbours. However, the cultural proximity still enjoys statistical significance.

The above summary of an analysis of determinants of the extent of penetration by Japanese MNEs across countries highlights that Japanese MNEs highly value geographical proximity and cultural affinity, and the quality of infrastructure available in host country more than Western MNEs. That may partly explain their lack of interest in South Asia more than that of the Western MNEs. Some of the attractions or special advantages of Asian NIEs may lie in more active and perhaps aggressive approach to attract FDI by governments in some of these countries which might not be adequately covered by policy variables as measured in this exercise. The more exact nature and scope of these attractions remains to be comprehended.

3. Export-Orientation of Japanese Affiliates

It is clear that Japanese MNEs have neglected South Asian countries as location of their investments. What is the quality of the Japanese FDI in South Asia compared to other regions and of FDI inflows in the region from other sources of FDI?

Here we focus on export-orientation of production of Japanese affiliates as an indicator of their quality. This is justified on two accounts. South Asian countries, like most of the developing countries attach a high priority to expansion of their manufactured exports as a means of resolving their balance of trade problems. Hence, export-oriented production by MNEs would be valued highly by the host governments in the region. Most of the South Asian countries have also set up export-processing zones to attract MNEs to locate export-oriented manufacturing units by providing a liberal trading regime and infrastructural facilities and tax treatments. The other reason for focusing on export-orientation is the fact that Japanese MNEs have increasingly relocated their production abroad to access cheaper raw materials and labour available in other countries for home market consumption. This process of relocation received special thrust since the Plaza Accord in 1985 which led to appreciation of yen on a sustained basis. The bulk of such relocated production has gone to developing countries because of availability of cheaper labour.

Table 3 summarises the trends in export-oriented production abroad by Japanese MNEs. One finds that the proportion of exports in turnover of Japanese affiliates has declined over time from 52.72 per cent in 1980 to 33.72 per cent in 1992. The Plaza Accord of 1985 which led to a sharp appreciation of yen appeared to have motivated

Table 3 Trends in Export Orientation of Japanese Affiliates Abroad

	All countries			Developing countries		
Year	Exports to Japan (% sales)	Exports to third countries (% sales)	Total Exports (% sales)	Exports to Japan (% sales)	Exports to third countries (% sales)	Total Exports (% sales)
1980	35.50	17.22	52.72	25.55	22.41	47.96
1983	23.48	17.10	40.57	45.95	12.37	58.32
1986	13.83	16.44	30.27	49.07	34.06	83.14
1989	18.84	23.92	42.76	59.16	19.89	79.05
1992	14.48	19.25	33.72	66.35	8.98	75.33

Source: Kumar (1998a) on the basis of unpublished extracts from MITI's surveys on overseas activity of Japanese corporations, various years.

Japanese corporations to relocate production abroad as the share of exports in affiliate sales went up from 30.27 per cent in 1986 to 42.76 per cent in 1989. In the subsequent period, however, exports' share declined from 42.76 to 33.72 in 1992. It appears that the Japanese industry improved its competitiveness by restructuring itself and absorbed the initial shock of yen appreciation. Evolution of flexible automation may have aided the Japanese industry's effort to regain their competitiveness. Most of the decline is with respect to exports to Japan. The proportion of sales exported to the third countries has actually increased slightly as compared to 1980 but declined after 1989. The Japanese affiliates in developing countries export a much higher proportion of their sales than all affiliates. This proportion peaked in 1986 at 83.14 per cent and declined afterwards. It would appear that early investments of Japanese corporations in developing countries were largely export-oriented in nature and that they had focused their attention increasingly to domestic markets in the subsequent period. Unlike all affiliates, exports to Japan of developing country affiliates have steadily increased from 25.55 per cent in 1980 to 66.35 per cent in 1992. Exports to the third countries have declined after 1986. It would suggest, therefore, that Japanese MNEs relocate production in developing countries mainly for labour intensive processing for final consumption or further processing in their home country.

It is also interesting to note that the third country markets oriented FDIs of Japanese corporations have increasingly concentrated in the industrialised countries in the late 1980s and 1990s. It is to be explained in terms of increasing regional trade integration in Europe and North America in the recent years which favours localisation of manufacture within the region for feeding the markets in customs union participating countries.

The export intensities of Japanese affiliates in developing countries in 1986 and 1992 are summarised in Table 4. The initial round of export-oriented investments by Japanese corporations was concentrated in East Asian countries. Of late, a number of Latin American countries have emerged as important locations for export-oriented Japanese FDI. Japanese investments in Middle East and Africa are rather small although their natural resource intensive nature has implied rather high export ratios.

Table 4 Export-Orientation of Japanese Affiliates in Developing Countries, 1986–1992

Region/ country	1986			1992		
	Sales*	Total Exports (% sales)	Exports to Japan (% sales)	Sales*	Total Exports (% Sales)	Exports to Japan (% sales)
World	**17,601,847**	**30.27**	**13.83**	**49,572,421**	**33.72**	**14.48**
Latin America	**726,820**	**38.50**	**20.02**	**1,449,761**	**47.17**	**22.90**
Panama	119,685	60.64	42.28	368,137	45.19	10.22
Brazil	372,324	32.15	11.72	390,668	56.29	29.54
Bermuda	20,030	99.80	0.00	143,341	90.61	80.75
Mexico	35,312	18.93	2.57	87,778	37.09	3.12
Peru	26,720	9.82	9.72	30,203	36.20	29.36
Argentina	8,994	2.64	1.33	63,667	30.83	22.02
Venezuela	6,289	5.60	0.00	130,745	34.46	5.03
Chile	6,281	0.54	0.54	74,402	37.04	29.37
Puerto Rico	15,046	0.00	0.00	54,228	6.54	0.00
Colombia	29,014	2.23	2.23	65,866	23.46	9.21
Asia	**2,887,749**	**54.69**	**19.84**	**8,963,860**	**40.61**	**21.81**
South Korea	333,572	50.01	20.02	516,298	21.69	10.46
Taiwan	326,671	47.93	26.11	1,151,299	19.17	10.90
Hong Kong	909,911	78.26	23.71	1,813,924	50.31	25.70
Singapore	567,903	57.12	21.59	2,265,257	63.99	36.75
Thailand	306,472	19.43	9.49	1,277,686	20.24	8.44
Malaysia	193,793	41.98	7.34	749,739	48.81	22.49
Indonesia	97,457	9.32	2.52	668,713	28.30	17.69
Philippines	119,066	56.08	30.00	184,934	26.75	13.19
Brunei	107	68.22	21.50	2,227	0.00	0.00
China	11,464	9.79	7.72	133,346	53.28	42.72
India	20,064	6.11	0.00	152,360	5.77	0.22
Pakistan	0			40,927	0.00	0.00
Bangladesh	491	0.00	0.00	348	95.40	69.54
Sri Lanka	665	14.14	4.96	3,609	53.67	12.64
Mid & Near East	**109,783**	**81.21**	**66.94**	**411,949**	**92.12**	**51.66**
Kuwait	2,145	0.00	0.00	1,275	0.00	0.00
Iran	2,578	0.00	0.00	2,663	38.57	38.49
UAE	67,657	98.37	98.37	12,299	91.76	91.67
Saudi Arabia	21,814	32.15	17.19	58,105	60.90	16.88
Bahrain	15,589	100.00	20.44	334,175	98.52	56.62
Africa	**74,674**	**51.22**	**26.11**	**77,280**	**62.66**	**23.79**
Liberia	8,189	82.83	82.83	24,286	81.65	20.94
Nigeria	2,768	1.12	1.12	737	0.00	0.00

* Sales of affiliates reporting geographical breakdown of sales.

Source: Kumar (2001, forthcoming: Chapter 5) on the basis of unpublished extracts from MITI's surveys on overseas activity of Japanese corporations, various years.

The pattern of export propensity of Japanese enterprises across countries has changed significantly since 1986. In 1986, affiliates in East Asian NIEs viz. Hong Kong, Taiwan, South Korea and Singapore along with Philippines had high ratios of total as well as Japanese market oriented exports. By 1992 the export intensities of affiliates in the East Asian NIEs had declined. The apparent reason seems to be the rising wages and currency appreciations in these countries in the late 1980s. The investments that had been moved from Japan to the East Asian countries in 1970s and early 1980s to take advantage of low cost labour were moved once again to Southeast Asian and Latin American countries. Among the Southeast Asian countries, China, Malaysia (and to some extent Indonesia) have emerged as major hosts of export-oriented investments by Japanese MNEs. In 1992, Japanese affiliates in China exported 53.28 per cent of their sales, of which 42.73 per cent were directed to their home country compared to under 10 per cent share of exports in 1986.

Hence, the pattern seems to follow the footloose character of export-oriented investment and fitting in the pattern predicted by the flying geese theory. This shift in the country focus has also been observed by Urata (1998). Among the Latin American countries, Bermuda, Brazil, and Panama have been successful in attracting export-oriented FDI from Japanese MNEs. South Asian countries including India have failed to attract significant amount of export-oriented FDI so far. Japanese investments in Bangladesh and Sri Lanka are quite trivial although their export propensities are high. In the case of India, the export ratio has actually declined from an already low figure of 6.1 per cent to 5.7 per cent over the 1986–92 period.

The neglect of South Asian countries as bases for export-oriented production by Japanese MNEs leaves one wondering for explanations given the abundance of the region in low cost but highly qualified labour and mineral resources that drive much of the export-oriented production abroad. To find answers once again we turned to our recent analysis of the determinants of export-orientation of Japanese and US MNEs [see Kumar, 1998a, 2001, for details].

Factors Determining the Home Market-orientation of Japanese Affiliates

The analytical framework developed for explaining the locational pattern of export platform production abroad by MNEs takes into account the destination of exports. We have argued that export platform production by MNE affiliates geared to their home markets is of a different nature than that serves the third countries [see Kumar 1998a]. Hence, different factors determine them. This framework emphasizes on the role of a number of geopolitical and strategic factors in shaping the locational pattern of export platform production, besides structural and policy characteristics of host countries. These include the trend of regional economic integration in different parts of the world that increasingly affects the global pattern of production, investment and trade. This framework is then used to analyze the determinants of export-oriented production by US and Japanese corporations abroad with Glob-Ted database which allows us to capture three dimensions in the analysis viz. 74 host countries, seven broad branches of manufacturing, and three points of time over the 1982–94 period.

Among the findings pertaining to performance of specific explanatory variables, wage rate was statistically significant with a predicted negative sign while explaining

the proportion of exports to Japan by Japanese affiliates. So an important motivation for relocation of production for the consumption in the home countries of MNEs is to benefit from availability of low cost labour abroad. The countries with a pool of cheaper labour have an obvious advantage in attracting this production from MNEs, controlling for the quality of labour. Mineral endowments also had a predicted positive significant effect on home bound export intensity of Japanese affiliates. Therefore, countries with abundant natural resources stand a better chance to attract home market oriented production from Japanese MNEs, holding other factors constant. South Asian countries having been endowed with large pools of skilled and unskilled labour and also mineral reserves are not at a disadvantage on these accounts.

Geographical distance from Japan came up with a negative and significant influence while explaining the home market exports of Japanese affiliates. Therefore, geographical proximity with the home country seems to be an important advantage for attracting the home country market oriented investments, holding for other factors. The significance of backyard effect might explain the concentration of export oriented investment by Japanese MNEs in the East Asian countries and their relative neglect of the South Asian Countries.

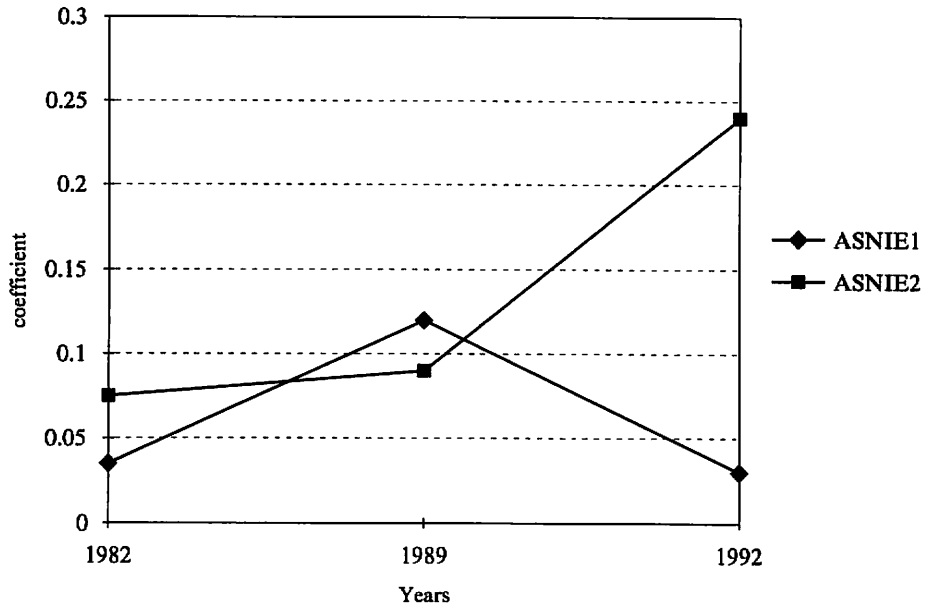
The policy of setting up enclaves providing liberal trading environment and infrastructure in the form of export processing zones has helped countries attract home market oriented production from MNEs which are essentially of labour processing type. Having established export processing zones, South Asian countries are not at a disadvantage in this respect either.

Special Regional Advantages of East Asian Countries and Prospects for South Asia

East and Southeast Asian economies are known to have been particularly successful in attracting export platform investments from MNEs and in expanding their manufactured exports rapidly over the past two decades. It could be explained by the availability of relatively cheap and educated work force, favourable policy environment and other factors specified in the reported exercise. In order to examine if these countries enjoyed any special advantages that are not captured by the factors specified here, we repeated the model estimations with dummy variables identifying these countries. These countries were identified with two dummies, one separating the first generation of NIEs viz. South Korea, Taiwan, Hong Kong, and Singapore (*ASNIE 1*), and the second including the fast growing Thailand, Indonesia, Malaysia, Philippines, and China (*ASNIE 2*).

There may a dynamic element in the special advantage of these countries. The first generation of NIEs have experienced sustained appreciation of their currencies, labour scarcity, and loss of Generalised Sytem of Preferences (GSP) benefits, and quotas under the Multifibre Agreement (MFA) since the mid-1980s and have emerged as important sources of outward FDI including export-oriented one themselves [Kumar, 1998b]. Because of that reason they may be disadvantaged as hosts of export-oriented FDI especially in the more recent period. The second tier NIEs, however, have recently emerged as important hosts of export-oriented FDI as seen above. Therefore, there may be interaction with time in the effect of these variables. In order to detect the movement in their special advantages over time, time variant regional dummies were used.

Figure 2 Coefficients of Special Advantages of Asian NIEs



The coefficient of *ASNIE 1* in 1982 was not significantly different from zero. It becomes statistically significant with a positive sign and again loses its magnitude as well as statistical significance for 1992. Hence, the first generation of Asian NIEs were tapped by Japanese MNEs for home market oriented production significantly in the period following the Plaza Accord of 1985. However, by 1992 they had lost their competitiveness as attractive locations for home market oriented processing by MNEs. This tends to corroborate the prediction in light of trends observed earlier such as rising wages, appreciating currencies, loss of GSP benefits and MFA quotas etc. The impact of these trends on the East Asian economies has been so significant that their national enterprises are globalizing production and have themselves become significant sources of export-oriented FDI over the past one decade.

The second tier Asian NIEs, on the other hand emerged as increasingly important hosts for home market oriented production by Japanese MNEs with their significant positive effect and increasing magnitudes of the coefficients over time. Figure 2 shows the changing magnitudes of the special advantages of ASNIEs in a graphic manner. This tends to confirm the footloose nature of export platform production by MNEs which moves from place to place on the basis of changing comparative advantage. The literature has emphasized on the flying geese pattern of location of export-platform production where the new countries fill the space vacated by others (see e. g. Ozawa 1990; Braga and Bannister, 1994).

This characterization would create hopes for South Asian countries as the probable locations for export-platform product by Japanese after saturation of the South-east Asian (or *ASNIE 2*) countries. However, the recent economic turmoil in East Asia has upset those hopes. Because of steep devaluations of currencies of the East Asian countries, the need for relocation of production for regaining competitiveness has diminished. South Asian countries, hence, will have to wait for some more time. Let us hope that the wait is not indefinite!

4. Concluding Remarks

In the foregoing, we have examined the patterns of Japanese FDI inflows and their export-orientation in the perspective of South Asia as a destination of global inflows. It is found that Japanese MNEs have neglected South Asia as a base for their operations for domestic as well as for their home markets. We have tried to understand these trends in the context of determinants of location of Japanese FDI and their export orientation. Japanese FDI flows are found to be more sensitive to geographical and cultural proximity than their Western counterparts, holding other factors constant. That probably explains their high concentration in the East Asian countries. As Japanese MNEs become more global in their outlook in future, the relative importance of distance and culture as major determinants of their location may diminish and they may be more inclined to venture into South Asia.

The export-orientation of Japanese investments is also sensitive to distance. But there is evidence of the footloose nature of export-platform investments and its relocation to other host countries when the competitive advantage of original host countries as a location diminishes. This had led to Southeast Asian countries to take over from the East Asian NIEs as preferred hosts of export platform production by Japanese MNEs in the 1990s. The transition from Southeast Asia to South Asia, however, may take some more time in the light of the disruption caused by the recent currency crisis in Asia.

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