EAST ASIA AND EUROPE: RECENT TRENDS IN FOREIGN DIRECT INVESTMENT

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Introduction

In a previous Working Paper (Dicken 2002) a series of aggregate data on trade and foreign direct investment were presented as a broad context within which to set the analysis of global production networks. The present paper focuses specifically on FDI alone. Its primary objective is to provide an up-to-date statistical picture of FDI relationships between the EU, East Asia and Eastern Europe, particularly in the light of developments in the past decade or so. The paper both updates the FDI data presented earlier and also expands the scope of the analysis for specific countries.

The paper draws primarily upon three data sources[1]:

1. UNCTAD (2002) *World Investment Report*, *2002*.
2. OECD (2002) *International Direct Investment Statistics Yearbook, 1989-2000*.
3. European Commission (2002) *European Union Foreign Direct Investment Yearbook, 2001*.

Some background

The EU-East Asia FDI relationship was first explored in detail in two parallel reports published just before the 1997 financial crisis in East Asia. The EC Report, *Investing in Asia's Dynamism: European Union Investment in Asia (EC 1996)* addressed the flow of FDI from the EU to East Asia and argued that EU firms were under-investing in what was seen to be the world's most dynamic economic region:

> Developing Asia is the world's most significant developing region in terms of FDI, having overtaken Latin America and the Caribbean in the 1980s. Between 1988 and 1993, developing Asia's stock of FDI doubled – an increase unrivalled by any other developing area. Now almost half of all the FDI stock in developing regions is in this area…Japan, the United States and the European Union are the predominant sources of FDI flow to this region…[However]…*The European Union has the smallest FDI stock among triad investments in the developing Asian region* (EC1996: 9, emphasis added).

An UNCTAD report, *Sharing Asia's Dynamism: Asian Direct Investment in the European Union (UNCTAD 1997)* addressed the other side of the EU-East Asia FDI relationship. Again, the low level of FDI interaction between the two regions, this time from the East Asian side, was emphasized:

> The European Union is the largest host to foreign direct investment in the world, absorbing nearly two-fifths of global investment flows and stocks. Asian countries, for their part, have recently emerged not only as the largest host region in the developing world but also as home to dynamic international investors. Indeed, flows from Asia have played a major role in the recovery of international capital flows from the foreign-direct-investment recession of 1991-1992, contributing about two-thirds of additional outflows during 1993-1994.
>
> *Asian investors have, however, paid relatively little attention to the European Union and other parts of the European continent. This is evident from the relatively small European shares in the investment outflows from such Asian economies as Hong Kong, the Republic of Korea, Malaysia, Singapore, Taiwan Province of China and Thailand* (UNCTAD 1997: iii, emphasis added).

Both reports proposed various policy measures to address what was seen to be a significant problem from the perspective of the EU economies. However, the ink was barely dry on these two reports when the totally unanticipated East Asian financial crisis suddenly broke in July 1997. Although the *schadenfreude*-type reactions of some western observers have not been fully realised – and, indeed, substantial recovery has occurred in many, though not all, East Asian economies - there is no doubt that the crisis triggered a substantial re-evaluation of economic circumstances both internally and externally.

In particular, changes in the valuation of productive assets within several East Asian economies (including Japan) have led to a substantial wave of corporate restructuring, often involving the acquisition of East Asian firms by western investors. Notable examples include the acquisition by Renault of a controlling shareholding in Nissan, Ford's effective takeover of Mazda, GM's acquisition of the Korean assets of Daewoo, and Wal-Mart's purchase of a controlling stake in the Japanese supermarket chain, Seiyu. At the same time, the ambitious overseas investment plans of a number of leading East Asian firms (notably from South Korea) have been either abandoned or, at least, severely curtailed or postponed.

Considerably less systematic attention has been devoted to FDI relationships between the EU and the 'transitional' or 'emerging market' economies of Eastern Europe.[2] There was, of course, much speculation, in the immediate aftermath of the collapse of the state-command systems in the early 1990s, that there would be an avalanche of FDI into Eastern Europe. More recently, in the context of the anticipated enlargement of the EU, a number of analyses have appeared of the nature of FDI in the candidate countries (see, for example, Lovino 2002a,b; Lovino and Passerini 2002). There is also case evidence of some locational shifts of productive investment by firms (both European and non-European) from sites in the EU to Eastern Europe (see, for example, *The Financial Times* 3 February 2003).

Limitations of FDI data

Despite their many imperfections, FDI data are the only comprehensively collected – and regularly updated - statistical data on the cross-border activities of business firms. FDI data are of two kinds:
stocks are the current accumulated book values of FDI at a given date while *flows* are the net annual increases or decreases in a firms' overseas assets/liabilities. Stock measures are more stable measures than flows and, therefore, give a better long-term picture of FDI trends. By definition, however, they do not show short-term changes in FDI positions. Flows are more volatile than stocks; indeed, a single large investment (say an acquisition or a disposal) can give a highly distorted impression of underlying trends and positions. On the other hand, periods of sustained increases or decreases in flows will eventually be translated into changes in stocks.

Hence, FDI *stock* data provide a valuable insight into the cumulative development of investment over time while FDI *flow* data show the more volatile, short-term changes in the investment position at the global, regional, and national scales. Of course, FDI data reflect only one dimension of the geographically dispersed operations of TNCs as expressed through ownership of equity. As such FDI data do not capture other modalities of TNC activities, notably strategic alliances and sourcing relationships. Neither do the data enable us to identify the components of change involved, particularly the distinction between greenfield investment and acquisition/merger.

Global trends in FDI, 1986-2001

In aggregate terms, FDI has grown extremely rapidly in the past forty years, with a particularly marked acceleration after the mid-1980s (see Dicken 2003: 52-53). However, after unprecedented rates of growth during the second half of the 1990s -

growth in FDI stocks of 18-20% per year and of flows of 30-50% per year in1998-2000 - there was a dramatic fall in growth rates in 2001. FDI outflows declined by 55% in 2001 whilst inflows fell by 51% (Table 1). According to UNCTAD

> this is the third downward cycle in FDI, each punctuating a long upward trend in FDI every ten years or so…[previous cycles were in the late 1980s/early1990s and in 1982/1983]…These swings reflect changes in several factors. The main ones are business cycles, stock market sentiment and M & As. These short-term factors work in tandem with longer-term factors, sometimes offsetting and at other times reinforcing them (UNCTAD 2002:4)

Without doubt, mergers and acquisitions (M & As) constituted the major process driving the very high levels of FDI growth during the 1990s. Indeed**,** UNCTAD (2000: 10)) claimed that "over the past decade, most of the growth in international production has been via cross-border M & As rather than greenfield investment…The value of completed cross-border M & As (defined as the acquisition of more than 10 per cent equity share) rose from less than $100 billion in 1987, to $720 billion in 1999." International M & A activity grew by an average of 43 per cent per year during the 1980s and 1990s but then collapsed dramatically in 2001 (UNCTAD 2002). This was undoubtedly a major cause of the dramatic reversal of FDI growth in that year.

Table 1 Aggregate growth trends in FDI stocks and flows, 1986-2001

Annual percentage change

	1986-1990	1991-1995	1996-2000	1998	1999	2000	2001
FDI outward stock	19.8	10.4	17.8	20.9	17.4	25.1	7.6
FDI inward stock	15.6	9.1	17.9	19.8	20.0	22.2	9.4
FDI outflows	24.3	15.8	36.7	52.8	52.3	32.4	-55.0
FDI inflows	23.6	20.0	40.1	44.9	56.3	37.1	-50.7
GDP	11.5	6.5	1.2	-0.9	3.5	2.5	2.0
Exports	15.8	8.7	4.2	-1.5	3.4	11.7	-5.4

Source: based on UNCTAD (2001)Table I.1; UNCTAD (2002) Table I.1

Geographically, global FDI continues to be dominated by the European Union, the United States and East Asia, as Table 2 shows. The three regions account for almost 90% both of outward stocks and of outward flows, a share that has remained extremely stable for two decades. The EU is clearly the dominant region for outward FDI with more than 50% of both stocks and flows. Roughly half the EU's total outward FDI in 2001 of $3,440,890 was invested outside the EU itself and half inside. Even when intra-EU investment is excluded, the EU remains the world's biggest source of FDI.

Table 2 Geographical concentration of outward FDI

Per cent of total world stocks

Source	**1980**	**1985**	**1990**	**1995**	**1998**	**1999**	**2000**	**2001**
EU	40.6	41.4	46.0	45.6	47.2	48.9	52.1	52.5
USA	42.0	35.5	25.1	24.3	24.1	22.6	20.8	21.1
E Asia	4.7	7.6	14.1	14.6	14.1	14.7	14.2	13.6
Japan	*3.7*	*6.2*	*11.7*	*8.3*	*6.6*	*5.0*	*4.7*	*4.6*
Total*	87.3	84.5	85.2	84.5	85.4	86.2	87.1	87.2

Per cent of total world flows

Source	**1989-1994 annual average**	**1995**	**1998**	**1999**	**2000**	**2001**
EU	46.1	44.8	63.8	71.6	67.2	58.8
USA	21.5	25.9	18.4	14.2	12.1	18.4
E Asia	21.7	18.1	7.6	5.7	10.1	11.1
Japan	*13.0*	*6.3*	*3.4*	*2.3*	*2.9*	*6.1*
Total*	89.3	88.8	89.8	91.5	89.4	88.3

* excluding Japan

Source: based on UNCTAD (2002) Annex Tables B2, B4

In fact, the extent of intra-EU FDI varies somewhat between individual member states. The lowest intra-EU FDI participation is, in fact, that of the UK which, in 1999, had only 33% of its outward FDI stocks and 30% of its FDI outflows within the EU. The comparable figures for France were 52% and 60% and for Germany 50% and 62%.

Table 2 also shows the significant acceleration in outward FDI from East Asia which occurred between 1985 and 1990. Initially, that surge was driven by the rapid growth of Japanese FDI although, more recently, FDI from other East Asian countries, notably Hong Kong, Singapore, South Korea, and Taiwan, has grown rapidly. In the 1990s, in fact, the growth of FDI from Japan slackened considerably. A considerable proportion of East Asian FDI is, like that in the EU, *intra*-regional (see Dicken and Yeung 1999:111-115). In particular, within East Asia, an increasing volume of East Asian FDI is flowing to China. In addition to the very strong Chinese orientation of Taiwanese and Hong Kong FDI, Japanese firms are investing very heavily there (see JETRO 2002: 20-21; UNCTAD 2002: 44-45).

Within these broad aggregates for the EU and East Asia as sources of FDI there are, of course, significant variations in the importance of individual countries. As Table 3 shows, five EU countries account for 80% of total outward EU FDI, of which the UK is by far the most important, followed by France and Germany. Within East Asia, although the top five sources account for 90% of the region's outward FDI total, two countries are especially significant as FDI sources: Hong Kong and Japan.

Table 3 Leading sources of outward FDI in the EU and East Asia

EU	$m	%EU	East Asia	$m	%EA
United Kingdom	942,848	27.4	Hong Kong	374,780	42.1
France	515,475	15.0	Japan	300,115	33.7
Germany	513,835	15.0	Singapore	63,225	7.1
Belgium/Luxembourg	449,044	13.1	Taiwan	54,667	6.1
Netherlands	328,422	9.5	South Korea	40,825	4.6
Total	2,749,624	79.9	Total	833,612	93.6

Source: based on UNCTAD (2002) Annex Table B4

EU FDI in East Asia

The extent of EU FDI in East Asia

The EU is the biggest source of FDI in the world. How much of the extra-EU investment is located in East Asia? We noted earlier the concern expressed by the European Commission in the mid-1990s that the EU's involvement in East Asia was lower than it might be. Has the picture changed since then? Table 4 shows the broad pattern of extra-EU FDI from 1994 to 2000.

Table 4 Distribution of EU outward FDI, 1994-2000

	% of stock							*% of flows*	
Destination	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**		**1999**	**2000**
East Asia	**10**	**10**	**11**	**10**	**9**	**9**		**8**	**7**
'Other'Europe*	**3**	**4**	**5**	**7**	**8**	**7**		**6**	**6**
C. America	7	7	6	7	5	4		4	5
S. America	7	8	8	8	10	10		11	9
USA	44	44	43	44	48	52		63	47

* Includes Eastern Europe, the Baltic States and the CIS

Source: based on EC (2002): 22

Clearly, outward FDI from the EU is overwhelmingly dominated by stocks in, and flows to, the United States. In comparison, all other investment locations pale into insignificance. East Asia's share of total EU FDI hardly changed during the 1990s. Overall, the region contains slightly less than 10% of the extra-EU total stocks and a slightly smaller percentage of flows; very similar to the situation for South America. But these figures do not reveal underlying growth trends, which give a slightly different picture. Eurostat data show that EU FDI stock in East Asia grew by 29% in 1996, by 8% in 1997, 4% in 1998, and then surged by 48% in 1999. FDI flows were, of course, much more volatile. After growing strongly in 1996, there were sharp falls in 1997 and, especially, 1998, but then a spectacular bounce back in 1999 (annual growth of more than 2000%!) followed by a small decline in 2000.

Table 5 Leading EU countries' FDI involvement in East Asia

% share of outward FDI stock

Country	**1989**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
United Kingdom	6.0	8.3	8.5	9.6	8.1	5.1	5.4
Germany	3.9	4.6	4.7	5.4	4.9	5.1	5.6
Netherlands	4.1	5.6	5.0	6.3	5.8	4.7	5.4
France	2.0	2.5	2.3	3.0	2.7	2.9	2.5
United States	*10.4*	*13.6*	*13.3*	*12.3*	*12.4*	*12.1*	*12.4*

Source: calculated from OECD (2002)

The extent of involvement by individual EU countries in East Asia varies considerably. Table 5 shows the pattern for the four leading EU sources of FDI together with comparable figures for the United States to provide an external reference point. In all four EU cases, the trend was for an increasing share of their outward FDI stocks to be directed to East Asia up to 1996 and then for a decline in the levels. But there are also considerable differences between the four EU countries in terms of their extent of FDI involvement in East Asia. France, in particular, has a much lower level of involvement than the three other countries. Of these others, the UK's involvement in East Asia was initially (i.e. in the late 1980s and early 1990s) significantly higher than that of either Germany or the Netherlands. But whereas East Asia declined in relative importance for the UK after 1997 the same was not true of Germany and the Netherlands. In fact by 1999 (the latest year for which data are available) Germany had slightly more of its outward FDI in East Asia than the UK. However, a striking feature of Table 5 is the very much higher degree of FDI involvement in East Asia by the United States. Clearly the region is far more important as a location for FDI than it is for EU countries. Such a discrepancy resonates with the concerns of the EC report referred to earlier.

The geography of EU FDI in East Asia

So far we have been concerned with the aggregate picture of EU FDI in East Asia as a whole. Let's now turn to the detailed geography of EU FDI within East Asia to identify the major investment foci. Figure 1 shows the distribution of total EU FDI stocks within East Asia in 1999 (the latest year for which comprehensive data are available) together with the share of each host country's total held by the four leading EU investors.

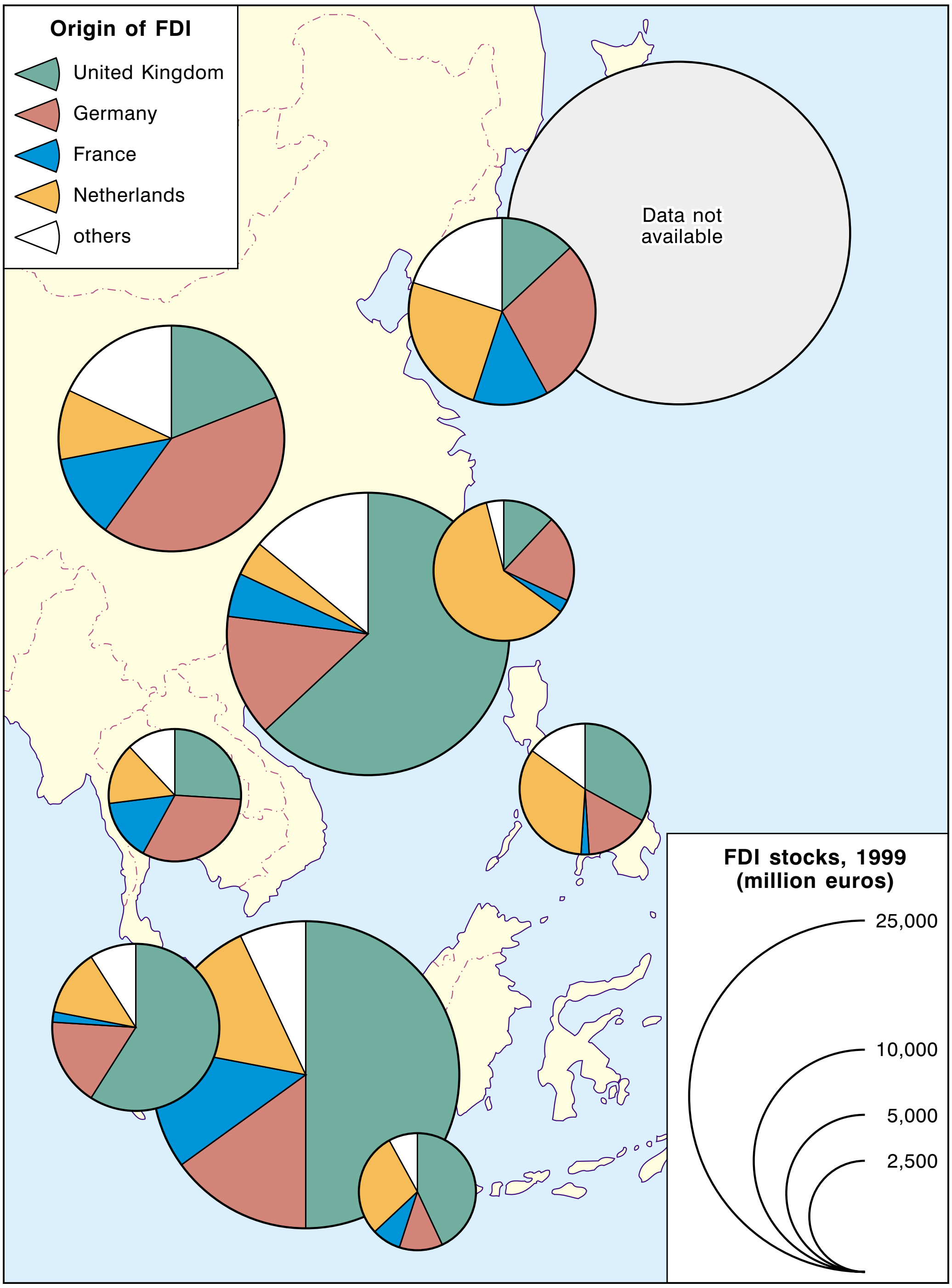

Figure 1 Distribution of EU FDI stocks within East Asia,1999

Source: derived from data in EC (2002): 64; Annex 1; OECD (2002)

Almost two-thirds of EU FDI in East Asia in 1999 was located in just three countries: Japan (25%), Singapore (20%), and Hong Kong (17%). But the pattern has been changing. In both years, as Figure 2 shows, the distribution was dominated by investment in the same three countries. But whereas in 1994, these three countries contained 66% of total EU FDI in East Asia, their share had fallen by four percentage points to 62% by 1999. Of the three, the steepest fall in its share was experienced by Singapore, down from 23% to 20% of the total. Japan's share fell by 1.5 points while Hong Kong's share increased very slightly.

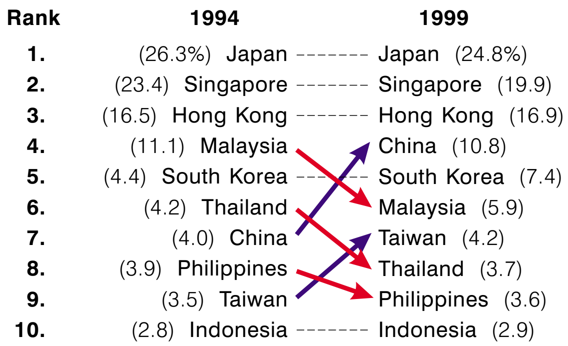

Figure 2 The changing distribution of EU FDI within East Asia, 1994-1999

Source: calculated from data in EC (2002): Annex 1

The major increase in the share of EU FDI was experienced, not surprisingly, in China. In 1994, China contained 4% of the region's EU total and was in seventh position; in 1999, China's share had risen to 11% (fourth position). There was also a significant increase in South Korea's share of the EU total (from 4% to 7%) and a smaller increase in Taiwan's share. In fact, the major divide was between South East Asia on the one hand and North East Asia on the other. The South East Asia share of EU FDI fell sharply from 45% to 36%, with especially marked falls in the relative importance of Malaysia (from 11% to 6%). These figures bear out the more anecdotal reports of a relative shift in inward FDI towards North East Asia and, most notably, China. Such trends are the focus of increasing concern within ASEAN itself.

The flow data bear out some of these conclusions. However, because of the high degree of volatility of flow data (see above, p. 4), it is more difficult to make inferences from individual years. As Figure 3 shows, for example, there was a dramatic reversal in the net flow of EU FDI into Hong Kong between 1999 and 2000 and significant, though less marked reversals in the case of Thailand. But the general relative shift away from South East Asia is evident in the flow data: its share of annual flows in 1999 was 27% compared with 33% in 1994. But, again, we need to be cautious in drawing too strong a conclusion from flow data alone.

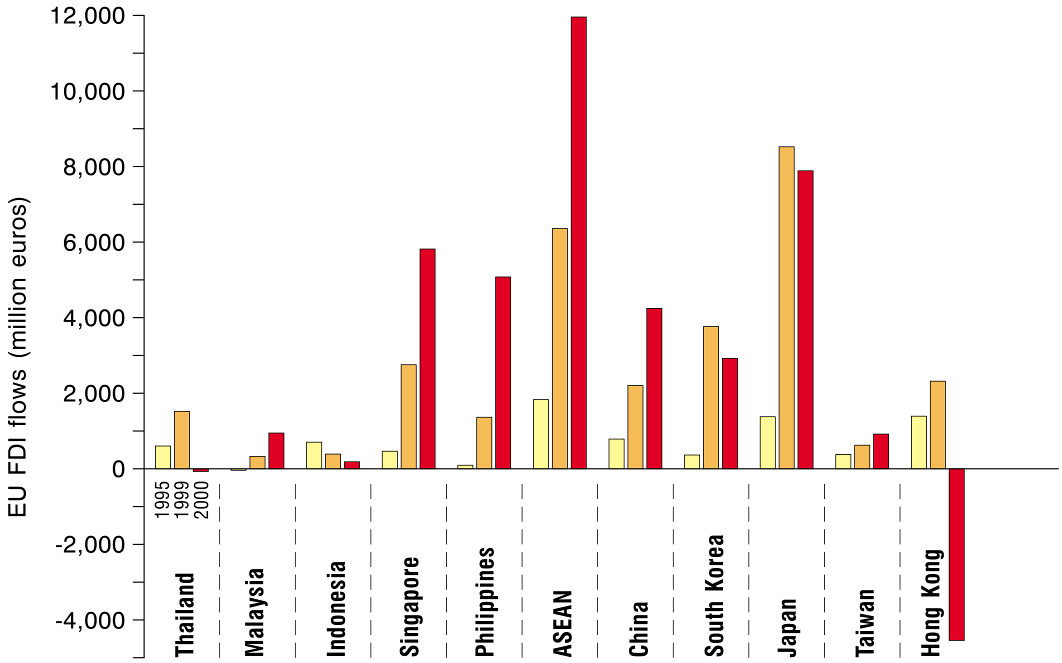

Figure 3 **Distribution of EU FDI flows within East Asia, 1995, 1999, 2000**

Source: calculated from EC (2002): Annex 1

The geography of the leading EU investors within East Asia

The UK is by far the most significant EU FDI source for East Asia, with twice the level of FDI of Germany. Of the total EU FDI in East Asia (excluding Japan, for which comparable individual country data are not available), almost 40% comes from the UK, 20% from Germany, 16% from the Netherlands, and 9% from France. In total, these four account for 84% of all EU FDI in East Asia, outside Japan. However, Figure 4 shows that there are some highly significant differences between individual EU countries in the geographical foci of their East Asian FDI.

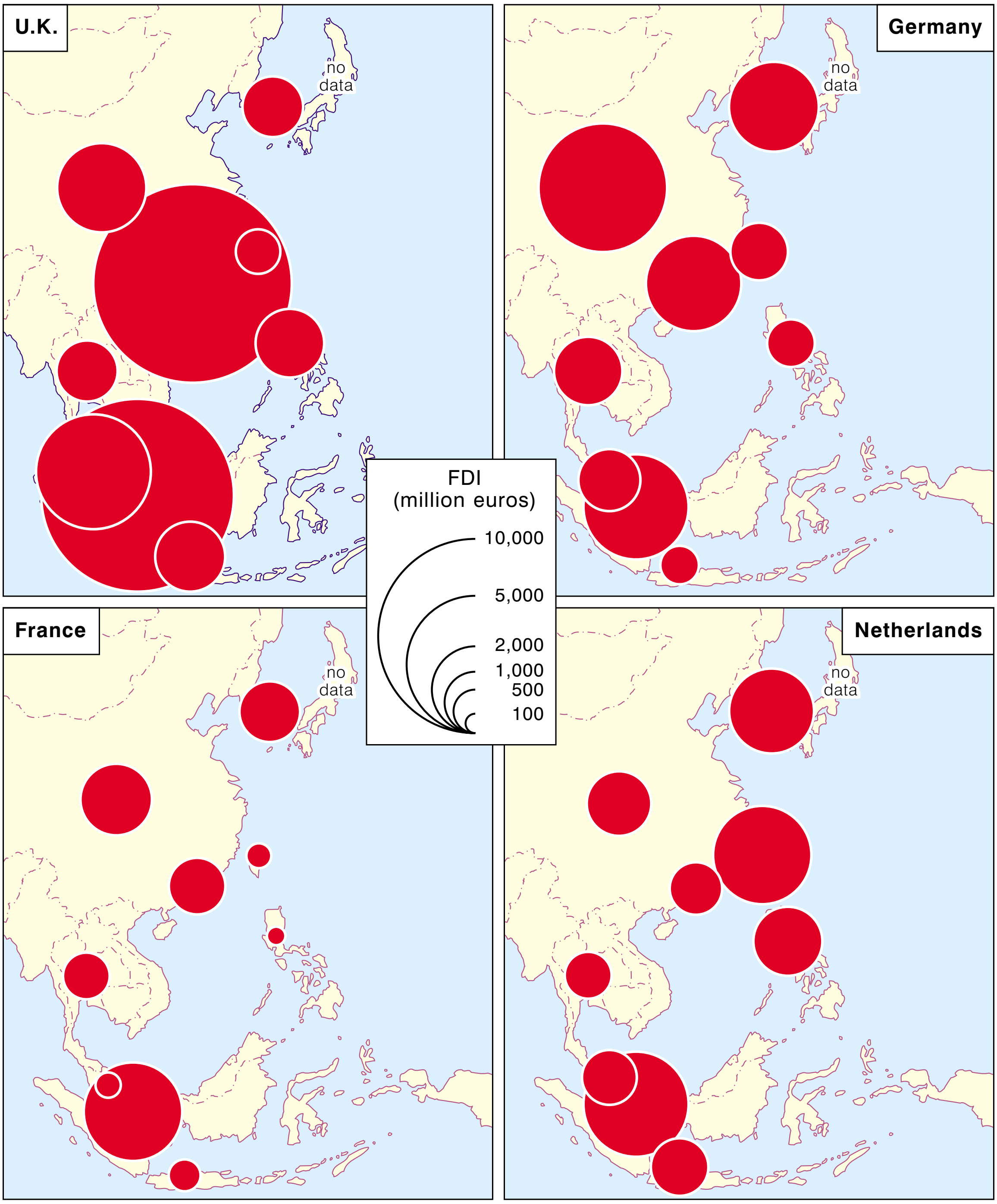

Figure 4 Distribution of FDI from the UK, Germany, France and the Netherlands within East Asia, 1999

Source: derived from data in EC (2002): 64

FDI from the UK is the most heavily concentrated geographically, with 78% of the total being located in three countries: Hong Kong (34.3%), Singapore (32.3%) and Malaysia (11.2) – a fairly clear reflection of the colonial legacy. The UK also has the strongest orientation towards South East Asia (55% of its total investment in East

Asia). It is also notable that the UK has only a modest presence in China, the fastest-growing FDI location in East Asia. Only around 7% of the UK's East Asia FDI is located in China. However, as Figure 5 shows, China's importance as a focus for UK FDI rose significantly between 1994 and 1999. In 1994, China ranked ninth (and bottom) in the list; in 1999 it ranked fourth – though still small in absolute terms. Figure 5 also shows that Thailand and Taiwan became relatively less important for the UK, as did, to a lesser extent, Singapore, the Philippines, and Taiwan.

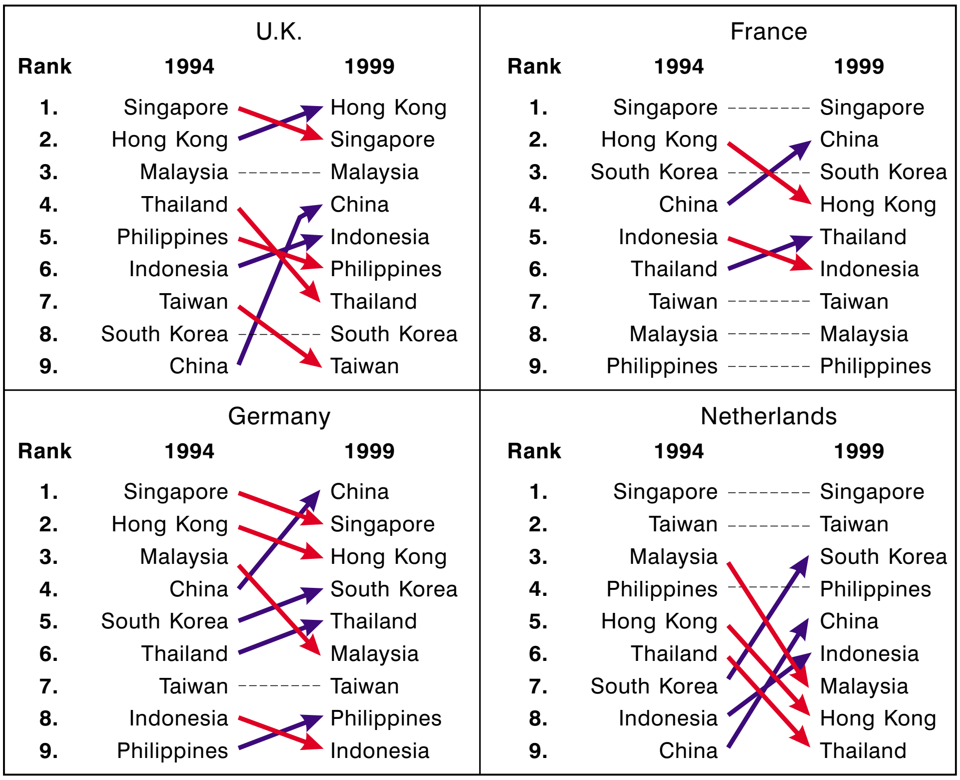

Figure 5. Changes in the relative importance of East Asian countries as locations for FDI from the leading EU countries, 1994 and 1999

Source: calculated from data in OECD (2002)

FDI from Germany and from the Netherlands was rather more widely distributed within East Asia. Germany – the second most important EU investor in the region – had a three-country concentration ratio of 62%. Both Singapore and Hong Kong were major foci in both 1994 and 1999 but the most striking aspect of Germany's East Asian investment is the increasingly dominant position of China. In 1999, China was by far the most important focus of German FDI in East Asia (excluding Japan) with 28% of the German total. China had displaced Singapore as the first-ranking destination for German FDI in the region, moving up from 4th to 1st place since 1994. In fact, Germany has the lowest degree of orientation towards South East Asia of the four EU countries, with only 38% of the total located there. There was an especially heavily fall in the relative importance of Malaysia as a location for German FDI. North East Asia, then, is a more important focus for German investors. In addition to the large investments in China, Germany has the largest amount of EU FDI in South Korea.

The Netherlands is the third most important of the four leading EU investors in East Asia and has the widest spread within the region. Only 59% of its FDI is concentrated in the top three countries: Singapore (23%), Taiwan (20%), and South Korea (15%). Interestingly, Hong Kong is one of the least important destinations for Netherlands FDI with only 6% of the total. In the case of the other three EU countries, Hong Kong is in the first four. Perhaps surprisingly, in view of its history as a Dutch colony, Indonesia ranks only sixth out of nine as a location for Dutch FDI.

French FDI in East Asia (excluding Japan) is significantly lower than that of the others and only about 40% of the UK total. 71% of the French total is concentrated in three countries: Singapore (38%), China (20%), and South Korea (14%). As Figure 5 shows, the French pattern remained the most stable of all four EU countries between 1994 and 1999. The major change was displacement of Hong Kong as the second ranking destination by China. Overall, France has the second strongest orientation towards South East Asia (53% of its total East Asian FDI).

Thus, the geographical distribution of EU FDI within East Asia shows considerable variety. Overall, among the considerable degree of stability, the most significant development has been the considerably increased importance of China as a major FDI destination for EU investors. Conversely, there is some evidence of a relative decline in the attractiveness of South East Asia, particularly if we take out Singapore (which, for all the EU investors, remains an extremely important location). At the same time, Hong Kong's importance may be declining a little. Although its importance increased for the UK between 1994 and 1999 its relative importance was reduced for the other three leading EU countries. Of course, it is becoming increasingly difficult to think of Hong Kong separately from China in terms of FDI flows from both outside and inside East Asia.

EU FDI in Eastern Europe

The extent of EU FDI in Eastern Europe

It is clear from Table 4 (p.10) that what the EC calls ‘Other Europe’ (essentially what is termed here ‘Eastern Europe – see footnote 2) has become increasingly important as a destination for FDI from the EU. As the Table shows, whereas only 3% of outward FDI from the EU went to ‘Other’ Europe in 1994 compared with the 10% going to East Asia, the gap has narrowed dramatically. By 1999, there was only a two- percentage point difference. This convergence between the two regions as foci for EU FDI can be seen in the relative growth figures in Table 6. Even allowing for the fact that Eastern Europe was starting from a much lower absolute level the rate of growth during the second half of the 1990s was impressive. Overall, total FDI from the EU in Eastern Europe grew by 445% between 1994 and 1999 compared with 132% in East Asia. But it is interesting that, in terms of flows, there was far more volatility from year to year in East Asia than in Eastern Europe.

Table 6 Relative growth rates in EU FDI in East Asia and Eastern Europe, 1994-1999

FDI stocks

	1994-1995 %	1995-1996 %	1996-1997 %	1997-1998 %	1998-1999 %	1994-1999 %
East Asia	+8.1	+28.7	+8.0	+4.3	+47.9	+131.9
Eastern Europe	+24.1	+41.3	+59.1	+43.5	+36.1	+444.7

FDI flows

	1994-1995 %	1995-1996 %	1996-1997 %	1997-1998 %	1998-1999 %
East Asia	+92	-32	-85	+2126	-2
Eastern Europe	-1.6	+54.4	+67.4	+7.2	+25.0

Source: calculated from data in EC (2002) Annex 1

However, although the rate of growth of FDI into Eastern Europe has clearly accelerated, its *relative* importance – expressed as a percentage of GDP – is, as yet, substantially lower than in most East Asian countries. Table 7 shows the position in both regions for the 1990-2000 period. Not surprisingly, FDI was already highly significant domestically in East Asia in 1990 (17.5% of regional GDP) whereas in Eastern Europe it represented less than 2% of the region's GDP. There were substantial intra-regional differences in both cases. In the Asian case, the low figures in Japan, South Korea, Taiwan, and China reflected a more restrictive institutional environment within a region in which FDI was generally encouraged. In Eastern Europe, political-economic change in the post-Soviet era had barely started.

In both regions, the relative importance of inward FDI (from all sources, not just the EU) accelerated markedly between 1995 and 2000. By 2000, more than one-third of East Asian regional GDP was represented by inward FDI, with significant increases in most cases, including countries like South Korea where FDI had been relatively limited. In Eastern Europe, every country experienced a substantial relative increase in the importance of inward FDI. In 2000, the highest values in terms of GDP were in Estonia, Hungary, and the Czech Republic.

Table 7 Inward FDI stock as a percentage of GDP, 1990-2000

East Asia					***Eastern Europe***			
Country	**1990**	**1995**	**2000**		**Country**	**1990**	**1995**	**2000**
China	7.0	19.6	32.3		Bulgaria	..	3.4	26.4
Hong Kong	198.1	125.0	263.8		Czech Rep	3.9	14.1	42.6
Indonesia	34.0	25.0	39.6		Estonia	..	14.1	53.2
Japan	0.3	0.6	1.1		Hungary	1.7	26.7	43.4
Korea	2.3	2.0	13.7		Latvia	..	12.5	29.1
Malaysia	23.4	32.3	58.8		Lithuania	..	5.8	20.6
Philippines	7.4	8.2	16.6		Poland	0.2	6.2	21.3
Singapore	77.9	71.5	103.8		Romania	2.0	3.2	17.7
Taiwan	6.1	5.9	9.0		Russ. Fed.	..	1.6	7.7
Thailand	9.6	10.4	20.0		Slovakia	0.5	4.4	24.2
East Asia	*17.4*	*18.9*	*36.4*		Slovenia	3.8	9.4	15.5

.. no data

Source: based on UNCTAD (2002): Annex Table B6

Returning to the specific case of EU FDI in Eastern Europe there is, as in the case of East Asia, substantial variation between individual EU countries in Eastern Europe's importance as a location for FDI(Table 7). There is a fairly clear 'neighbourhood effect' evident in these figures, notably in the fact that Germany is the EU country with the highest share of its outward FDI in Eastern Europe, followed by the Netherlands. Germany has almost the same share of its outward FDI in Eastern Europe as in East Asia, as does France, whereas for both the UK and the Netherlands Eastern Europe is significantly less important than East Asia. A recent analysis by the EC (Lovino 2002b: 5) shows the neighbourhood effect very clearly:

> In general, EU investors showed a preference for the CCs [Candidate Countries] which are geographically close to their own country. Swedish, Finnish and Danish investors were active in the Baltic countries, contributing 49% of inward FDI stocks. In particular, Swedish investors supplied 41% of Estonian and 17% of Lithuanian inward FDI stocks…Austrian and German investors were important sources of FDI for Slovenia and the Slovak Republic.

Table 7, like Table 5, includes data on the United States for comparative purposes. The contrast between the US's involvement in East Asia and its involvement in Eastern Europe is stark. Whereas 12% of total US outward FDI in 1999 was located in East Asia, Eastern Europe's share of the US total was a mere 1%. Even more evidence, perhaps, of the strong regional effect in many FDI distributions.

Table 8 Leading EU countries' involvement in Eastern Europe

% share of outward FDI stock

Country	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
United Kingdom	0.4	0.5	0.4	2.6	3.6	2.3
Germany	2.6	3.4	4.0	4.5	5.3	5.0
Netherlands	0.7	1.0	1.9	2.3	3.2	3.6
France	0.4	0.9	1.1	1.5	1.6	2.0
United States	*0.9*	*0.9*	*1.0*	*1.0*	*1.0*	*1.0*

Source: calculated from OECD (2002)

The geography of EU FDI in Eastern Europe

Figure 6 maps the geographical distribution of EU FDI stocks within Eastern Europe in 1999, together with (where the data are available) the share of each host country's total held by the four leading EU investors.

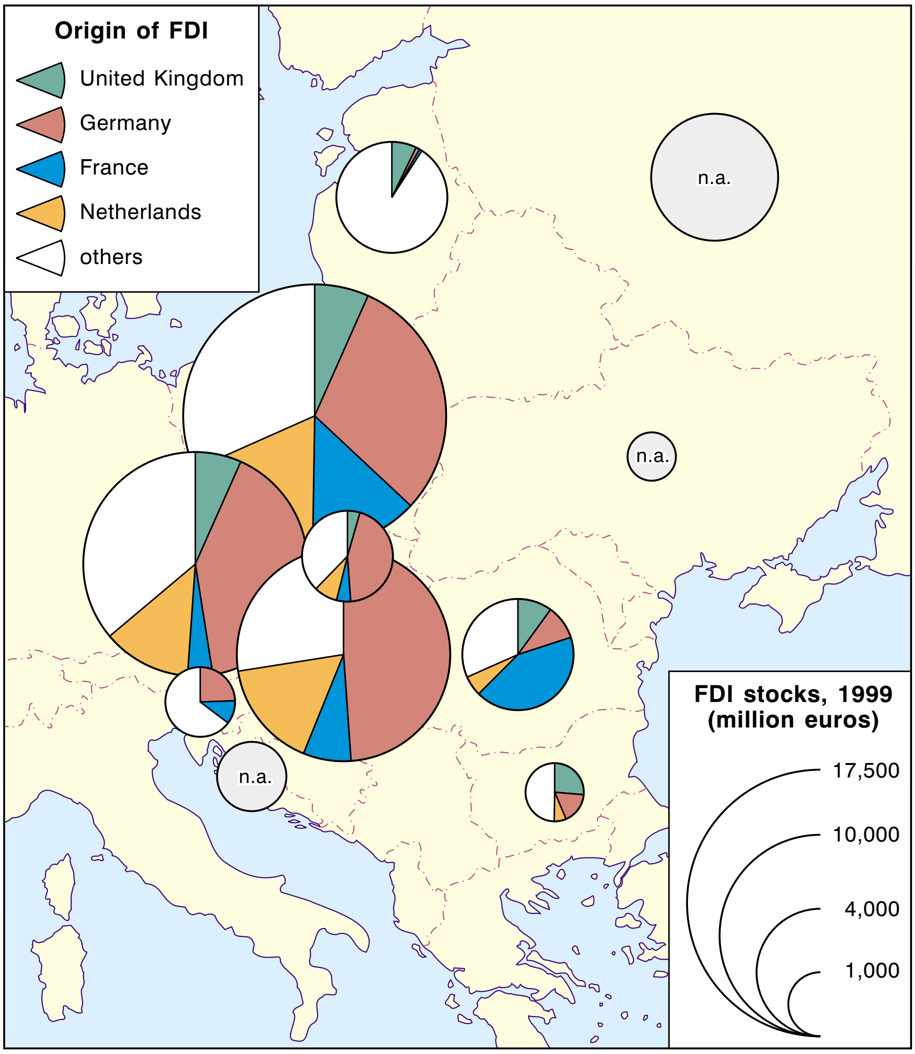

Figure 6 Distribution of EU FDI stocks within Eastern Europe, 1999

Source: derived from data in EC (2002): 56; Annex 1

Just over 50% of EU FDI in Eastern Europe in 1999 was located in three host countries: Poland (22%), the Czech Republic (16%), and Hungary (14%). This is a significantly lower level of geographical concentration than is the case for EU FDI in East Asia (see p.13). In fact, as Figure 7 reveals, this degree of geographical concentration is substantially less than in 1994, when 74% of the EU total was located in the same three countries.

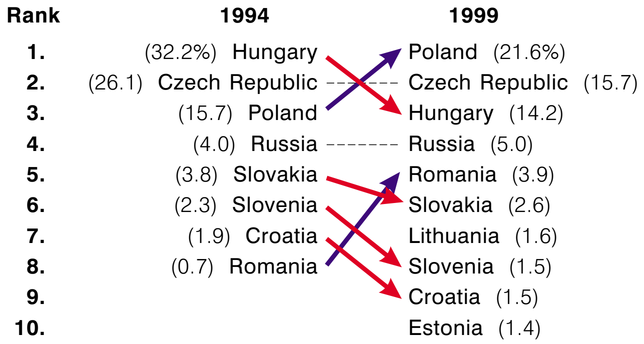

Figure 7 The changing distribution of EU FDI within Eastern Europe, 1994-1999

Source: calculated from data in EC (2002): Annex 1

The most striking changes between 1994 and 1999 were the very substantial decline in Hungary's relative share of EU FDI (from 32% to 14%) and, conversely, the significant increase in the share going to Poland (from 16% to 22%). The Czech Republic's share also fell (from 26% to 16%) although it remained the second most important FDI destination. Otherwise, the greatest change in position involved Romania, which increased its share of EU FDI from less than 1% in 1994 to 4% in 1999.

Table 9 Changing FDI flows to major Eastern European host countries, 1995-1999

Million ECU/EUR

Country	**1995**	**1996**	**1997**	**1998**	**1999**
Czech Republic	1,960	1,125	1,148	3,303	5,932
Estonia	154	119	235	513	284
Hungary	3,675	1,803	1,928	1,815	1,849
Lithuania	55	120	313	826	456
Latvia	136	301	460	318	334
Poland	2,797	3,542	4,328	5,678	6,821
Romania	320	207	1,071	1,812	977
Slovenia	235	210	414	178	78
Slovakia	181	279	154	504	306

Note: 1995 and 1996 data are drawn from a different time series than data for the following years

Source: Lovino and Passerini 2002: 7

These relative shifts are reflected in the changing patterns of FDI *flows*, as Table 9 shows. In particular,

> Hungary presents a reduction of FDI received from abroad not only as a share of the total aggregate for the region, but also in absolute terms. The ECU 3.7 billion received in 1995, the highest level in the region, was a peak of the time series, representing twice the value of the following years (1.8 billion in 1999) (Lovino and Passerini 2002:2)

Thus, Hungary's relative position peaked in the mid-1990s, whereas both Poland (in particular) and the Czech Republic experienced especially rapid growth of inward FDI from the EU between 1997 and 1999. Indeed, the 'Czech Republic and Poland made up half of their positions [in terms of FDI stock] between 1997 and 1999' (Lovino and Passerini 2002: 5). Overall, each of the major Eastern European host countries (though not Hungary) doubled their FDI stock over the three year period, 1997-1999, a clear indication of the accelerated attractiveness of these locations for FDI.

The geography of the leading EU investors within Eastern Europe

Four EU countries contributed 66% of all EU FDI to Eastern Europe. Germany is by far the most important, accounting for 33% of all EU FDI in the ten leading Eastern European host countries in 1999. The Netherlands had 13%, France 10% and the UK a mere 7% of the EU total. Figure 8 maps the geographical distribution of each of these four countries' FDI in Eastern Europe.

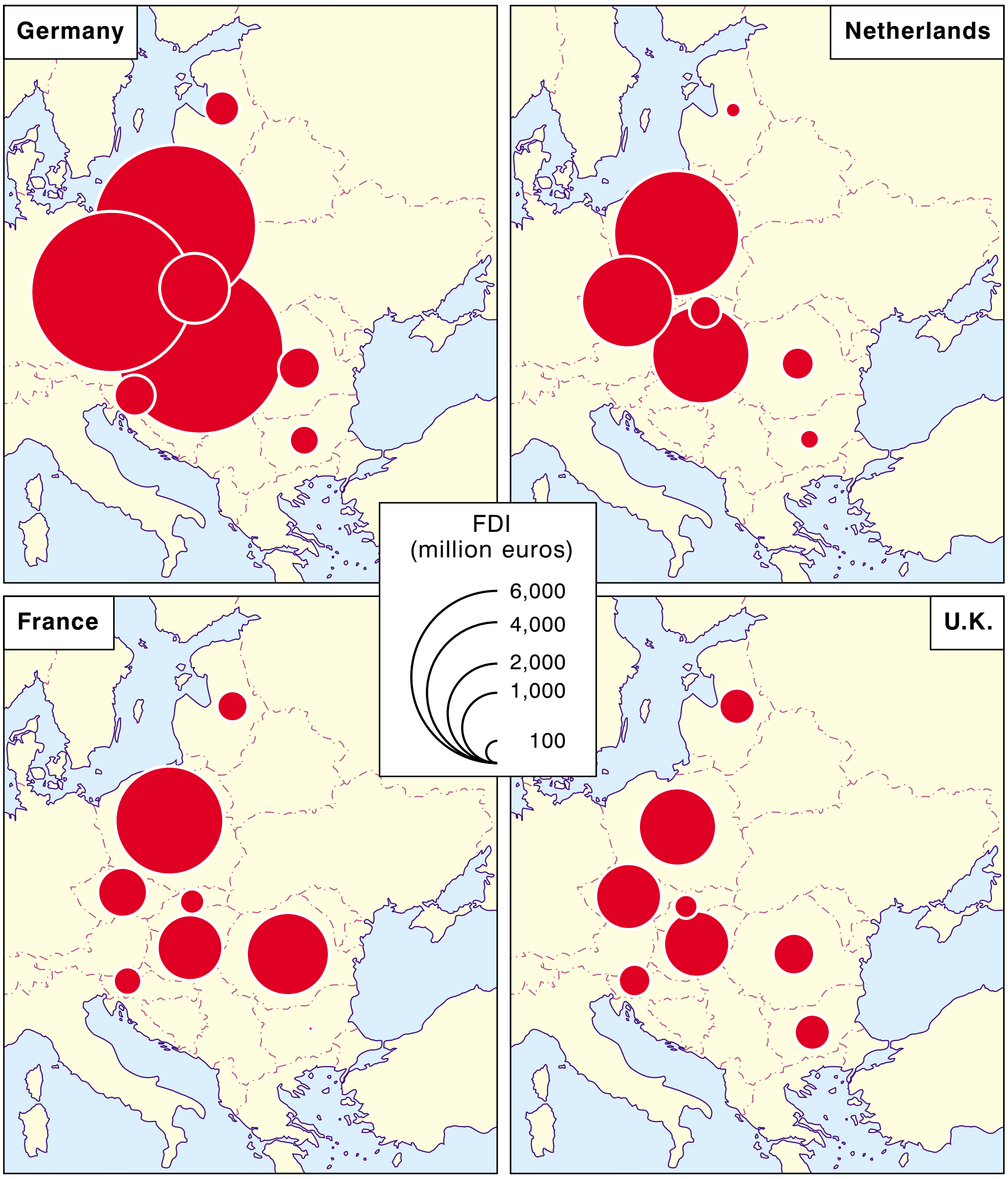

Figure 8 Distribution of FDI from the UK, Germany, France and the Netherlands within Eastern Europe, 1999

Source: derived from data in EC (2002): 56

Almost 90% of Germany's FDI in Eastern Europe is in the three leading host countries: Hungary (31%), Poland (29%) and the Czech Republic (29%). Otherwise, German FDI is spread thinly though with 5% of the total located in Slovakia. Dutch FDI is even more heavily concentrated geographically. 94% of the Dutch total is located in the same three host countries, with an especially marked focus in Poland (44%). The pattern of French FDI in Eastern Europe is rather different. 44% of the total is located in Poland and 15% in Hungary. The most distinctive feature of the geography of French FDI, however, is the fact that fully 25% of the total is located in Romania, whilst only 9% is in the Czech Republic. Lastly, not only is the UK by far the least significant of the four leading EU investors in Eastern Europe but also a far smaller proportion of its total investment – 73% - is concentrated in the three leading host countries. Of these, Poland is the most significant focus (31%) with Hungary and the Czech Republic each containing 21% of the UK total. As a consequence of this lower level of geographical concentration, the UK has larger investments than the others in Romania (8%), Bulgaria (6%) and in the Baltic countries (6%).

East Asian FDI in the EU

East Asia was the source of roughly 14% of world FDI stocks in 2001. However, East Asian FDI outside East Asia itself tends to be much more strongly oriented towards the United States than towards Europe. In fact, the East Asian share of total FDI stock in the EU actually declined from almost 10% of the EU total in 1994 to 6% in 1999. Although virtually all East Asian countries have some FDI in the EU, more than 95% is generated by just four countries (Table 10). Of these four, Japan accounted for 78% of the total in 1999, down from 86% in 1994. Singapore had 10% of the total in 1999: double its 1994 share. Hong Kong had around 6% (up from 4% in 1994) and South Korea had 3% in both 1994 and 1999.

Table 10 Leading East Asian investors in the EU, 1994-1999

% of total East Asian FDI in the EU

1994	**%**	**1995**	**%**	**1996**	**%**	**1997**	**%**	**1998**	**%**	**1999**	**%**
Japan	86	Japan	84	Japan	82	Japan	83	Japan	81	Japan	78
Sing	5	S Korea	5	Sing	8	Sing	8	Sing	8	Sing	10
HK	4	Sing	5	S Korea	4	S Korea	3	HK	5	HK	6
S Korea	3	HK	3	HK	3	HK	1	S Korea	3	S Korea	3
Total 4	*98*		*97*		*97*		*95*		*97*		*97*

Source: calculated from EC (2002) Annex 1

Between 1994 and 1999, East Asian FDI in the EU grew by 34%, whereas total FDI in the EU (excluding intra-regional investment) grew by 110%. Clearly, East Asian FDI in the EU did not grow especially strongly in the second half of the 1990s. Much of this modest growth is explained by the slowdown in Japanese FDI after a very strong decade of expansion in Europe during the 1980s (see Dicken 1988;

Dicken, Tickell and Yeung 1997) and also the effect of the 1997 financial crisis on South Korean FDI.

The geography of the leading East Asian investors within the EU

There are no data for aggregate East Asian FDI comparable with those produced for the EU by the European Commission. However, we can identify the major geographical trends for three of the four leading East Asian investors in the EU: Japan, South Korea, and Singapore. Table 11 shows the changing relative importance of the EU as a location for FDI from these three countries between 1987 and 1999. After substantial growth during the 1980s, the EU's share of Japanese outward FDI stabilized at just below 20%. From much lower base levels there was also a significant increase in the relative importance of the EU for both South Korea and Singapore. But for both Japan and South Korea, North America remains far more important as a location for their FDI.

Table 11 The changing position of the EU as a destination for FDI from Japan, South Korea, and Singapore, 1987-1999

% of outward total

Source country	**Destination**	**1987**	**1992**	**1997**	**1999**
Japan	**European Union**	**12.7**	**18.4**	**16.3**	**19.3**
	Eastern Europe	**-**	**0.2**	**0.1**	**0.2**
	North America	38.9	44.4	37.8	49.7
	East Asia	*19.0*	*15.4*	*30.3*	*18.1*
South Korea	**European Union**	**2.2**	**6.4**	**8.9**	**9.6**
	Eastern Europe	**-**	**0.7**	**3.7**	**4.0**
	North America	41.0	42.8	30.1	30.5
	East Asia	*25.9*	*35.7*	*45.5*	*44.6*
Singapore	**European Union**	**..**	**8.3**	**16.1**	
	Eastern Europe	**..**	**..**	**..**	
	North America	..	8.9	4.2	
	East Asia	*..*	*51.9*	*52.8*	

.. no data

Source: derived from data in OECD (2002); Singapore Department of Statistics

However, when we look at flows of FDI, the picture is far more volatile. Figure 9 shows the annual changes in FDI into the EU by the four leading East Asian investors. Of the four, only Singapore shows a consistent increase in FDI into the EU. At the other extreme, Hong Kong FDI in the EU grew very rapidly in 1998, far more slowly in 1999 and experienced a massive decline in 2000. Japan had negative growth in 1999.South Korean FDI in the EU grew strongly in 1998 but then declined in both 1999 and 2000. Much of this was caused by the postponement or abandonment of major electronics projects in the UK by Hyundai and LG.

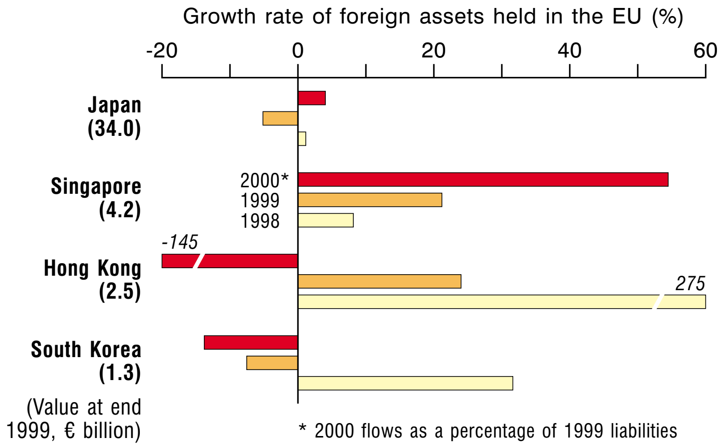

Figure 9 Growth rates of FDI from leading East Asian investors in the EU, 1998-2000

Source: derived from EC (2002): 36

Within the EU itself, FDI by Japanese, South Korean and Singaporean investors is geographically highly concentrated (Figure 10). Almost three-quarters of Japanese FDI stock in the EU in 1999 was located in the UK (37%) and the Netherlands (36%). Significant concentrations, though very much smaller, were in Germany 7%), Belgium-Luxembourg (7%), and France (6%). Together, these five countries contained 94% of Japanese FDI in the EU. South Korean FDI in the EU was primarily in the UK (38%), Germany (22%), the Netherlands (13%), and France (11%). Singaporean FDI in the EU is even more geographically concentrated, with more than two-thirds of the total located in the UK and a further one-fifth in the Netherlands.

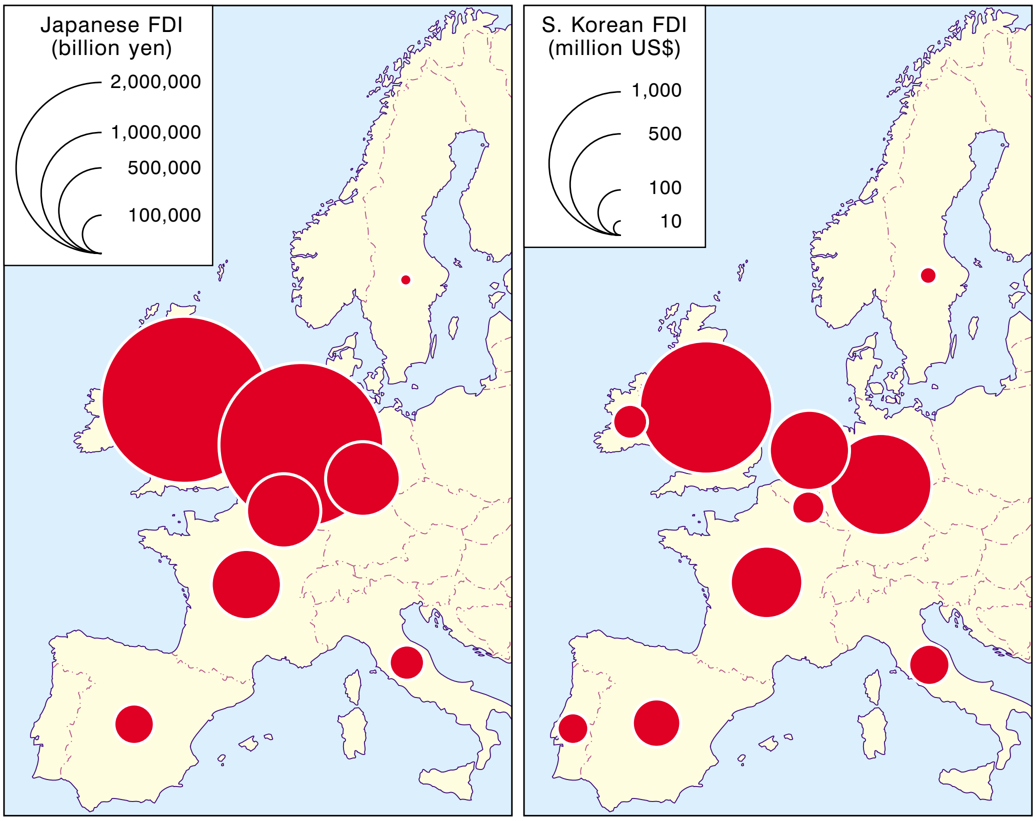

Figure 10 Distribution of FDI from Japan and South Korea within the EU, 1999

Source: calculated from data in OECD (2002); Singapore Department of Statistics (2002)

East Asian FDI in Eastern Europe

Finally in this exploration of FDI trends we turn to the case of Eastern Europe. Here, of course, we are dealing with a far more recent phenomenon because prior to the collapse of the Soviet-dominated planned economies there was relatively little FDI in the region. As we saw earlier (Table 6, p. 18), Eastern Europe has become increasingly significant as a location for FDI from EU countries. However, and perhaps not surprisingly, so far Eastern Europe has not exerted the same level of attraction for East Asian investors. As Table 11 (p. 26) indicated, only 0.2% of Japanese FDI was located in Eastern Europe in 1999. Most of that investment is located in the Czech Republic, Hungary, and Poland. In terms of recent FDI flows from Japan (1999-2001), FDI in the Czech Republic grew by 84% whilst falling by 82% in Hungary and by 42% in Poland (METI 2002).

The East Asian country with the heaviest degree of involvement in Eastern Europe is South Korea. As Table 11 showed, in the second half of the 1990s, Eastern Europe had become the focus for 4% of all South Korean outward FDI (and for almost 30% of South Korean FDI in Europe as a whole – compared with only 1% of Japanese FDI in Europe). Much of this Korean FDI was undertaken by a small number of the *chaebol*, notably the automobile operations of Daewoo and electronics companies like Samsung. The current restructuring of the *chaebol* has put some of these investments at serious risk. This is notably the case of Daewoo, whose Korean plants were recently taken over by GM but whose Eastern European plants are to be sold. Figure 11 maps South Korean FDI within Eastern Europe. Almost half of the total was located In Poland (47%), with 26% in the Ukraine and 24% in Romania. Compared with EU FDI in Eastern Europe, South Korean involvement in both Hungary and the Czech Republic was relatively small.

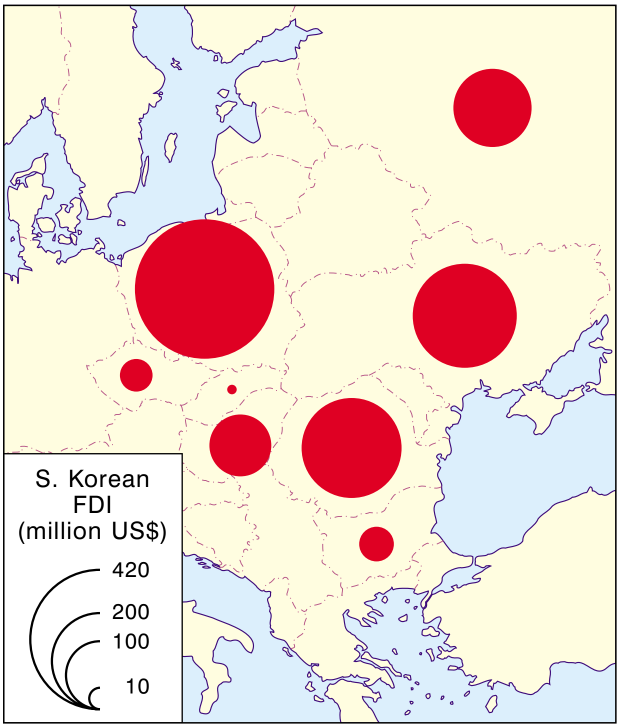

Figure 11 The distribution of South Korean FDI within Eastern Europe, 1999

Source: calculated from OECD (2002)

Conclusion

The aim of this Working Paper has been to identify some of the major trends in the growth and the geography of FDI between and within Europe and East Asia using aggregative statistics on stocks and flows. As such, it helps to provide some of the context within which more specific firm-focused cases can be set. The trends themselves are complex, although certain basic patterns are clear.

Overall, East Asia continues to be a fairly modest location for FDI from the EU: only about 9% of total EU outward FDI is located there. In that sense, the findings of the EC (1996) Report still apply. Of the EU countries, the UK is the biggest source of FDI in East Asia (twice as large as the second EU source, Germany). EU FDI within East Asia is quite heavily concentrated in three countries – Japan, Singapore and Hong Kong – which contain almost two-thirds of the EU total in the region. But there is strong evidence that China is becoming an especially significant destination for EU FDI, although rather less so in the case of the UK. There is some evidence of a relative shift towards North East Asia and away from South East Asia, although Singapore remains an especially important focus for EU FDI in East Asia. In detail, there are some quite distinctive differences in the locational propensities of individual EU countries, some of which reflect particular historical circumstances.

During the 1990s, Eastern Europe became increasingly important as a destination for EU FDI. Indeed, between 1994 and 1999, the region's share of the EU total grew from 3% to 7% - to within two percentage points of East Asia's share. Whereas in East Asia the biggest EU investor is the UK, in Eastern Europe the dominant position is held by Germany, suggesting the influence of a 'neighbourhood effect' (an effect also evident in the strong orientation of Scandinavian investors towards the Baltic States). Within Eastern Europe, around half of EU FDI is located in just three countries: Poland, the Czech Republic and Hungary. But the relative importance of these three countries has been changing. In particular, Hungary became relatively far less important and Poland far more so in the latter part of the 1990s.

East Asian FDI in the EU is dominated by Japan (which generates almost four-fifths of the total) followed, a long way behind, by Singapore, Hong Kong and South Korea. After very rapid growth in the 1980s, Japanese FDI in the EU slowed down dramatically. South Korean FDI in the EU surged in the mid-1990s but then was hit by the country's 1997 financial crisis. East Asian FDI within the EU is very heavily concentrated in the UK, the Netherlands and, to a lesser extent Germany and France. So far, at least, East Asian FDI in Eastern Europe has been very limited in scale and scope. The most prominent player has been South Korea though, again, the 1997 financial crisis has had negative effects in Eastern Europe.

These broad trends in the growth and the changing geography of FDI between and within Europe and East Asia pose large questions about underlying causalities. Such questions need to be addressed at a more micro level but certain generalizations can be made. Most fundamentally, FDI tends to be driven by a variable – and dynamic - mix of market-access and asset-seeking motivations. Historically, access to localized natural resources and, much later, to low-cost, malleable labour, helps to explain much EU FDI in East Asia. But with the spectacular economic growth of East Asia the significance of the East Asian market as a locational attraction has increased. At the same time, the rapid upgrading of the technological base and rising labour costs in the first generation NIEs, together with the recent emergence of China, both as a market and as a production base, have changed the locational calculus within the region as a whole. This has potentially important implications for countries in South East Asia, notably Malaysia.

East Asian FDI in the EU was stimulated initially (i.e. from the 1970s onwards) primarily by the perceived need to be based inside a political unit seen to have protectionist tendencies. The clearest examples of this were in the automobile and electronics industries, where internal non-tariff barriers (NTBs) proliferated prior to the implementation of the Single European Market. Within the EU, the twin attractions of the English language and the rather looser regulatory environment help to explain the strong locational orientation towards the UK. However, the UK's position outside the Eurozone has created a new element which may encourage East Asian (and other) investors to shift towards mainland Europe.

In this context, the position of Eastern Europe becomes increasingly significant. Rather like Mexico in the North American context, Eastern Europe has the advantage of close geographical proximity to – and in several cases, imminent membership of – the EU. As a relatively cheap production base close to one the world's biggest markets, Eastern Europe presents an attractive option both for EU firms looking to reduce costs without straying too far from the market and for East Asian firms looking to access the EU market cheaply.

Thus, one of the interesting questions is the extent to which East Asia and Eastern Europe represent alternative locations that are, to a greater or lesser degree, substitutable. To what extent can/will European firms seeking lower production costs switch their operations from East Asia to the geographically more proximate Eastern Europe? Alternatively, will Eastern Europe serve as a ‘Trojan horse’ for East Asian investors seeking access to the EU market? There is some anecdotal evidence to support both of these positions but, as yet, no systematic analysis.

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[1] The OECD, UNCTAD, and EC sources rely essentially upon data collected at the individual country level by national statistical agencies. Although these national data, in general, comply with the IMF *Balance of Payments* criteria there are considerable differences of detail between countries in the precise definitions and coverage employed. The OECD *International Direct Investment Statistics Yearbook* provides a detailed analysis of such differences for the OECD member countries. Although UNCTAD, the OECD and the EC aim to produce harmonized FDI data consistent with their own needs it is difficult to directly compare FDI data from each of the sources because their data are denominated in different currency units. Whilst UNCTAD uses US dollars, the EC uses euros and the OECD retains the individual national currency units with no attempt to convert into a common unit. Such variations pose very considerable problems of compatibility and can give slightly different results depending on the source used. A far as possible, the sources have been cross-checked to produce the most accurate result but, inevitably, some inconsistencies remain. Thus, too much should not be made of relatively small differences. I am reasonably confident that the correct orders of magnitude have been preserved.

[2] In this paper the term 'Eastern Europe' is used very broadly to encompass the countries formerly within the Soviet orbit. It includes, therefore, the Baltic states, the CIS as well as what are commonly referred to as the countries of central and eastern Europe.