Discussion note, based on "The FDI Shift to Services- How does it Impact Asia?"

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Emerging market and developing economies have been competing in attracting foreign direct investment (FDI) because of its perceived positive productivity spillovers on the receiving countries. For many developing countries FDI stands as the most important foreign source of financing. Among all the regions, South East Asia and the Pacific (SEAP) exhibits an uplifting case story. After the financial crisis of the 2007-8, FDI has been on a path of steady growth in this region. This is in sharp contrast to Western Europe, where it collapsed and to the regions of Latin America and Eastern Europe and Central Asia, where it slowed down after the crisis (Figure 1).

A major concern of policy makers is that the traditional kind of FDI primarily absorbed by the manufacturing sector has been gradually substituted by services FDI with financial services FDI, emerging as one of the most substantial international capital flows worldwide. If the link between manufacturing FDI inflows and growth is strong, this development would have potentially a direct deleterious impact on the manufacturing sector's growth rate, contributing to a process of "deindustrialization" of the domestic economy. In that respect, developments in SEAP mimic the world trends. Total services FDI overtook manufacturing FDI in late 1990s and has been the major driver of total FDI inflows (Figure 2).

In general, productivity spillovers from FDI to domestic firms are attributed to transfer of superior technologies from foreign to domestic subsidiaries'. They can, however, be either positive or negative (Aitken and Harrison, 1999). Negative spillovers can occur, if FDI in one industry depletes resources, such as skilled labor, from another (Doytch and Uctum, 2011). In this study, we find both positive and negative spillovers from FDI.

When industry-level FDI in SEAP are considered, various types of services FDI appear to have a positive impact on aggregate growth: financial services, trade and transport and communications FDI. These three flows work out their impact on the aggregate economy via their positive impact on growth of the services sector. This sector also benefits from tourism and business services FDI flows although the last two effects do no transpire at the aggregate level.

However, the beneficial to the services sector FDI depletes the manufacturing sector from resources. This is specifically true for trade and business services FDI, which we observe producing negative effects of manufacturing growth.

Geared with the empirical results at the sectoral level, which we obtain from a somewhat heterogeneous sample of countries- all South and East Asian economies, researchers must focus next on micro-level research within these economies. What do the case studies specific to a single country show? Is there competition for resources between domestic and multinational firms in specific industries? Who wins the competition in countries where the educated human resource is scarce? What industries tend to win from the penetration of multinational firms? Is there a complementarily between services FDI and skilled labor, as well as manufacturing FDI and unskilled labor in impacting growth? What role do instructions play when combined with the above mentioned factors: services FDI, manufacturing FDI, skilled labor and unskilled labor?

References:

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Figure 1: Total FDI/GDP by Region

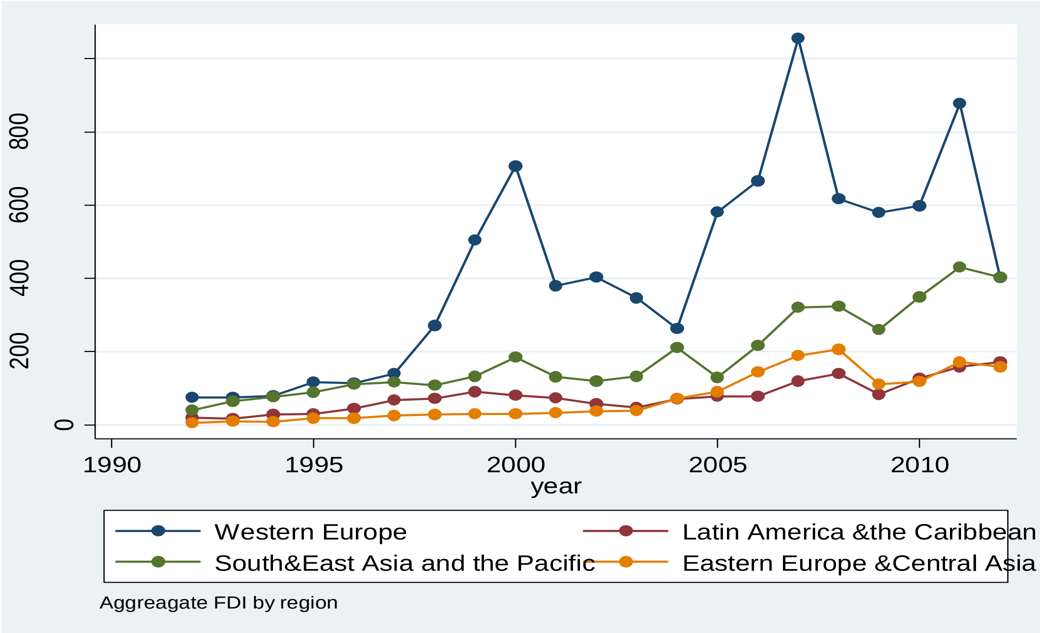

Figure 2: SEAP FDI/GDP by Industries