Policy Review on Myanmar Economy

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What Myanmar Can Learn on FDI from Other East Asian Countries: Positive and Negative Effects of FDI

By **Masami ISHIDA**[1]

The government of the Republic of the Union of Myanmar has announced a series of political and economic reforms since Mr. Thein Sein became the first president in March 2011. More than a few companies which had hesitated to invest in Myanmar from the EU, the United States, Japan and ASEAN have now started to seek a way to invest in the country effectively with minimal risk. Many other companies, however, have not changed their "wait and see" attitude without making a decision to invest in Myanmar. Nevertheless, for the Myanmar government, it is necessary to make adequate preparations for attracting foreign direct investment (FDI) irrespective of the realization of an investment boom in the country. Here, in order to give input to the government and business community of Myanmar, we would like to consider the positive and negative effects of FDI in accordance with the experiences of other East Asian countries.

Before going into the discussion, we confirm the definition of FDI and make clear major types of FDI received by ASEAN and China so far. FDI is defined as an investment in which the investor acquires a substantial controlling interest in a foreign country. FDI involves ownership and/or control of the company abroad (Markusen, et al, p. 394). From the companies' viewpoint, expected profits by doing FDI in Country A should be higher than exporting the products from the mother country to Country A. In the case of FDI received by ASEAN and China, foreign companies have enjoyed the advantage of lower labor cost compared with the home countries. Export-oriented FDI conducted by Japan and Asian NIEs (newly industrialized economies) into ASEAN is one of the major streams of such FDI; China is a major location in the world for domestic-market-oriented FDI. In addition, some foreign companies enjoy advantages in locating the factories close to the origins of raw materials, such as a cement factory in proximity to a limestone quarry. Finally, we would like to mention that Malaysia, Thailand and China, which have received a lot of FDI so far, now have become foreign direct investors into other developing countries, including Myanmar.

1. Positive Effects of FDI

Job creation is one of the positive effects of FDI. As far as lower wages being one of the biggest advantages for developing countries in attracting FDI, the sectors where many FDIs gather are the labor-intensive sectors. For example, the Washington Post on June 18, 2008, reported that "nearly 20,000 workers went

[1] Senior Research Fellow, JETRO Bangkok, Institute of Developing Economies.

on strike at a Nike factory run by a Taiwanese contractor in Vietnam." Of course, the point which I would like to emphasize is not a strike behavior but the number of workers. A Japanese-affiliated wire harness firm, Yazaki Haiphong Vietnam, employs 5,272 employees. If several such companies gather in an industrial estate, FDIs can create several hundred thousand jobs. The effects of job creation are welcomed by the host countries; consequently, some ASEAN countries have given incentives to foreign companies which create much employment. For example, the Malaysian government announced the extension of tax holidays for companies which employ 500 persons and more from five years to ten years in 1987 (JETRO 1988, p. 142).

Technology transfer can be expected in receiving FDI. For example, in the case of an investment of a foreign firm producing TVs, the company sets up the factory layout and assembly lines, machines and equipment and brings product designs, parts and components, and production techniques. Then the company supervises and trains local workers to assemble the product through on-the-job training (Kagami 1998, p. 3). Through such processes, technology is surely transferred to the host country and the quality of products can be expected to be upgraded.

However, it is not appropriate to assume that foreign companies or multi-national companies (MNCs) are positive about promoting technology transfer, although I have met several presidents of local affiliated companies who are enthusiastic in transferring technologies. First, it costs a lot to invent a new technology, and thus technology is not free. Second, foreign companies feel a threat of the "boomerang effect," that the engineers of the host country could manufacture exact copies of the products with lower cost or even with improved quality. It is in the more developed countries, however, where this kind of phenomenon can occur and these cases are the advanced ones of transferring technologies from Japan to the Asian NIEs in the past or from the Asian NIEs to China.

As far as the transferred technologies being standardized technologies instead of newer ones, other reasons have to be considered by the developing host countries, while there have been claims from some host countries that foreign companies only transfer secondhand technologies. First, the education and the technological level of local engineers, producers of parts and components, and factory workers in the host country are not enough to receive a transfer of more advanced standardized technologies. Second, in a case that "job hopping" is common, the foreign companies do not have incentives for transferring higher technologies to the engineers and workers who might quit soon (so far, ibid., pp. 4-12). Under such conditions, it is more appropriate to consider that foreign companies just transfer the required minimum level of technology for the most efficient production in order to receive profits constantly.

In the past, however, foreign companies sometimes could not avoid transferring more advanced standardized technologies. At the beginning of the 2000s, many foreign companies in ASEAN countries were faced with lower-priced products made in China. In order to decrease the price of their products, the foreign companies could not import parts and components any more from the home country; they had to search for local suppliers which could produce products of similar quality or cultivate local producers (Ishida, pp. 100-101). Such kinds of technologies and knowledge are expected to be transferred to local companies as a spill-over effect by way of the mobility of labor forces and technological collaborations between MNCs and local companies as long as the local labor force is highly educated (Todo, et al 2009, pp. 626-637). In such a situation, the host countries have to utilize the opportunities. For foreign companies also have choices to relocate to other countries if other countries offer better investment climates. As a matter of fact, many ASEAN countries have given higher incentives to foreign companies which can transfer high technologies.

In addition to job creation and technology transfer, financial power can be expected. For example, the amount of investment by apparatus industries which require enormous automated equipment for providing a specific scale of production and service, such as refinery and electricity generators, often exceeds a billion US dollars. Although such apparatus industries are extreme cases, some big projects often need the financial power of foreign capital.

2. Negative Effects of FDI

Besides giving benefits to the host countries, FDI can also cause negative effects. If there is a local company manufacturing a specific product and the quality and price are the same as the product manufactured by foreign companies, the local people will prefer the one produced by the local company. In many cases, however, foreign companies produce such a product with more reasonable prices and/or better quality. Not mentioning the case of importing the foreign products, if such foreign companies invest in the host countries and produce the same kind of products locally, more than a few existing local companies cannot help but close down or be purchased by the foreign companies.

As a matter of fact, when FDI into China was accelerated it was reported nationalistically in China in the 1990s that “about 50% of the detergent market was occupied by foreign companies, about 70% of fifty domestic beer companies had been incorporated or acquired, the domestic market share of machine tools is only about 37% and a well-known domestic brand was also acquired by foreign companies and disappeared.” However, the situation that foreign companies progressed rapidly and domestic companies declined in the 1990s was mainly because of the delayed management rationalization of state-owned companies. Leaving the management of such inefficient companies can further encourage the inefficiency. Nevertheless, considering that the quasi-unemployment ratio including redundant workers to whom salary was not paid or was furloughed as of 1996 was estimated to be 20%, undertaking “a shock treatment” was not realistic in China in the 1990s (Li, 1998). In view of this, the governments of developing countries should consider prudently whether they should protect existing local industries or not. Even so, the protection for local companies should be temporary and the local companies should be accustomed to competition with FDI companies.

Or, promoting joint ventures between local companies and the FDI companies is another way.

As another negative effect of FDI, it should be considered that inflow of massive FDI can overheat the economy, as shown in the inflation that occurred in Vietnam over a couple of years. First, the FDI can deteriorate the current account deficit because the inflow of foreign capital brings about capital formation. More concretely, the FDI company imports capital goods such as machines (Fry 1996, pp. 462-465) as it is rare that local companies can provide such capital goods in developing countries. After starting the operation, the FDI company further imports intermediate goods such as parts and components, as in the case of advanced ASEAN countries like Malaysia, Thailand and Indonesia in the 1990s. Referring to the counties attacked by the Asian currency crisis in 1997, the policy to peg to the US dollar induced borrowing short-term overseas funds because large international interest spreads with developed countries, and then the current account deficits were further deteriorated although the local currencies should have been depreciated in accordance with the current account deficit (Baharumshar, et al 2003, pp. 466-471). Therefore, prudent macro-economic control is required in expanding the FDI.

Massive inflow of FDI can also result in shortages of infrastructure by way of excessive demand over supply. An increase in income or economic growth indirectly caused by FDI and an increase in population in metropolitan areas induced by expanded employment have resulted in serious traffic jams in the metropolitan locations. Development of by-pass and outer-ring roads is needed in metropolitan areas such as Hanoi, Ho Chi Minh City, Phnom Penh and Yangon, but has not been completed (Ishida 2011, pp. 5-10). Telephone call attempts had failed easily because of shortages of telephone lines in Kuala Lumpur at the beginning of the 1990s, based on my own experience. Another phenomenon of excessive demand over supply can be seen when FDI increases massively. An example is that the price of a one-night stay at hotels in Yangon has appreciated by three times in 2012 compared with 2011. This shows that inflation can be one of the sub-products of massively increased FDI.

Summary

As shown so far, receiving FDI can also result in negative effects. However, seeing the successful economic performance by utilizing FDI in advanced ASEAN countries and China, the positive effects should be much larger than the negative ones. Thus the sectors to be protected should be minimized and the protection period has to be specified while the Myanmar government should be prudent in the screening process. The interest groups in business sectors are likely to request an expansion of the sectors for protection in future discussions. Considering this, if the Myanmar government follows wholly to such opinions, Myanmar can lose good opportunities for attracting FDI.

Currently, Myanmar has a comparative advantage in lower labor cost. In this way, Myanmar has larger competitiveness in attracting FDI in export-oriented labor-intensive sectors. When receiving FDI, the Myanmar government should confirm the positive effects in creating employment and watch that workers in the country have become skillful in the standardized technologies. At the same time, human resource development such as higher education on technologies and vocational training, in addition to infrastructure like transportation and electricity, should also be strengthened. If the skill level of average workers continues to increase and the infrastructure availability follows the demand, then Myanmar can have the opportunity to receive FDI which needs higher technical skills. This is the best way to step up the technological ladder.

Finally, back to the discussion of openness for FDI, it is not an easy question to answer on how wide the Myanmar government should open the gate. It should be considered with the capacity of macro economy in Myanmar and the position of Myanmar compared with other ASEAN countries in various indicators of investment climates. At any rate, a moderate attractiveness, which does not cause massive FDI, is required for economic development in Myanmar. Regarding the position of Myanmar, we would like to discuss this in another policy review in the future.

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Contact: Bangkok Research Center, JETRO Bangkok TEL:+66-2253-6441 FAX:+66-2254-1447