ASIAN ECONOMIC CRISIS, FOREIGN DIRECT INVESTMENT AND STABILIZED ECONOMIC GROWTH: CRISIS REVISITED AND IMPLICATIONS FOR APEC MEMBER ECONOMIES

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ABSTRACT

The Asian economic crisis of 1997 gives us a valuable lesson that foreign direct investment (FDI) can play a more important role in promoting economic stability than other capital flows such as bank lending and portfolio equity investment. This paper explains the relationships between FDI and the crisis. Specifically, it studies the role of FDI in stable economic growth. Recent developments of inward FDI policies by the Asian member economies of APEC are then analyzed, after which they are categorized into four groups within a framework that is developed in this paper. Some important, generalized implications for FDI policies are also provided.

Key words: *Asian Crisis, Foreign Direct Investment, Economic Growth, APEC*

INTRODUCTION

There are signs of vigorous recoveries in Asia, so recently stricken by the financial crisis. Confidence has been rebuilt, with relatively strong macroeconomic indicators such as high savings rates and output growth. However, such favorable macroeconomic developments may weaken the public's willingness to push fundamental and structural reforms in the economies of Asia. Although some people argue that the Asian economic crisis is over, there is still continuing debate over the real causes of the crisis. This is a very important issue because history may repeat itself, and we do not want to make similar mistakes. In addition, analysis of the real

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causes of the crisis will yield insights on how seriously we should push our structural reforms.

In this regard, the paper critically reviews some prevailing views on the causes of the Asian economic crisis and presents a possible solution to the conundrum. In order to fully recover from the crisis and to sustain strong economic growth in the long run, the Asian economies should consider the notion that the economic crisis in the late 1997 was fundamental and that the recent recovery may be temporary. The Asian economies must continue their restructuring efforts.

One of the most important required structural reforms is to upgrade the investment environment for foreigners. From the experience of the crisis, the Asian economies have realized that foreign direct investment (FDI) plays a more important role than other types of international capital flows (such as portfolio investment and bank lending) for stable economic growth in the long run. The main objective of this paper is to study the role of FDI as a source of stabilized economic growth and to evaluate the efforts of the Asian member economies of APEC to upgrade the FDI environment.

ECONOMIC CRISIS REVISITED

There has been an exhaustive discussion about the economic crisis of 1997, making it needless to fully revisit the issue here. However, it is still useful to review briefly some important issues in order to understand the role of FDI. After reviewing the IMF programs for the Asian economies and the debates they sparked, we will suggest a more fundamental cause of the crisis than has previously been acknowledged.

IMF Programs in Three Asian Economies

On August 20, 1997, the International Monetary Fund (IMF) approved Thailand's request for a loan about $3.9 billion, 505 percent of Thailand's quota of about $780 million. Thailand's economic situation had deteriorated progressively in the preceding years, as reflected in a persistent and widening current deficit, which peaked at 8 percent of GDP in 1996, and an associated high external debt burden (50 percent of GDP), of which about 40 percent was short-term. Structural reforms to address the causes of economic difficulties were essential to the strategy – in particular, strengthening the financial system and eliminating inefficient regulations. Special emphasis was directed toward boosting exports and strengthening secondary education and training to assist in the structural adjustment to higher-technology production and exports.

The credit for Indonesia, about $10.14 billion, 490 percent of Indonesia's quota of about $2.07 billion, was approved on November 5, 1997. The primary economic problems were rigidities in domestic trade regulations and some import monopolies. At the same time, relatively less than transparent decision-making increased uncertainty and adversely affected investor confidence. Large capital inflows intermediated through a weak banking system exposed Indonesia to a shift in financial market sentiment. Indonesia's banking sector, coupled with inefficient regulations in many business areas, compromised the country's ability to withstand the financial crisis. Important elements of Indonesia's structural reform efforts included privatization as well as deregulation. Responsibility for the management and restructuring of public enterprises was shifted from line ministries to the Ministry of Finance, and a new Privatization Board was established. A clear framework for the management and privatization of government assets was being developed, which would establish explicit criteria for determining whether an enterprise should be shut down, restructured, or privatized.

Korea was approved for a credit of about $21 billion, which was equivalent to 1,939 percent of Korea's quota of about $1.09 billion. In its press release, the IMF explained Korea's economic problems as detailed government intervention at the micro level, an inefficient financial sector, a highly leveraged corporate sector, and ineffective market discipline. In order to solve these problems, the IMF demanded a painful process of structural adjustment. In particular, Korea had to lower the growth rate, together with implementation of tight monetary and fiscal policies, which would increase unemployment. Korea then had to pursue more fundamental reforms in the financial and corporate sectors.

The main criticism leveled at the IMF is that its reform conditions are too harsh. Another criticism is that the IMF recommends the same, standardized solution package to economies whose problems may have different causes. These two issues have been critically discussed by some popular scholars such as Jeffrey Sachs, Henry Kissinger, and Martin Feldstein.

Debates over the Asian Economic Crisis

Jeffrey Sachs (1997), a well-known critic of the IMF, argued that there was no "fundamental" factor that brought about the Asian crisis, since macroeconomic variables such as budgets, inflation, savings rates, and export growth were good. In addition, he claimed that an appropriate solution would have been for the IMF to stress the strengths rather than the weaknesses of the Asian economies, in particular of Korea. Sachs furthermore maintained that the IMF could have quietly encouraged Japan, the United States, and Europe to provide some credit support to the troubled economy.

Former U.S. Secretary of State, Henry Kissinger (1998), advanced a somewhat different perspective on this problem. He blamed two outside variables – the high value of the U.S. dollar and rampant currency speculation – as causes of the problem. Since the causes of the crisis were exogenous and quite uncontrollable, however, Kissinger could not provide specific solutions, suggesting only that world leaders should have a better understanding of global capital flows and their potential impact on the global economy.

Another expert on this issue, Martin Feldstein (1998), also criticized the IMF Programs. He pointed out that the IMF's role in Asia went far beyond the agency's mandate, to the extent that the government of Indonesia was told to end the economy's widespread corruption and the special privileges of President Suharto's family. Feldstein held that the primary cause of the Southeast Asian crisis was the fixed exchange-rate policy, and he argued that the Korean situation was different because Korea had a flexible exchange-rate system. According to Feldstein, therefore, Korea's problem was a case of temporary illiquidity rather than fundamental insolvency.

Although these critics have somewhat different perspectives, they share one common view – that the Asian crisis was not fundamental. However, we contend that the crisis was real and that the troubled economies should continue fundamental economic reforms to enable full recovery from the crisis. In order to correctly understand the causes of the crisis, we have to pinpoint where the crisis started.

Real Causes of the Crisis

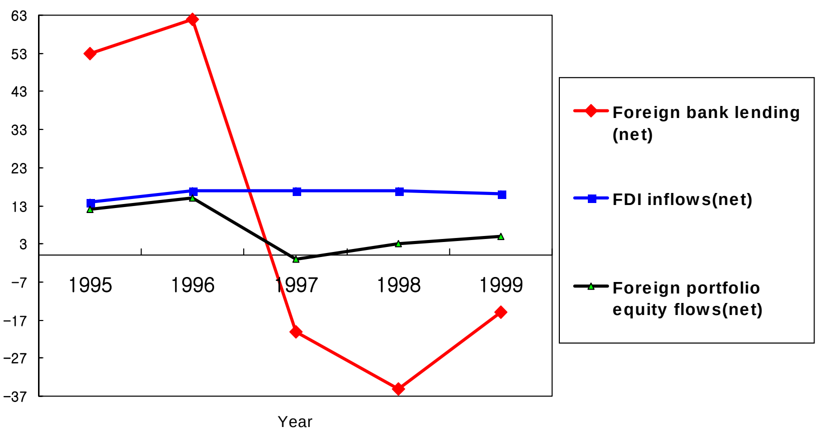
The Asian crisis spread from Thailand, which turned to the IMF in August 1997, but in fact it started a little earlier. Hong Kong was hit first in early July when international investors began to reshuffle their portfolios across economies. But Hong Kong survived. Some economies, such as Singapore, Chinese Taipei, and Japan also survived, while others did not. The collapse of Thailand, Indonesia, and Korea soon followed.

The Asian crisis was basically international in nature within the region. The same "flu virus" attacked several Asian economies. The most important question is why some economies could survive while others could not. The answer is that immune systems are different among economies. Without improving the immune system, the flu cannot be cured. Some medicines may reduce the symptoms, but only temporarily. So, the Asian crisis was indeed a "fundamental" problem. Furthermore, the crisis was not just financial, but economic. A country in trouble needs to reform the fundamental structure of its economy to restore and enhance its international competitiveness.

FDI AS A SOURCE OF SUSTAINED INTERNATIONAL COMPETITIVENESS

According to the World Investment Report (1999: 56), FDI flows into the five crisis-hit economies (Indonesia, Korea, Malaysia, the Philippines, and Thailand) as a group have remained almost constant, while portfolio equity investment and bank lending to affected economies have fallen sharply as shown in Figure 1. This is because these three types of capital flows have different characteristics and motivations. Short-term borrowing and portfolio equity investment usually fall sharply when a crisis comes and thus cannot be used as solutions for the crisis. In contrast, FDI is a long-term investment in the host nation, and thus can help restore the troubled economies. Furthermore, FDI involves not just capital flow, but also other resources such as technology and management skills that are important sources of productivity for host economies. So, FDI is a more important source of sustained international competitiveness than are portfolio equity investment and bank lending.

***Figure 1.* FDI flows, foreign portfolio equity flows and foreign bank lending to the five Asian countries most affected by the financial crisis, 1995-1999** (Billions of dollars)



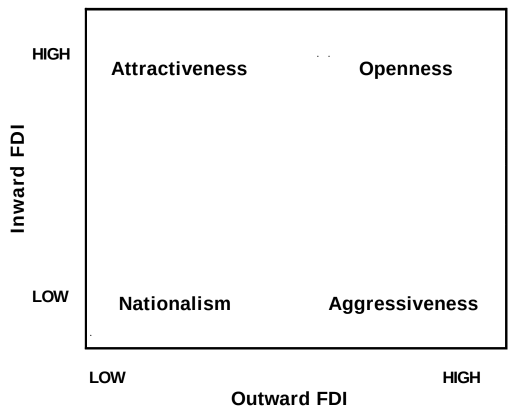
***Source*: UNCTAD**, World Investment Report 1999

Robert Reich (1990), Harvard Professor and former Labor Secretary of the United States, presented an interesting perspective on national competitiveness by contrasting two types of corporations. Corporation A, for example, IBM Japan, is headquartered in the United States, but most of its employees are non-Americans. This company undertakes much of its R&D and product design, and most of its complex manufacturing, outside the borders of the United States. Corporation B, for example, SONY America, is headquartered abroad, but most of its employees are Americans. This company undertakes most of its manufacturing and much of its other activities in the United States. Now who is "us"? According to Reich, the answer is the American work force (i.e., Corporation B), but not particularly the American corporation (i.e., Corporation A). So, Reich preferred inward FDI to outward FDI for national competitiveness.

Michael Porter (1990), Harvard Professor and a guru of national competitiveness, presented an opposite perspective. While he emphasized the importance of globalization, he argued that inward FDI should not be the first best solution. As the best indicators of national competitiveness, Porter chose exports and outward FDI, based on skills and asset created in the home economy.

We can now develop a simple, but very useful model for explaining different types of FDI policies. According to Reich, an economy must open its borders to investors from around the world. So, this can be termed the "attractiveness" strategy of inward FDI. In contrast, the Porter type of outward FDI can be termed an "aggressiveness" strategy. Notwithstanding, neither Reich nor Porter is comprehensive in explaining the ideal type of FDI policy in the era of globalization. An FDI policy can be adopted that is open to both inward and outward FDI. This is an "openness" strategy. FDI is beneficial in both inward and outward directions (Moon, Rugman, and Verbeke 1998). These three types of FDI policy are contrasted in Figure 2.

***Figure 2.* Inward-Outward FDI model**



We have applied this model to the Asian member economies of APEC to find relationships between different FDI policies and the pattern of the economic crisis in 1997. Vietnam and Brunei are not included because relevant data are not available. Figure 3 shows inward and outward FDI flows (for the three periods of 1995, 1996, and 1997) as a percentage of gross fixed capital formation for each of the ten Asian member economies of APEC. We can divide them into four groups for our analysis.

Figure 3. **Inward and outward FDI flows as a percentage of gross fixed capital formation, by region and economy, 1995-1997** (percentage)

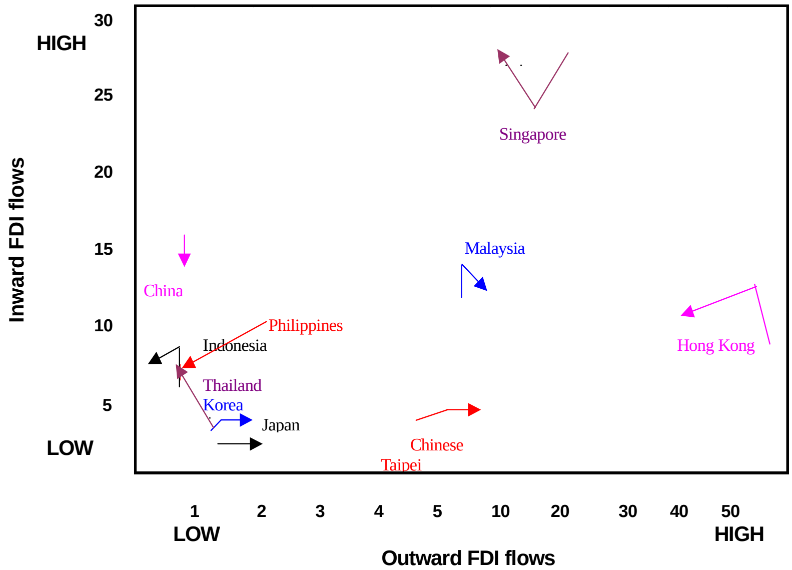
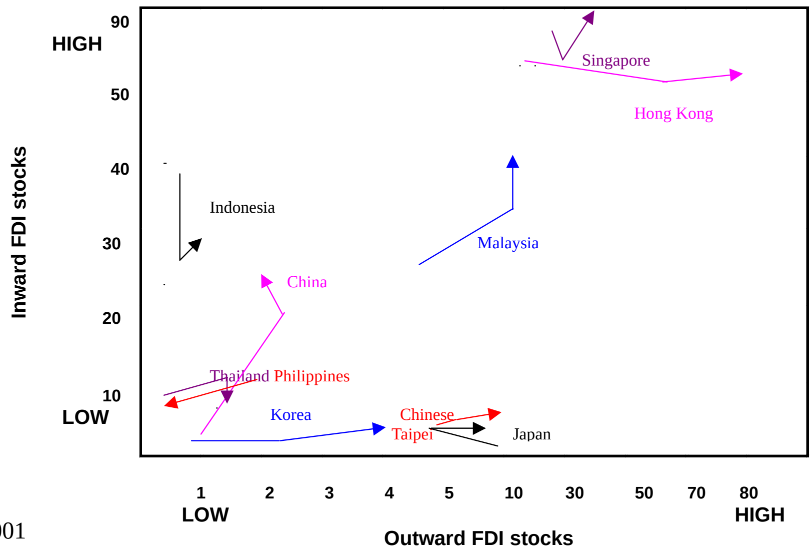


Figure 4. **Inward and outward FDI stocks as a percentage of gross domestic product, by region and economy, 1990, 1995 and 1997 (percentage)**



Group 1 economies include Singapore, Hong Kong, and Malaysia, which are basically open to both outward and inward FDI. These economies have been the least influenced by the Asian economic crisis, although Malaysia was at the margin. Group 2 economies are Chinese Taipei and Japan, which have been relatively less influenced by the crisis. Group 3 economies include the Philippines, Indonesia, Thailand, and China. These economies have been struck hard by the crisis, except for China. Finally, Korea is a Group 4 economy and has been most severely struck by the crisis. Therefore, we can posit some important relationships between FDI and economic stability. A similar conclusion can be reached by means of an alternative measure, namely inward and outward FDI stocks (for the three periods of 1990, 1995, and 1997) as a percentage of gross domestic product by economy, as shown in Figure 4.

However, it is important to note that in this analysis there are two exceptional cases: Japan and China. These two economies are relatively large compared to other Asian economies. So, the absolute amounts of FDI associated with these economies are correspondingly very large (see Figure 5 and Figure 6), although the relative size of FDI as a percentage of gross capital or gross domestic product is not significant compared to that of the other economies. Since both absolute and relative sizes of FDI are important, these two economies need to be considered separately from the other Asian economies.

Excluding Japan and China, we can find more direct effects of FDI on economic stability and development. The remaining eight Asian economies can be categorized into the first Newly Industrializing Economies (NIEs), which include Singapore, Hong Kong, Chinese Taipei, and Korea, and the second NIEs, which include Malaysia, the Philippines, Indonesia, and Thailand. As per Figure 3, among the first NIEs, Korea is the least open to FDI and the only economy that received the IMF bailout money. Among the second NIEs, Thailand and Indonesia are relatively less open to FDI and were more severely damaged in the economic crisis than were the Philippines and Malaysia.

The Korean case is particularly interesting. For its relative importance in the world economy, Korea is low in both outward and inward FDI. Some Korean people still think that inward FDI does not benefit their economy on the grounds that inward FDI exploits the economy's resources.

Korea's anti-foreign attitude scares foreign investors off, although the Korean government is providing various incentives to attract FDI (Korea Herald, March 19, 1998). Many Korean people also think that outward FDI does not benefit their economy, either, believing that outward FDI hollows out national industries. In order to exploit greater international opportunities, Korea may need a bigger change in FDI policies and in national sentiment toward foreignness.

It is thus now quite evident that there are strong relationships between FDI and stabilized economic growth. In our previous analysis, Japan and China were excluded for simplicity. However, their economic situations are also much influenced by FDI, both to and from these economies.

Figure 5. **FDI inward and outward stock, by host region and economy, 1995,1997 and 1998** (Billions of dollars)

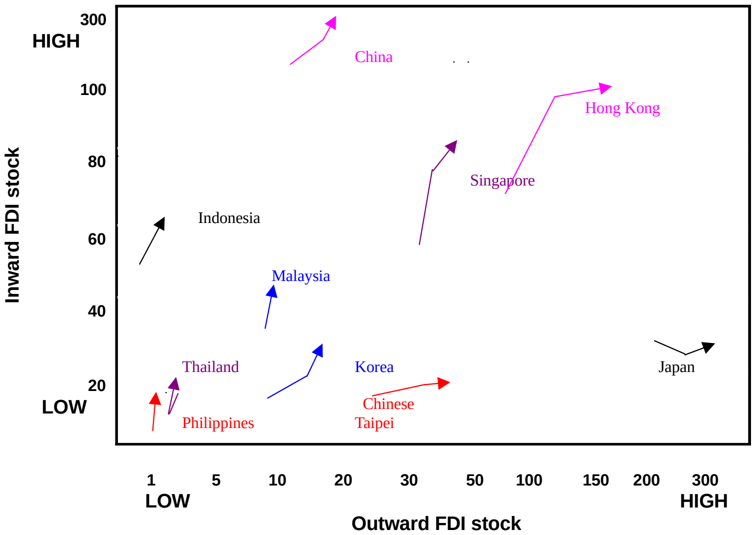
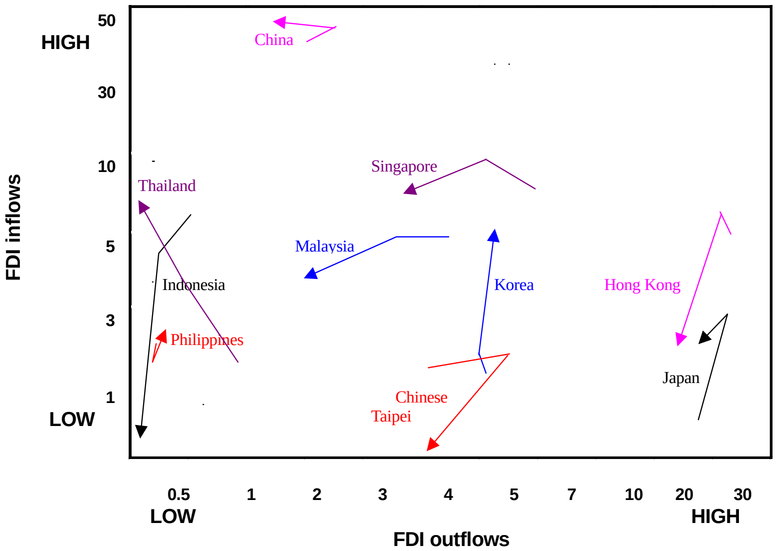


Figure 6. **FDI inflows and outflows, by host region and economy, 1996-1998** (Billions of dollars)



Consider Japan, first. This economy is active in outward FDI, but very defensive against inward FDI. The low level of inward FDI is a result of a sophisticated Japanese system that is related to the unique Japanese culture and policy framework. Because of this limitation, Japan may be more vulnerable to foreign exchange crisis than other economies. It is difficult for Japan to attract FDI when the economy needs foreign currency. This can explain the difficulty that Japan experienced recently in defending the value of yen.

In contrast, China has made remarkable achievements in attracting FDI since the adoption of the policy of reform and opening to the outside world in 1979. By the end of 1998, the number of foreign-invested enterprises had reached 324,620. In 1998, industrial output of foreign-invested enterprises was 22 percent of total national industrial output, and actual realized FDI amounted to US$45.46 billion, accounting for 13 percent of total national investment in fixed assets. FDI has played a positive role in maintaining the sustained development of China's national economy, accelerating the restructuring of state owned enterprises, increasing employment, and introducing advanced technologies.

We have so far found that FDI in both outward and inward directions plays an important role for stabilized economic growth. Outward FDI is more a function of the level of economic development; in other words, the more developed a economy is, the more outward FDI would take place. On the other hand, most economies, whether developed or developing, would like to attract FDI. According to the World Investment Report (1999), of a total of 145 regulatory changes relating to FDI made during 1998 by 60 economies, 94 percent directed toward creating more favorable conditions for FDI, and 6 percent in the direction of greater control (see Table 1). Indeed, during the period 1991-1998 as a whole, the same proportion, 94 percent, of the FDI regulatory changes were aimed at creating a more favorable environment for FDI, in both developed and developing economies.

INDIVIDUAL ACTION PLANS OF THE ASIAN MEMBER ECONOMIES OF APEC

Within the inward-outward FDI model, we have classified four groups of economies, characterized by openness, aggressiveness, attractiveness, and nationalism. We will now specifically analyze and evaluate the recent changes in FDI policy in the Asian member economies of APEC. The information is based on the individual action plans (IAPs) that were submitted to APEC by member economies in 1999 in order to implement the Osaka Action Agenda.

Group 1: Hong Kong, Singapore, and Malaysia

Group 1 economies are taking an "openness" strategy. Hong Kong is one of the world's most open economies. Hong Kong has not sought any Most-Favored-Nation (MFN) exemption relating to foreign investment in its schedule of commitments under the WTO General Agreement on Trade in Services (GATS). The economy maintains a free and open regime for FDI, with no requirement for prior authorization or post-establishment notification. Except for some restrictions in a few sectors including banking, broadcasting and airport support services, Hong Kong offers a level playing field for foreign and local investors. Hong Kong will strive to open its economy further. For example, before 2005, it will de-regulate the television broadcasting sector by enacting new legislation to remove restrictions on voting control by non-residents with respect to pay television (except domestic free television service), subscription television, and video-on-demand program service licenses.

Table 1. **National regulatory changes, 1991-1998**

Item	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65	76	60
Number of regulatory changes	82	79	102	110	112	114	151	145
of which:								
More favourable to FDI[a]	80	79	101	108	106	98	135	136
Less favourable to FDI[b]	2	-	1	2	6	16	16	9

Source: **UNCTAD,** World Investment Report 1999.

[a] Including liberalizing changes or changes aimed at strengthening market functioning, as well as increased incentives
[b] Including changes aimed at increasing control as well as reducing incentives

Singapore, similarly, has one of the world's most open and liberal investment regimes. The Singapore government actively encourages foreign investment and treats foreign capital the same as local capital. Potential investors are not screened. They only need to register with the Registrar of Companies and Businesses. No restrictions are placed on investment except for national security purposes and in certain industries. License requirements, if any, stem mainly from the special conditions of the specific sector and are applicable to all investors. Recent efforts to liberalize the service sector include corporatization of the Port of Singapore Authority in 1997, corporatization of the power supply, opening up of the banking sector over a 5-year period as announced in 1999, and removal of foreign ownership limits by publicly listed companies as started in 1998. Over the medium and long term (2001 – 2010), Singapore will regularly review policies pertaining to investment to ensure that its investment regime remains open.

Malaysia maintains a liberal investment regime, and foreign investments in the manufacturing sector are welcomed. There is no legislation specific to foreign investors and Malaysia's investment regulations are applicable to both foreign and domestic investors. Although there is no particular discrimination against foreign investors, there exist some unnecessary regulations on investment and the market does not function very well. Malaysia continues to relax regulations in order to improve market function. For example, the government has relaxed the export condition imposed on all manufacturing companies effective from January 1, 1998 to December 31, 2000. With this relaxation, existing companies with export conditions can now apply to the Ministry of International Trade and Industry (MITI) for approval to sell up to 50% of their output in the domestic market. However, there are still some restrictions on the types of products eligible. Malaysia will work towards improving regulations on investment with a view towards facilitating and liberalizing its investment regime.

Group 2: Japan and Chinese Taipei

Japan and Chinese Taipei have taken an "aggressiveness" approach. Japan has been much more active in outward FDI than inward FDI. Recently, the government has realized that inward FDI is also important for its economy. Japan has not only made its regime more open, but has made it a high-priority policy goal to increase foreign investment in Japan. The Japan Investment Council was established in 1994 under the chairmanship of the Prime Minister to address this goal. In April 1999, the Council issued a statement entitled "Toward an Age of Diversified Ideas through Foreign Direct Investment in Japan," declaring that no effort will be spared to further promote inward FDI based on the recommendations made by the Expert Committee of the Japan Investment Council.

As a specific effort, the government has removed some restrictions on FDI in the mining sector, moving from prior notification to ex post facto reporting (April 1998). Also, in telecommunications sector, the government has abolished the limitations on

FDI in all Type 1 telecommunications carriers (except for NTT), including those for radio licenses (June 1998). Regarding the Cable Television industry, the regulations on FDI were abolished in June 1999. However, there are still some strict restrictions on industries related to national security and public order, which include aircraft, space development, arms, explosives, nuclear energy, electric utility, gas utility, heat supply, water supply, passenger transport, telecommunications and broadcasting, vaccines, and security guard services. The government will continue to liberalize and facilitate the FDI regime.

Chinese Taipei used to protect its domestic market from foreign investors, but is now directing its efforts toward market opening. One important effort was to revise the negative list for inward FDI. From May 27, 1998, "power generation," "power transmission," and "power distribution," classified under the "Electric Light and Power Supply" industry, were removed from the list of "Prohibited Industries" to "Restricted Industries." From March 10, 1999, "Military Aircraft" was similarly moved from the "Prohibited" to the "Restricted " category. Other policy changes include simplification of investment auditing procedures, liberalization of the securities market, reduction of obstacles to the entry and exit of foreign firms, and cooperation with other APEC member economies. Chinese Taipei is expected to further open its market to foreign investors in future.

Group 3: China, the Philippines, Indonesia, and Thailand

Group 3 economies can be classified as those economies following the "attractiveness" startegy. China has been very active in attracting FDI since the government realized the important role of foreign investments and opened its economy to the outside world in the late 1970s. The economy has made significant progress in expanding sectors for FDI, in particular, during the 1990s. Now foreign investors can do business in service sectors such as financial services, insurance, foreign trade, commercial service, accounting, transport, medical, tourism and so on. Some of these sectors have been opened to foreign investment based on the experience of pilot programs in coastal cities; and the region opened to FDI has been expanded to some inland cities in recent years. In line with stipulations in relevant laws, prior authorization mechanism applies in establishment, expansion and other alterations to the foreign-invested enterprises. Upon establishment, foreign-invested enterprises enjoy more preferential treatment than domestic enterprises in tax policy, import and export rights, self-managerial authority and so on, with the most preferential tax treatment granted to the high-tech enterprises, enterprises promoting export development and other enterprises encouraged by the state policy. Over a medium term (2001 – 2010), China will further expand sectors for and remove restrictions on FDI.

The Philippines encourages domestic and foreign investments that generate quality employment, facilitates appropriate technology transfer, promotes strategic industry, or provides other significant benefits. All areas are open to FDI, except those restricted under negative lists: (a) by legal and/or constitutional constraints; or (b) for reasons of security, defense, risk to health and morals or protection of small-and-medium size enterprises. The Philippines regularly reviews existing agreements to expand coverage of national treatment. The Board of Investments One Stop Action Center (OSAC), which was established in 1987, serves investors by providing them with a full line of governmental services in one physical location. OSAC not only minimizes documentary procedures required for investors, but also provides immediate answers to questions and problems that they may encounter. Nonetheless, there still exist unnecessary restrictions and transparency problems.

Indonesia opens most manufacturing sectors to foreign investors, with the exception of a few fields. The Negative Investment List (NIL) of 1995 has been replaced by a Presidential Decree (No. 96/1998). By this new Decree, the NIL has been reduced to only 16 business sectors that are totally closed to investment and 9 sectors closed to foreign investment. Various measures have been taken to facilitate and improve Indonesia's investment and business climate. In principal, foreign investors may hold 100% equity in a company. The use of a joint venture is only required in eight investment sectors vital to the public interest, such as the operation of harbors, telecommunications, power generation, shipping lines, airlines, potable water, public railways and nuclear power generation. Investment application/approval procedures have been substantially simplified. For instance, FDI applications with a value of up to US$ 100 million, which formerly needed President's approval, currently are only subject to the approval of the Minister of Investment/Chairman of the Investment Coordination Board. However, investment applications with a value of more than US$ 100 million still need an approval from the President. Despite the Indonesian government's continuous efforts, foreign investors are not yet satisfied with the process and transparency with regard to FDI. Indonesia will have to continue to simplify investment procedures with increased transparency.

Thailand's major legislation governing foreign investment is the Announcement of the National Executive Council No. 281 (1972), commonly known as the Alien Business Law. Entities with at least 50% foreign equity or those whereinat least one-half of the shareholders or partners are aliens are subject to this law. These entities are not allowed to do business in certain types of activities. This law is being revised to allow greater foreign participation. The new draft legislation, entitled the "Foreign Business Act," was approved by the Cabinet on August 18, 1998 and later by the parliament. However, regulations and procedures are still complicated in many areas. In June 1997, the Office of the Board of Investment, in collaboration with the Immigration Bureau and the Department of Employment, established the "One-Stop

Service Center for Visas and Work Permits" to handle all aspects of visa extensions and issuance of work permits for direct investors and experts. This center helps reduce the visa and work permits extension process from 45 days to three hours. This implies that there is still a great deal of room for improving the investment environment in this economy.

Group 4: Korea

Recently, Korea has been taking an "attractiveness" approach. However, Korea had not previously been very open to foreign investors, in particular when compared to its competitors among the other NIEs such as Chinese Taipei, Hong Kong, and Singapore. Since the crisis, Korea has made greater progress than any other economy in improving the FDI environment. Korea's efforts are well reflected in its 25 pages of IAP on FDI, as reported to APEC. The length of the reports on FDI by most of the other APEC member economies had just a few pages. The Korean government has replaced the old Act on Foreign Direct Investment and Foreign Capital Inducement with the new Foreign Investment Promotion Act, which became effective on November 17, 1998.

There are two major principles governing the new FDI regime. The first principle is to formulate policies from the perspective of foreign investors. To reduce the number of contact points and administrative procedures, the Korean government launched One-Stop service through the Korea Investment Service Center (KISC) at KOTRA as of April 30, 1998. This service was intended to help foreign investors through all stages of investment, from consulting to after-service. The Korean government also established the Office of the Investment Ombudsman within the KISC in November 1999. This office will make the utmost effort to help foreign corporations in Korea resolve problems, whether they are investment or settlement-related. In addition, the requirement that non-residents appoint a resident of Korea as proxy to submit notification applications of FDI to the government has also been abolished. To further facilitate this process, notification forms to be submitted to the government have been published in English and Korean (previously, notification forms were only available in Korean). The second principle is to establish a FDI system in which local government, in efforts to advance regional development, plays the central role in competitively courting FDI. The central government can also support local government efforts, with initiatives such as development of foreign investment zones. However, there are still some restrictions on investment in cases where the maintenance of national security, public order, public health, environmental preservation, or social morals is threatened. Despite Korea's vigorous efforts, some foreign investors still complain that procedures are not transparent and that there is an anti-foreign sentiment in the economy.

CONCLUSION

One of the most important lessons from the recent economic crisis in Asia is that FDI plays a more important role than do bank lending and portfolio investment in an economy's sustained and stabilized economic growth. FDI is relatively long-term and involves not just capital but also other resources such as technology and management skills. After the crisis, therefore, many economies have made great efforts to competitively enhance their environment for foreign investors. However, efforts vary across economies and there is still much room for further improvement in the FDI environment.

Some important policy implications can be derived with regard to the relationship between FDI and economic growth. First, a more open economy will be more stabilized. People may think that the more open an economy is to foreign investors, the more vulnerable it is to international crisis; however, the opposite is true. The most open economies, such as Hong Kong and Singapore, were the least affected by the crisis; while the least open economies, such as Korea, were most seriously affected.

Second, simpler rules attract more FDI. Some developing economies are still worried about the possibilities of exploitation by foreign investors. Economies like Indonesia, Thailand, and the Philippines try to open their economies step by step with sophisticated rules and procedures in many areas. However, foreign investors prefer simple rules and transparent procedures.

Third, the government should pursue positive interventions. The policy of strict regulation on FDI is the worst. A passive, *laissez faire* approach is not good, either, because there may exist market failures and deficiencies in institutions. Therefore, to maximize the benefits of FDI, the host government has to be able to provide the most competitive environment for foreign investors, by eliminating failures and deficiencies.

Finally, FDI policies should be formulated with a long-term view. Although some macroeconomic indicators have moved favorably, the Asian nations should not neglect on-going efforts to attract FDI and to reform other policies. With these continuous efforts, the attractiveness of the Asian economies will be enhanced. Although many Asian economies suffered from the crisis in 1997, they learned valuable lessons. The more seriously they consider these lessons, the more likely they will be to succeed in achieving stabilized economic growth.

This study can be extended along the following dimensions. First, this paper has shown that FDI is an important source of economic growth. But we need to know the specific welfare impacts of FDI on different areas of an economy such as the production side, the demand side, and other aspects of the business environment. Second, we have used yearly data in this study. But monthly data may be more useful, particularly because the investors were very quick to respond during the 1997 economic crisis. Finally, it would be very interesting to compare and contrast specific government policies in the affected economies, in response to the international capital movements during the crisis.

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