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JAPANESE FDI IN MALAYSIA AND OTHER ASIAN COUNTRIES: ARE THEY COINTEGRATED?

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Abstract

ASEAN has been developed partially due to the large inflows of FDI from various countries, in which one of them is Japan. While the contribution of Japanese FDI is no longer a secret, the inconsistent inflows of Japanese FDI into Malaysia has questioned the ability of Malaysia to retain its attractiveness as the primary location for FDI. Are they complementing or competing to each other? With limited information available, this study approaches the issue by focusing on the experiences of Malaysia with regards to other Asian countries. ARDL model is employed and this study observes that Japanese FDI in Malaysia is integrated with Japanese FDI inflows to other Asian countries. However, the direction or sign of effect varies across countries.

Keywords: Japanese FDI; Asian Countries; Malaysia; ARDL

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1. Introduction

Japanese foreign direct investment (FDI) has been contributing to world FDI significantly to the extent that Japanese multinational corporations (MNCs) have successfully established strong investment positions in the US, Europe and Asia (Anand & Delios, 1996). Japan is currently the second largest investors in the US. Considering the importance of Japanese FDI in world FDI flows, there are numerous studies on Japanese FDI such as on performance of Japanese FDI (Siripaisalpipat & Hoshino, 2000) and lcoational factors (Blonigen, Ellis & Fausten, 2005; Cheng, 2008).

As shown in Table 1, North America, including the USA, Asia and Europe have been the major locations for Japanese FDI. Although the North America's share drops from about 50 percent in 1987-1996 to less than 30 percent on average in the 2010-2014, the percentage is still above the portion that goes to Asian region. Moran and Oldenski (2015) stated that Japanese FDI is the largest sources of FDI in 2013 for the first time since 1992 with injection of almost $45 billion. Prior to 1992, Japanese firms were among the primary investors in the USA since 1980s, but surpassed by MNCs from European countries. In particular, when the North American Free Trade Agreement (NAFTA) passed in 1994, it gave a boost for Japanese direct investment in automotive by Japanese MNCs such as Honda, Toyota, Nissan, Mitsubishi and Subaru in North America. Another crucial factor that led to direct investment in the US market by Japanese MNCs are the fluctuation in exchange rate and cost of transportation (Moran & Oldenski, 2015). Institutional quality, especially protection of property right that can promote R&D by Japanese MNCs in the USA can serve as another crucial to lure FDI from Japan (Arora, Branstetter & Dew, 2015). Asia has been successfully attracting Japanese FDI b virture of its rapid development. Asia offers large consumers and industrial markets and result in relocation of Japan manufacturing to Asian countries in the 1980s (Anand & Delios, 1996). Out of total,

China obtained the largest share of between 1/5 to 1/3 of total inflows of Japanese FDI into Asian region.

Table 1: Japanese FDI across the Globe (in trillion USD)

	Asia	China	Malaysia	Vietnam	India	North America	Oceania	Europe	Middle East	Africa	World
1987	n.a.	0.2 [0.9]	n.a.	n.a.	n.a.	9.9 [50.7]	n.a.	n.a.	n.a.	n.a.	19.5
1996	9.7 [41.6]	2.3 [9.9]	0.5 [2.2]	0.3 [1.3]	0.3 [1.1]	11.5 [49.0]	0.7 [3.0]	2.9 [12.4]	0.3 [1.1]	-0.1 [-0.5]	23.4
1997	13.1 [50.3]	1.9 [7.2]	1.0 [3.8]	0.3 [1.0]	0.5 [1.9]	7.8 [29.8]	0.3 [1.1]	2.6 [10.0]	0.2 [0.8]	0.1 [0.5]	26.1
2005	16.2 [35.6]	6.6 [14.5]	0.5 [1.2]	0.2 [0.3]	0.3 [0.6]	13.2 [29.0]	0.9 [2.1]	8.2 [18.1]	0.5 [1.2]	0.02 [0.1]	45.5
2010	22.1 [38.7]	7.3 [12.7]	1.1 [1.9]	0.7 [1.3]	2.9 [5.0]	9.0 [15.8]	6.4 [11.2]	15.0 [26.3]	-0.3 [-0.6]	-0.4 [-0.7]	57.2
2011	39.5 [36.3]	12.6 [11.6]	1.4 [1.3]	1.9 [1.7]	2.3 [2.1]	15.2 [13.9]	8.8 [8.1]	39.8 [36.6]	0.7 [0.7]	0.5 [0.4]	108.8
2012	33.5 [27.4]	13.5 [11.0]	1.3 [1.1]	2.6 [2.1]	2.8 [2.3]	35.8 [29.2]	11.1 [9.1]	31.0 [25.6]	0.4 [0.4]	0.1 [0.1]	122.4
2013	40.5 [30.0]	9.1 [6.7]	1.3 [0.9]	3.3 [2.4]	2.2 [1.6]	46.5 [34.4]	6.1 [4.5]	32.2 [23.9]	0.1 [0.1]	-0.5 [-0.4]	135.0
2014	35.4 [29.6]	6.7 [5.6]	1.0 [0.8]	1.3 [1.1]	1.8 [1.5]	43.9 [36.6]	5.6 [4.6]	25.9 [21.6]	0.5 [0.4]	1.5 [1.2]	119.7

Note: Figure in [ ] denotes % of total world Japanese FDI.Asia refers to China, Hong Kong, Taiwan, South Korea, Singapore, Thailand, Indonesia, Malaysia, the Philippines, Vietnam and India. n.a. stands for not available.
Source: JETRO (2015).

Without exception, Malaysia also places huge emphasis on FDI inflows to maintain as well as improve its economic development. Malaysia is among the largest recipient of FDI inflows in the 1980s with Japan and USA are the primary sources of FDI inflows during that period. As can be seen from Table 1, Malaysia maintained its importance in the eyes of Japanese MNCs at about 1 percent of total world Japanese FDI since 2011, but consistently managed to ensure US1 trillion of FDI inflows for the past few decades. Apart from the rising concern about the ability of Malyasia to continuously lure Japanese FDI, it is also equally important to understand whether the inability of Malaysia to increase the volume as well as the percent of Japanese FDI inflows is due to the emergence of new locations for Japanese FDI. New locations basically refer to emerging countries such as China, India and Vietnam. Cook (2014) stated that Japanese FDI is the largest inflows in ASEAN with Malaysia, Thailand and Indonesia rely heavily on Japanese FDI as a primary source of foreign capital. In other words, this study aims to examine whether the relationship between Japanese FDI in Malaysia and other ASEAN or Asian countries is complementary or substituting. This is particularly crucial as Malaysia only the largest recipient of Japanese FDI during the first wave (1985 – 1990) but is no longer in the list of top three ASEAN largest recipient during the second wave (2008-2013). During the second wave, Indonesia and Vietnam have taken over the position as the top three, replacing Malaysia and Singapore. Thailand remains consistent with the prefered location of Japanese FDI in both waves. The knowledge pertaining to Japanese FDI behavior in various ASEAN and Asian countries may offer critical answer on the strategy to attract Japanese FDI. For different result, it will require different set of strategies applicable to lure Japanese FDI.This study can serve as another crucial input, especially to Malaysia to design optimal strategy to attract more Japanese FDI to Malaysia.

The remaining organization of this study is as follows: the next section will review related studies pertaining to Japanese FDI in various locations, followed by methodology section. Discussion of the results of analysis will in the next section and conclusion will be offered in the last section.

2. Literature Review

With the development is taking place primarily in the Eastern China, China's government has taken another crucial steps to encourage FDI to inflows into the hinterland, particularly the Western China. Cheng (2008), especially, drawn an analysis to assess the effect of reorientation of China's FDI favorable policies on the changes of Japanese investors' location choices. Cheng (2008) study is particularly interesting although it is limited to the case of China. The section 2.1 on evolution of China's FDI preferential policies offers significant implication and may reflect the behavior of FDI among Asian or any possible production networking area such as ASEAN+China or ASEAN+China+Korea+Japan. Section 2.1 of Cheng (2008) basically described the need for FDI preferential policies to boast inward FDI into the more economically lagged behind western and middle regions of China. Starting from the establishment of special economic zones (SEZs) in 1978 to 1984, structural changes and industrial priorities related policies in 1984-1992, and a mere political pressure lessening of channeling poverty relief funds in 1992-1997, all FDI policies seem to be unsuccessful in bringing impact on the volume of FDI inflows intoor any investment activities in the non-coastal area and therefore, no significant economic growth momentum can be seen till 1997 for non-coastal provinces (Wong & Zheng, 2001). Only from 1997 onwards, the Chinese government has seriously launched development programs that cater the need of interior areas by initially initiating more government investment, enhanced infrastructure and enlarged fiscal transfers and later on complemented by 'go west' policies, which are expected to bring in more FDI and needed expertise. The extent of efforts done by Chinese government to promote attractiveness of interior areas to FDI akin to the efforts among Asian or ASEAN countries to make themselves as the most preferred location by multinational corporations (MNCs). What is interesting to note is regarding the nature of integration of various inflows of FDI in Asian or ASEAN – are they complementing or substituting? Unfortunately, literature on this point is scarce.

Agglomeration is observed as a crucial factor in the location decisions of FDI (Head, Ries & Swenson, 1995; Broadman & Sun, 1997; Ford & Strange, 1999; Cheng & Kwan, 2000; Belderbos & Carree, 2002; Cheng, 2008).Ford and Strange (1999) in the case of Japanese FDI in Europe, Head et al. (1995) for Japanese FDI in the US and Cheng (2008) for Japanese FDI in China, have all confirmed that Japanese FDI tends to display a strong nationality agglomeration, converging around previous Japanese FDI. Together with other studies, these studies formed a sound literature on agglomeration effects which have mainly consisted of national-level studies (Wheeler and Mody, 1992; Devereux and Griffith, 1998) or choices of states in the USA (Carlton, 1983; Friedman et al., 1992; Head et al., 1999).

The preceding work on location choices in Europe at a lower geographical level than countries has considered choices of regions by foreign investors in the European territory (Ferrer, 1998). Mayer and Mucchielli (1999) considered, in an integrated way, the national and regional choices of Japanese investors in Europe. Some papers have considered location problems at a very thin geographical level for Brazil (Hansen, 1987), China (Head & Ries, 1996) and Indonesia (Henderson & Kuncoro, 1996). However, to our knowledge, nobody has studied the determinants of location choice at a larger level such as Asian or ASEAN level. Hence, this study

could be among the first in the area to study the relationship between Japanese FDI in Malaysia and Japanese FDI in other ASEAN or Asian countries.

3. Methodology

Since our primary objective is to investigate the relationship between Japanese FDI in Malaysia and Japanese FDI into other countries, the basic equation is as follows:

$$JFM_t = \alpha_0 + \alpha_1 GDP_t + JFO_t + \varepsilon_t \quad (1)$$

Where *JFM* stands for Japanese FDI in Malaysia, *GDP* denotes gross domestic product and *JFO* refers to Japanese FDI in other countries. GDP is added because it represents domestic market size which generally become the objective of FDI to inflow into certain country. The data analysis period spans from 1995 to 2014. This study employs the autoregressive distributed lag (ARDL) approach of Pesaran and Pesaran (1997) and Pesaran, Shin and Smith. (2001) to test for existence of a relationship between the JFM, GDP, and JFO in levels. As noted, this approach can be applied to series irrespective of whether they are I(0), I(1), or mutually cointegrated. The methods adopted in the literature in previous years mainly concentrate on cases in which the underlying variables are integrated of order one (Pesaran et al., 2001). The ARDL method involves three steps. The first step is to test for the presence of cointegration among the variables by employing the bounds testing procedure (Pesaran & Pesaran, 1997; Pesaran et al., 2001). This test can identify the long run relationship with a dependent variable followed by its forcing variables.Without having any prior information about the direction of the long run relationship between JFM and JFO, this study constructs the following regressions. Thus, after transforming all variables into log:

$$\Delta \ln JFM_t = \beta_0 + \beta_1 \ln JFM_{t-1} + \beta_2 \ln GDP_{t-1} + \beta_3 \ln JFO_{t-1} + \sum_{i=1}^{N} \beta_{4i} \Delta \ln JFM_{t-1} + \sum_{j=1}^{N} \beta_{5j} \Delta \ln GDP_{t-j} + \sum_{k=1}^{N} \beta_{6k} \Delta \ln JFO_{t-k} + \varepsilon_i \quad (2)$$

$$\Delta \ln GDP_t = \alpha_0 + \alpha_1 \ln JFM_{t-1} + \alpha_2 \ln GDP_{t-1} + \alpha_3 \ln JFO_{t-1} + \sum_{i=1}^{N} \alpha_{4i} \Delta \ln JFM_{t-1} + \sum_{j=1}^{N} \alpha_{5j} \Delta \ln GDP_{t-j} + \sum_{k=1}^{N} \alpha_{6k} \Delta \ln JFO_{t-k} + \varepsilon_i \quad (3)$$

$$\Delta \ln JFO_t = \theta_0 + \theta_1 \ln JFM_{t-1} + \theta_2 \ln GDP_{t-1} + \theta_3 \ln JFO_{t-1} + \sum_{i=1}^{N} \theta_{3i} \Delta \ln JFM_{t-1} + \sum_{j=1}^{N} \theta_{5j} \Delta \ln GDP_{t-j} + \sum_{k=1}^{N} \theta_{6k} \Delta \ln JFO_{t-k} + \varepsilon_i \quad (4)$$

The null hypothesis of no cointegration in Equation (2) is $\beta_1=\beta_2=\beta_3=0$. The hypotheses are tested by computing the general F-statistics and comparing them with critical values in Pesaran and Pesaran (1997) and Pesaran et al. (2001).

The second step is to estimate the coefficient of the long run relationships identified in the first step. Having found long run relationships (i.e. cointegration) among JFM, GDP, and JFO, in the next step the long run relationship are estimated using the following selected ARDL(p,q,r) models as follows:

$$\ln JFM_t = \delta_0 + \sum_{i=1}^{p} \delta_{1i} \ln JFM_{t-i} + \sum_{i=0}^{q} \delta_{2i} \ln GDP_{t-i} + \sum_{i=0}^{r} \delta_{3i} \ln JFO_{t-i} + \mu_t \quad (5)$$

$$\ln GDP_t = \gamma_0 + \sum_{i=0}^{p} \gamma_{1i} \ln JFM_{t-i} + \sum_{i=1}^{q} \gamma_{2i} \ln GDP_{t-i} + \sum_{i=0}^{r} \gamma_{3i} \ln JFO_{t-i} + \mu_t \quad (6)$$

$$\ln JFO_t = \pi_0 + \sum_{i=0}^{p} \pi_{1i} \ln JFM_{t-i} + \sum_{i=0}^{q} \pi_{2i} \ln GDP_{t-i} + \sum_{i=1}^{r} \pi_{3i} \ln JFO_{t-i} + \mu_t \quad (7)$$

The lag lengths p, q and r are determined by Schwartz Bayesian Criteria (SBC) criterion following the suggestion of Pesaran and Pesaran (1997). Taking into consideration the limited number of observations, a maximum of 5 lags was used. The third step is to estimate the short run dynamic coefficients. The results are derived from equation (2)-(4).

4. Analysis and Discussion

Table 2 presents the results of correlation analysis. The overall results show that each variable has low correlation coefficient against other variable, implying there is no serious multicollinearity problem.

Table 2: Correlation Analysis

	lnGDP	lnJFM	lnJFI	lnJFP	lnJFS	lnJFT	lnJFV	lnJFC	lnJFIN	lnJFDA
lnGDP	1.00									
lnJFM	0.28	1.00								
lnJFI	-0.31	-0.19	1.00							
lnJFP	-0.36	-0.40	0.29	1.00						
lnJFS	0.20	-0.04	-0.47	-0.32	1.00					
lnJFT	0.17	0.89	0.01	-0.39	-0.24	1.00				
lnJFV	0.49	-0.25	0.08	0.19	0.21	-0.30	1.00			
lnJFC	0.15	0.06	-0.19	-0.32	-0.28	0.17	-0.12	1.00		
lnJFIN	0.45	0.21	-0.31	0.08	-0.16	0.11	0.26	-0.16	1.00	
lnJFDA	0.82	0.59	-0.35	-0.47	0.47	0.39	0.32	-0.12	0.39	1.00

Moving on to the bound cointegration test results in Table 3, the comparisons indicate that there are unique cointegrating relationships between the variables in the most models of ASEAN countries (upper panel of Table 3) with an exception for Singapore. The long run forcing variables are GDP and JFO in all relationships with the exception being when JFO is for Singapore. F(JFM|GDP, JFO)= 18.2 when JFO is for Indonesia indicates that there is a cointegrating relationship when the dependent variable is JFM but not vice versa. In this case, the forcing variables are GDP and Japanese FDI in Indonesia. For cointegration against non-ASEAN countries, JFM is found to be unilaterally integrated with Japanese FDI in China and India but not in the case of Hong Kong, Taiwan and South Korea. If we combined both cases, it seems that unique cointegration with JFO forcing JFM in the case of developing countries.

However, when first-tier newly industrializing Asian economies such as Singapore is considered, the co-integration is no longer unique.

Table 3: Bound Cointegration Test

	Indonesia	Philippines	Singapore	Thailand	Vietnam	ASEAN
f(JFM| GDP,JFO)	18.158***	9.010***	7.427***	7.953***	56.753***	13.333***
f(GDP| JFM,JFO)	2.217	3.146	0.149	0.314	0.314	0.989
f(JFO| JFM, GDP)	1.705	4.038	37.739***	2.472	4.155	1.884
	China	HK	India	Korea	Taiwan	Asian
f(JFM| GDP,JFO)	61.234***	18.41***	8.256***	11.03***	22.254***	20.487***
f(GDP| JFM,JFO)	2.033	0.833	3.398	4.529	0.065	4.249
f(JFO| JFM, GDP)	0.787	16.45***	2.254	27.28***	32.446***	6.142
	Critical Value		Lower Bound		Upper Bound	
	1%		5.15		6.36	

The long run test results reveal that *GDP* and *JFO* are the key determinants of *JFM* as shown in Table 4. The results of *GDP* are consistent with the previous studies that market size has significant impact on inward FDI such as Salike (2010) and Takagi and Zheng (2011). Interestingly, the effect of Japanese FDI in other small developing Asian countries on JFM is observed to be substituting or negative, except for the case of Thailand. Conversely, Japanese FDI in a more developed Asian countries as well as large Asian countries (i.e. China and India) is found to be complementary or positive to JFM. Although the results of Singapore, Hong Kong, South Korea and Taiwan are subject to further investigation due to non-unique cointegration, the results may suggest interesting fact that JFM tends to compete with medium income Asian countries but has a tendency to supporting or be supported by high income Asian countries.

Table 4: Long-Run – Basic Model

	Indonesia	Philippines	Singapore	Thailand	Vietnam	ASEAN
Constant	-25.681***	-20.933**	4.929	0.069	0.094	-24.455**
	(-11.979)	(-2.910)	(0.973)	(0.021)	(0.047)	(-2.667)
lnGDP	1.1175***	0.931**	-0.244	0.923***	0.376***	1.180**
	(13.676)	(3.267)	(-1.108)	(9.421)	(4.905)	(3.333)
lnJFO	-0.309***	-0.130**	1.064*	-0.745***	0.248***	-0.853*
	(-5.453)	(-3.001)	(6.701)	(-29.920)	(8.409)	(-1.966)
	Model Criteria					
LM-test	2.91{0.23}	0.31{0.85}		0.41{0.82}	2.91{0.23}	2.27{0.32}
ARCH	0.28{0.59}	0.27{0.59}		0.30{0.58}	0.37{0.54}	0.50{0.48}
Normality	0.01{0.99}	1.45{0.54}	8.59{0.01}	0.28{0.86}	1.01{0.60}	0.54{0.76}
	China	Hong Kong	India	Korea	Taiwan	Asian
Constant	-30.943***	-2.435	-22.241*	-5.955	-18.425***	19.985
	(-12.870)	(-0.844)	(-2.184)	(-0.492)	(-6.129)	(1.256)
lnGDP	1.212***	0.105	0.963**	0.399	0.818***	-0.876
	(12.660)	(0.949)	(2.374)	(0.896)	(6.953)	(-1.266)
lnJFO	0.772***	0.902***	0.068	-0.904**	0.195***	0.565**
	(19.539)	(10.914)	(0.583)	(-2.678)	(6.619)	(2.566)
.	Model Criteria					
LM	0.84{0.65}	5.21{0.11}	0.73{0.69}	0.83{0.49}	2.02{0.36}	2.52{0.28}
ARCH	0.16{0.68}	2.65{0.11}	0.04{0.82}	0.03{0.88}	0.31{0.57}	2.61{0.11}
Normality	0.92{0.62}	0.18{0.91}	1.84{0.88}	9.18{0.01}	2.05{0.36}	0.45{0.79}

Note: Asterisks *, ** and *** denote significant at 10%, 5% and 1% critical values, respectively. Figure in [ ] stands lag length in ARDL model at level.Figure in { } stands for p-value.

For short-run causality, consistent with the finding for long-run, GDP and JFO generally significantly affects JFM. The negative and significant error correction term (ECT) also suggests and supports earlier cointegration finding that there is long-run relationship among the variables.

Table 5: Short-run Granger Causality (Impact on lnJFM)

	ΔlnJFM	ΔlnGDP	ΔlnJFO	ECT(-1)	ΔlnJFM	ΔlnGDP	ΔlnJFO	ECT(-1)
	χ^2-stat			t-stat	χ^2-stat			t-stat
	vs Indonesia: ARDL(1,3,3)				vs the Philippines: ARDL(4,3,3)			
ΔlnJFM	15.87***	76.23***	10.74***	-2.98**	1 3 8.3***	90.17***	109.1***	-18.59**
	vs Thailand: ARDL(2,4,4)				vs Vietnam: ARDL(3,0,0)			
ΔlnJFM	58.36***	112.5***	182.8***	-6.51*	41.23***	0.011	0.005	-10.87**
	vs China: ARDL(3,0,1)				vs India: ARDL(3,3,2)			
ΔlnJFM	71.42***	4.98*	6.78**	-6.62***	107.4***	10.11**	9.37*	-4.47**
	vs Hong Kong: ARDL(3,3,3)				vs Korea: ARDL(4,2,2)			
ΔlnJFM	363.2***	4.03	165.8***	-8.26***	57.67***	4.936	5.477	-2.84*
	vs Singapore: ARDL(2,2,0)				vs Taiwan: ARDL(1,2,0)			
ΔlnJFM	14.82***	0.043	175.9***	-5.09***	0.199	15.91***	1.085	-2.69**
	vs Asian: ARDL(2,2,0)				vs ASEAN: ARDL(3,0,0)			
ΔlnJFM	18.91***	6.16*	2.78*	-11.25***	29.74***	0.366	172.9***	-20.24***

Note: Asterisks * and ** denote significant at 10% and 5% critical values, respectively. Figure in ( ) denote lag length.

CONCLUSION

This study examines the relationship between Japanese FDI into Malaysia with Japanese FDI into other Asian countries. Taking data for the period from 1995 to 2014 and applying dynamic time series modelling, this study observes an interesting results that Japanese FDI in Malaysia is complementary to Japanese FDI in other developed or high-income countries. This could mean that agglomeration effect is taking place in the region where Malaysia is part of the production networking or partner to a more developed countries in Asia. Nevertheless, among medium income countries, which Malaysia is fall under, the results demonstrate that Japanese FDI in Malaysia is also competing with Japanese FDI in other countries. Agglomeration effect is yet to be seen and those who can offer the least cost of production site will win the competition.

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