Challenge for Economic Development in Central America: How to Attract Foreign Direct Investment


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Although there are some individual differences between them, the countries of Asia are all showing continued dramatic economic growth. The main driver behind this trend is foreign direct investment, and there is a strong correlative relationship between the development of each Asian country and foreign direct investment.

In contrast, although the countries of Central America, with the enormous US market in the background, are also showing steady economic performance, in regard to the introduction of foreign investment, they lag behind compared to Asia. Moreover, in order for economic development there to progress smoothly in the future, the encouragement of further foreign direct investment is needed.

Asian Countries Emphasize Introduction of Foreign Investment

The state of the introduction of foreign direct investment into various Asian countries in 2009 can be seen in *Table 1*. Headed by China, with 280,000 companies, each country has over 2,000 foreign corporations that have entered its market. Viet Nam is an especially dramatic case: although an economic liberalization policy (Doi Moi Policy) was introduced at the 1986 Communist Party Congress, foreign direct investment in Viet Nam began in earnest only relatively recently, from around the year 2000 on. Nevertheless, already more than 5,000 foreign corporations have entered the Viet Nam market.

Although there are certain exceptions among foreign corporations, the majority of manufacturing corporations at first centered on production for exports. Expansion of exports leads to increased investment, and then this in turn is connected to further expansion of exports, in a so-called "positive cycle of investment and exports," leading to substantial contributions to the host country's economy.

Needless to say, foreign direct investment (FDI) brings many benefits other than the creation of employment to the host countries, such as expansion of exports, transfer of technology, etc. Taking the example of employment, in the case of Nicaragua, where the author was stationed, in 2010 the unemployment rate was 7.4% and there were about 210,000 unemployed. Now, in the same country, there is foreign direct investment by 148 companies, which employ around 90,000 people in total. That works out at an average of approximately 600 people employed by each company. Therefore, this means that if, for example, another 350 foreign companies were to enter Nicaragua and also employed an average of 600 people each, the country's unemployment problem would be instantly resolved.

Characteristics of Central & South American Countries

On a related note, the countries of Central and South America are often lumped together under the overall moniker of "Central and South America" or "Latin America." But, in fact, even when looking just at their origins, there are major differences between "Central America" and "South America." Many eons ago, the South American continent separated from Africa and moved to its present position. At the time this move was completed, however, it is believed that Central America did not yet exist. It is thought that the Central American isthmus belt came into being thereafter as a result of increased volcanic activity and uplifts of the ocean bed. Because of these differences in the "formation of the earth" of the two areas, in regard to the state of existing resources, too, they are substantially different.

For example, Brazil, one of South America's major representative countries, is blessed with many natural resources such as oil, coal and iron ore. Other South American countries also have abundant natural resources of various kinds – for example, Venezuela has oil and natural gas, Chile and Peru copper, and Bolivia natural gas and lithium. Meanwhile, in Central America, because of the aforementioned "origin of the earth," natural resources hardly exist at all, and at the most there is only a small amount of resources such as gold, etc. resulting from volcanic activity. Also, although there are differences depending on the level of development of each particular country, there are many countries where it cannot be said that there are sufficient savings available to establish industry.

Introduction of Foreign Investment: Key to Development

At the same time, in Central America there exists a good-quality, relatively low-priced labor force, while the Dominican Republic-Central America-United States FTA (DR-CAFTA) that connects the region with the huge neighboring market of the US, has already been put into effect. Also, an FTA with the EU has already been signed, as have various other bilateral FTAs between individual Central American economies and many other countries such as Mexico, Taiwan, Canada, Chile, etc. These trade promotion efforts have apparently been progressing smoothly. Looked at from these aspects, for the future economic development of the countries of Central America, I believe that more active utilization should be made of FDI.

If we look at the balance of FDI (stock base) in the various countries of Central America in 2009, the country with the highest is Panama, which has the Panama Canal, at \$18.6 billion, followed by Costa Rica at \$12.1 billion – these two countries are dramatically high in the region, but even so, compared to the state of FDI introduction in Asian countries, they are still at a low level *(Table 2)*. Other Central American countries are as follows: El Salvador \$7 billion, Guatemala \$6 billion, Honduras \$5.8 billion, Nicaragua \$4.2 billion – all of these are one digit lower than their Asian counterparts. An interesting point here is that, the higher the FDI in the Central American country, the greater the per capita GDP.

So, if Central America continues its current investment

TABLE 1

Number of foreign companies in major Asian countries

Unit: 100 (rounded off)

Country	Number of companies (of Japanese companies)
China	2,837 (223)
Singapore	252 (29)
Viet Nam	56 (20)
Malaysia	35 (14)
Thailand	29 (13)
Indonesia	28 (10)
Philippines	21 (7)

Sources: 1. Government Statisctics of each country
2. Japanese companies: Japanese Chamber of Commerce of each country (except for Viet Nam by JETRO estimate)

TABLE 2

Foreign direct investment, 2009

(Inward stock base)

Economy		Unit (in million US$)	Per capita (in US$)
Central America	Panama	18,675	7,133
	Costa Rica	12,141	6,345
	El Salvador	7,132	3,623
	Guatemala	5,989	2,662
	Honduras	5,841	1,823
	Nicaragua	4,190	972
Asia	China*	473,083	3,734
	Singapore	343,599	36,378
	Thailand	99,000	3,940
	Malaysia	74,643	6,950
	Indonesia	72,841	2,329
	Viet Nam	52,825	1,068
	Philippines	23,559	1,747
	Brunei Darussalam	10,672	25,386

*Note: *Mainland China only, excluding Hong Kong and Macao*
Sources: 1. Inward stock base: UNCTAD, UNCTAD statistics
2. Per capita: IMF, World Economic Database Oct. 2010

introduction activities, does that mean that FDI will increase, as it did in Southeast Asia? In the author's experience, the answer to this question is, "It's not that simple." Introduction of foreign investment is a competition between countries, and looking at the case of Southeast Asia, there is intense rivalry in regard to foreign investment introduction. In that case, what should be done? Below are some typical examples of areas for improvement.

1 Improvement of the "hard" infrastructure
Developing industrial zones and road networks, electricity-generation ability, etc.
2 Introduction of simplified procedures
Simplifying procedures to obtain manufacturing licenses and for visa issuance, etc.
3 Developing supporting industry
4 Special tax incentive measures
5 Introduction of thoroughgoing FDI attraction activities

In regard to the above, in particular the development of supporting industry, it is difficult to realize this in a short time. However, there is an urgent need to start by tackling whatever can be done now.

Learning from Example of Successful Countries

A fruitful way of developing efficient corporate introduction activities for the future would be to learn from the example of "successful countries." In Central America, Costa Rica and Panama, the leaders in this sector, provide useful examples, while below we introduce the example of Malaysia, where the author was stationed previously.

In Malaysia there are currently some 3,500 foreign companies; they form the core of the country's manufacturing industry. In regard to attracting these kinds of corporations to Malaysia, the "one-stop shop" concept was introduced there ahead of other countries, leading to the simplification of procedures, which proved very successful. Specifically, for manufacturing corporations, the Malaysia Industrial Development Authority (MIDA) serves as the window for conducting all the procedures, and the system enables all the necessary licenses such as "manufacturing licenses" and employment visas to be obtained at once. To facilitate this work, the necessary personnel are seconded to MIDA from relevant ministries and agencies.

Selecting Targeted Corporations based on Each Country's Industrial Strengths

The field of investment attraction, as I mentioned earlier, is one where "it's easy to say, but hard to do." Just aimlessly getting large corporations to move into action is unlikely to lead to success.

For example, to attract car companies, an important condition is that a wide-ranging parts industry has already been developed in the country, and it is basically impossible to attract car companies to a country that has no parts industry at all. First we have to thoroughly grasp "the strengths of each country's industry," and then, based on that, we should tackle FDI introduction activities.

In the past, almost 100% of car seats manufactured in the US were made domestically. Now, however, the majority is produced in Mexico. This reflects the fact that, because the car price war in the US has become severe, manufacturers have moved their base for production of car seats to neighboring Mexico, where there are advanced skills in both textiles and steel-processing. Among the foreign companies in Central America, many are in the textile field, so on this point there is a sufficiently advanced level of skill.

I believe it would also be possible to attract foreign manufacturing corporations in more advanced product-sectors to Central American countries, based on the present degree of textile-related skills. I hope that, in the near future, all the countries of Central America succeed in attracting foreign corporations, and that the Central American economy expands rapidly. JS

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