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Foreign Direct Investment, Trade Openness, and Economic Development in Asian Countries

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Abstract

Foreign direct investment and trade openness have become central components of economic development strategies throughout Asia. Foreign direct investment provides external capital, advanced technology, managerial expertise, employment opportunities, and access to international markets, while trade openness enables economies to specialize, expand exports, import productive inputs, and participate in global value chains. However, neither foreign investment nor trade liberalization automatically produces sustainable and inclusive development. Their benefits depend on human capital, institutional quality, financial development, infrastructure, technological capabilities, macroeconomic stability, and the capacity of domestic firms to establish linkages with multinational enterprises.

This analytical review examines the interconnected effects of foreign direct investment and trade openness on economic development in Asian countries. It draws on established economic literature and recent descriptive evidence from the World Bank, the World Trade Organization, and the United Nations Conference on Trade and Development. Recent investment patterns demonstrate considerable variation across Asian subregions. In 2025, foreign direct investment inflows to developing Asia increased from approximately US$623 billion to US$644 billion. South-East Asia, South Asia, West Asia, and Central Asia recorded increases, whereas East Asia experienced a decline. The article argues that foreign investment and trade openness are most productive when they complement domestic investment, innovation, workforce development, export diversification, and effective public institutions. Asian governments should therefore move beyond policies that merely maximize the volume of foreign capital or trade. They should focus on the quality, technological intensity, environmental sustainability, domestic linkages, and distributional effects of investment and trade. Such an integrated approach can help Asian economies transform international economic integration into productivity growth, industrial upgrading, employment generation, poverty reduction, and sustainable development.

Keywords: *Foreign direct investment, Trade openness, Economic development, Asia, Technology transfer, Global value chains, Institutional quality, Human capital*

Introduction:

Foreign direct investment, commonly known as FDI, refers to cross-border investment through which an investor obtains a lasting management interest in an enterprise operating outside the investor's home economy. The World Bank generally associates this lasting interest with ownership of at least 10 percent of voting stock. FDI includes equity capital, reinvested earnings, and other forms of long- and short-term capital between affiliated enterprises.

Trade openness is commonly measured through the combined value of exports and imports of goods and services as a percentage of gross domestic product. This indicator reflects the degree to which an economy is connected with international markets, although it does not independently measure tariff policies, regulatory barriers, logistical efficiency, or the composition of exports and imports. The connection among FDI, trade openness, and economic development is particularly relevant to Asia. The region includes advanced industrial economies, major emerging markets, export-oriented manufacturing centres, resource-rich economies, financial hubs, least-developed countries, and landlocked economies. Consequently, the effects of foreign investment and trade differ considerably across countries. The experiences of China, India, Malaysia, Singapore, Thailand, Indonesia, Bangladesh, Pakistan, Viet Nam, and other Asian economies demonstrate that external integration can support rapid structural transformation. Nevertheless, these experiences also reveal that openness alone cannot guarantee development. Economies that successfully converted foreign investment and trade into sustained growth generally combined international integration with education, infrastructure, industrial policy, domestic enterprise development, export promotion, technological learning, and institutional reform. This article adopts a narrative and analytical review approach. It does not claim to present original econometric estimates. Instead, it synthesizes major theoretical arguments, empirical findings, and recent investment trends. Its central proposition is that the developmental effects of FDI and trade openness are conditional. External capital and international trade generate greater benefits when local economies possess sufficient absorptive capacity to acquire technology, develop skills, finance domestic investment, regulate markets, and connect local suppliers with multinational production networks.

Theoretical Relationship Between Foreign Direct Investment, Trade Openness, and Economic Development

Foreign direct investment and trade openness are widely regarded as important components of economic development, particularly in developing and emerging Asian economies. Foreign direct investment occurs when an individual, company, or multinational enterprise from one country establishes a lasting economic interest in a business located in another country. Unlike short-term portfolio investment, FDI generally involves long-term ownership, managerial participation, technology transfer, and a continuing relationship between the foreign investor and the host economy. It may take the form of establishing a new production facility, purchasing or merging with an existing company, reinvesting profits, or expanding an already established foreign-owned enterprise. These different forms of investment can influence economic development through capital formation, employment creation, productivity enhancement, technology diffusion, and integration into international markets. One of the most important theoretical arguments in favour of FDI is that it helps overcome shortages of domestic savings and productive capital. Many developing Asian economies require substantial investment in industry, energy, transport, communications, agriculture, healthcare, housing, education, and digital infrastructure. However, their domestic financial systems may not generate sufficient long-term capital to meet these needs. Low household incomes, limited banking coverage, underdeveloped capital markets, and fiscal constraints can restrict the capacity of local governments and businesses to finance large development projects. FDI can

reduce this financing gap by introducing external capital into productive sectors. Foreign firms may construct factories, establish service centres, invest in renewable-energy projects, expand telecommunications systems, or develop transport infrastructure. These investments can contribute directly to gross fixed capital formation and indirectly stimulate related domestic investment. FDI is also significant because it provides more than financial resources. Multinational enterprises often possess advanced technologies, specialized production systems, internationally recognized brands, sophisticated management techniques, global marketing networks, research facilities, and access to international finance. When foreign companies establish operations in a host country, some of these capabilities may be transferred to local workers, managers, suppliers, distributors, and partner institutions. Employees trained by multinational firms may eventually move to domestic companies or establish their own businesses, carrying new skills and experience with them. Local suppliers may improve their production methods, product quality, accounting systems, labour practices, and delivery schedules to meet the requirements of foreign investors. Universities and research institutions may also benefit through partnerships, internships, technical training, and joint research programmes. Technology transfer represents one of the main channels through which FDI may support long-term economic development. Developing countries often lack access to modern machinery, patents, production processes, digital systems, and scientific knowledge. Foreign firms can introduce these technologies more rapidly than domestic firms might be able to develop them independently. However, the transfer of technology is not automatic. The ability of a country to benefit depends heavily on its absorptive capacity, which includes the education and skills of its workforce, the quality of its institutions, the technological capabilities of local firms, and the availability of supporting infrastructure. Borensztein, De Gregorio, and Lee emphasized that FDI can contribute to economic growth as a vehicle for technology transfer, but its positive effects are stronger in countries with an adequate level of human capital. A host country with weak education systems and limited technical expertise may attract foreign investment without obtaining significant knowledge spillovers. Human capital therefore plays a dual role in the relationship between FDI and development. First, the availability of educated and skilled workers helps attract higher-quality foreign investment. Multinational enterprises engaged in electronics, pharmaceuticals, engineering, information technology, finance, research, and advanced manufacturing prefer locations where qualified workers are available. Second, human capital enables domestic individuals and firms to understand, adapt, and improve the technologies introduced by foreign investors. Where educational attainment is low, foreign companies may import skilled workers or limit their operations to basic assembly and low-value activities. In such cases, employment may increase, but technological learning and industrial upgrading may remain limited. Trade openness is another major pathway through which economies can achieve higher productivity and development. Trade openness generally refers to the extent to which a country allows goods and services to move across its borders with relatively limited restrictions. It may be reflected in lower tariffs, fewer import quotas, simplified customs procedures, more efficient logistics, regional trade agreements, and a high ratio of exports and imports to gross domestic product. Openness enables firms to access foreign markets and increases the potential scale of production. Domestic businesses that previously served only a limited local market can expand their output by exporting to regional and international customers. Larger markets can allow firms to reduce average costs, specialize in particular products, and invest in more efficient technologies. The theory of comparative advantage provides a foundation for understanding the relationship between trade and growth. Countries can improve their overall welfare by specializing in goods and services that they can produce relatively efficiently and importing products that other countries produce at lower opportunity cost. In practice, comparative advantage is not fixed. It can be developed through

investment in education, technology, infrastructure, industrial capabilities, and institutions. Several Asian countries initially specialized in labour-intensive exports such as textiles, garments, footwear, toys, and basic electronics. Over time, some of these economies upgraded towards automobiles, semiconductors, telecommunications equipment, engineering services, pharmaceuticals, digital technologies, and advanced business services. Imports can also support economic development. Although imports are sometimes viewed negatively because they compete with domestic products, many imported goods are essential for production. Developing countries frequently import machinery, industrial equipment, energy resources, software, chemicals, components, and scientific instruments. These imports can improve productivity and allow domestic firms to produce higher-quality goods. Imported intermediate inputs may be incorporated into exports, making domestic industries part of global value chains. Access to foreign capital goods can also reduce the time and cost required for technological modernization. Frankel and Romer presented evidence that trade has a positive effect on national income. Their study addressed the challenge of determining whether trade causes growth or whether richer countries simply engage in more trade. By using geographical characteristics as instruments for trade, they found that greater trade exposure was associated with higher income levels. The broader implication is that international trade can increase productivity through specialization, competition, market expansion, technological diffusion, and access to productive inputs. FDI and trade openness are closely interconnected rather than independent forces. Multinational enterprises often choose investment locations based on their ability to import machinery and components, export finished products, and serve regional markets. An economy with high tariffs, slow customs procedures, weak ports, and restrictions on foreign exchange may be less attractive to export-oriented investors. In contrast, a country integrated into regional trade agreements can offer foreign companies access to a much larger market. This is one reason why countries in South-East Asia have attracted significant manufacturing investment. Companies can establish production facilities in one country while sourcing components and selling products across the wider region. FDI can also increase a host country's trade. Foreign investors may establish export-processing facilities, manufacturing plants, logistics centres, or digital-service operations that serve customers in several countries. They may connect local producers with global distribution networks, provide information about foreign demand, and help domestic firms comply with international standards. For example, investment in electronics manufacturing may increase imports of components while generating exports of assembled or processed products. Over time, the developmental benefit increases when domestic firms begin supplying more of the components, services, engineering, packaging, and logistics used in production. Makki and Somwaru found that FDI and trade can both contribute significantly to economic growth in developing countries. Their analysis also showed that the effects of foreign investment are influenced by human capital, domestic investment, macroeconomic stability, and institutional conditions. This supports the argument that openness should be understood as part of a broader development system. Foreign investment cannot compensate indefinitely for weak education, political instability, unreliable electricity, poor transport, ineffective courts, or limited access to finance. The relationship between openness and development can also produce negative effects. Import competition may force inefficient firms to close, leading to job losses in particular industries or regions. Although resources may eventually move to more productive sectors, the transition can be socially costly and may take many years. Workers with specialized skills may struggle to find new employment, while smaller businesses may not have the capital needed to modernize. Trade liberalization can therefore increase inequality if its benefits are concentrated among exporters, skilled workers, urban regions, and owners of capital.

Foreign investment may also create risks when multinational enterprises dominate local markets or receive privileges unavailable to domestic firms. Foreign companies may repatriate large profits, import most of their inputs, employ relatively few local workers, or operate with limited connections to the rest of the economy. In resource-based industries, FDI can generate substantial export revenue while contributing little to technological development or economic diversification. It can also create environmental and social costs when regulation is weak.

The theoretical relationship among FDI, trade openness, and economic development is therefore conditional rather than automatic. External investment and international trade can support capital formation, productivity, technology transfer, employment, and export diversification. However, their final effect depends on government policy, institutional quality, infrastructure, human capital, financial development, domestic entrepreneurship, and the ability of local firms to participate in new economic opportunities. Countries that combine openness with strong domestic capabilities are more likely to achieve sustained and inclusive development than countries that rely on market liberalization alone.

Foreign Direct Investment and Trade Patterns Across Asian Economies

Asia has emerged as one of the most important regions in the global economy. It contains some of the world's largest manufacturing centres, fastest-growing consumer markets, major financial hubs, leading technology producers, and most active international ports. The region's economic transformation has been supported by industrialization, urbanization, investment in infrastructure, demographic change, rising education levels, export growth, and increasing participation in global and regional value chains. However, Asia is highly diverse. It includes advanced economies, middle-income industrial powers, resource-dependent states, least-developed countries, financial centres, and small island economies. Consequently, patterns of FDI and trade vary substantially across the region. Developing Asia attracts foreign investment because of its large population, growing middle class, competitive production costs, natural resources, strategic location, and expanding digital markets. In many countries, governments have established special economic zones, industrial parks, export-processing zones, investment-promotion agencies, and tax incentives to attract multinational enterprises. Large public investments in highways, airports, seaports, energy, telecommunications, and urban infrastructure have also improved the investment environment. Regional integration agreements have increased market access and reduced trade barriers, making Asia attractive as a location for international production networks. Recent regional investment figures indicate that developing Asia remains a major destination for global FDI. Investment is concentrated in a relatively small number of economies, particularly those with large markets, strong manufacturing capabilities, advanced services, efficient logistics, and predictable institutions. Nevertheless, there are important differences among East Asia, South-East Asia, South Asia, West Asia, and Central Asia. These differences reflect economic structure, policy orientation, political stability, market size, resource endowments, labour skills, and access to regional and global markets. East Asia has historically received a large share of foreign investment because of the economic scale of China and the region's highly developed manufacturing ecosystems. China became a major destination for FDI through its large domestic market, extensive infrastructure, manufacturing capacity, skilled workforce, and integration into global supply chains. Foreign investment contributed to the expansion of electronics, machinery, automobiles, chemicals, consumer products, and export-oriented manufacturing. China also used joint ventures, local-content policies, industrial planning, research investment, and supplier-development strategies to build domestic capabilities. Over time, Chinese firms became important investors abroad as well as recipients of foreign capital. However, East Asia's investment patterns have been changing. Rising labour costs, geopolitical tensions, trade restrictions, supply-chain diversification, and increased competition have encouraged some

multinational enterprises to expand production in other Asian economies. This does not necessarily mean that China has lost its importance. Rather, companies increasingly adopt a "China plus one" strategy in which they maintain significant operations in China while establishing additional facilities in Viet Nam, Malaysia, Thailand, Indonesia, or India. This strategy reduces dependence on a single location and improves resilience against trade disputes, regulatory changes, natural disasters, or logistical interruptions. South-East Asia has become one of the most dynamic regions for FDI. Its attractiveness is supported by the Association of Southeast Asian Nations, which promotes economic cooperation, market integration, and trade facilitation. Singapore functions as a major financial, logistical, and corporate headquarters centre. Malaysia has developed strong electronics, semiconductor, medical-device, and service industries. Thailand has attracted automotive, electronics, food-processing, and tourism investment. Indonesia offers a large consumer market, substantial mineral resources, digital opportunities, and an expanding manufacturing base. Viet Nam has become an important production location for electronics, garments, footwear, furniture, machinery, and export-oriented manufacturing. South-East Asia's growing role in semiconductor and electronics supply chains is particularly important. Demand for digital technologies, electric vehicles, artificial intelligence, data centres, and renewable energy has increased investment in advanced components and manufacturing. Several countries have introduced incentives for semiconductor assembly, testing, packaging, and related industries. However, competition for investment is intense. Countries must improve skills, energy reliability, research capabilities, cybersecurity, and environmental regulation to move beyond labour-intensive assembly into higher-value design, engineering, and innovation. South Asia possesses substantial economic potential because of its large population, young labour force, developing consumer markets, and strategic location between East Asia, Central Asia, the Middle East, and major maritime routes. India is the dominant destination for FDI in the subregion. Its attractiveness reflects a large domestic market, information-technology capabilities, pharmaceutical industries, engineering skills, digital public infrastructure, expanding manufacturing incentives, and major investment in transport and renewable energy. India has attracted foreign capital in telecommunications, electronics, automobiles, financial services, software, healthcare, retail, logistics, and energy. India's experience illustrates the importance of market size and domestic capabilities. Foreign investors may enter India not only to produce for export but also to serve its large consumer market. At the same time, the country's extensive engineering and technology workforce has supported high-value foreign investment in research, design, software, and business services. Nevertheless, India continues to face challenges involving infrastructure gaps, regulatory differences among states, land acquisition, skills mismatches, employment creation, and the need to increase the participation of smaller firms in global value chains. Pakistan also has significant potential to attract foreign investment because of its large population, agricultural base, mineral resources, geographic position, and links with China, Central Asia, the Middle East, and the Arabian Sea. Major opportunities exist in agriculture, food processing, textiles, information technology, renewable energy, mining, logistics, tourism, housing, and infrastructure. The China–Pakistan Economic Corridor has generated investment in energy, transport, and connectivity. However, Pakistan's FDI performance has often been affected by political uncertainty, macroeconomic instability, foreign-exchange shortages, energy-sector difficulties, security concerns, inconsistent regulation, and limited export diversification. Bangladesh has attracted investment in garments, textiles, energy, telecommunications, and consumer goods. Its export-oriented garment sector has benefited from low labour costs, a large workforce, and access to international markets. Yet the country faces the challenge of diversifying beyond garments and improving labour standards, infrastructure, energy supply, and technological capacity. Sri Lanka's location near major

shipping routes creates opportunities in logistics, ports, tourism, services, and manufacturing. However, fiscal and external-debt crises have affected investor confidence. Nepal and Bhutan possess opportunities in hydropower, tourism, agriculture, and regional energy trade, although small markets and difficult geography can limit investment. West Asia presents a different investment structure. Several economies are major oil and gas producers and have historically attracted FDI in energy, construction, finance, real estate, logistics, and infrastructure. In recent years, Gulf countries have pursued economic diversification strategies aimed at reducing dependence on hydrocarbons. Investment is increasingly directed towards renewable energy, tourism, entertainment, technology, financial services, logistics, healthcare, education, advanced manufacturing, and urban development. Large sovereign wealth funds have also become major international investors. The United Arab Emirates has developed into a global business, aviation, trade, and financial hub. Saudi Arabia is implementing large-scale development programmes involving infrastructure, tourism, mining, renewable energy, manufacturing, and digital technology. Qatar, Bahrain, Oman, and Kuwait are also pursuing different forms of diversification. These efforts demonstrate that resource-rich countries can use public investment and foreign partnerships to develop new sectors. However, long-term success depends on productivity, workforce participation, private-sector development, environmental sustainability, and the creation of competitive industries beyond state-supported projects. Central Asia attracts investment primarily in oil, natural gas, mining, transport, agriculture, and infrastructure. Kazakhstan is the largest economy and principal investment destination in the subregion. Its natural resources and location between Europe and Asia provide important advantages. Uzbekistan has introduced economic reforms and increased openness to foreign investors, creating opportunities in manufacturing, textiles, energy, agriculture, tourism, and services. Central Asian economies can benefit from regional transport corridors and growing trade between China, Europe, Russia, South Asia, and the Middle East. However, landlocked geography, limited market size, infrastructure gaps, and governance challenges remain significant constraints. Trade patterns across Asia are equally diverse. Singapore, Viet Nam, Malaysia, and several other smaller economies have very high trade-to-GDP ratios because their production systems depend heavily on international markets. They import raw materials, components, technology, and energy, then export manufactured products and services. Large economies such as China, India, Indonesia, and Pakistan may show lower trade-to-GDP ratios because domestic production and consumption represent a larger proportion of their economies. Trade openness should not be judged solely by the total value of exports and imports. The technological level, domestic value added, product diversity, destination markets, and participation of local firms are equally important. An economy may have a high export ratio but remain dependent on one commodity or low-value product. Such dependence creates vulnerability to price changes, demand shocks, and technological transformation. In contrast, economies with diversified exports in manufacturing and services are generally more resilient.

The Asian experience also demonstrates the importance of global value chains. A product may be designed in one country, use components from several others, be assembled in another location, and then sold worldwide. Asian economies have become deeply involved in these networks, especially in electronics, automobiles, textiles, chemicals, machinery, and consumer products. Participation in global value chains can create jobs and export revenue, but the greatest developmental gains occur when countries progress from simple assembly to component production, engineering, design, branding, research, and ownership of intellectual property. Regional trade agreements have further shaped Asian trade and investment. The Regional Comprehensive Economic Partnership links major Asian and Pacific economies and provides a framework for tariff reduction, rules of origin, trade facilitation, and investment

cooperation. ASEAN economic integration has also supported regional production networks. These agreements may encourage FDI by allowing companies to serve multiple markets from a single production base. However, weaker economies need supportive policies to ensure that their firms can compete and benefit from greater market integration. Overall, Asian FDI and trade patterns show that market size, regional integration, infrastructure, institutional quality, workforce skills, and industrial capabilities strongly influence investment outcomes. Countries that provide only low-cost labour or natural resources may attract investment, but they may remain concentrated in low-value activities. Sustainable development requires continuous upgrading, stronger local enterprises, improved skills, innovation, and deeper domestic linkages with international production systems.

Summary

Foreign direct investment and trade openness have contributed significantly to Asia's transformation into a major centre of global production, commerce, technology, and investment. FDI can provide capital, employment, technology, managerial knowledge, and international market access. Trade openness can expand markets, increase competition, support specialization, lower the cost of productive inputs, and connect domestic firms with international value chains. Recent evidence demonstrates Asia's continuing importance in international investment. Developing Asia received approximately US$644 billion in FDI during 2025, although performance differed considerably across subregions. South-East Asia, South Asia, West Asia, and Central Asia recorded increases, while East Asia experienced lower inflows. The benefits of international integration are not automatic. They depend on human capital, financial development, technological capabilities, infrastructure, macroeconomic stability, effective institutions, environmental regulation, and linkages between foreign and domestic firms. Economies that lack these conditions may receive foreign investment without achieving substantial technological learning, productivity growth, or inclusive development.

Asian policymakers should consequently focus on the quality rather than merely the quantity of FDI and trade. Foreign investment should complement domestic enterprise, workforce development, innovation, export diversification, and sustainable infrastructure. Trade policies should be coordinated with industrial, educational, financial, social, and environmental strategies. The most effective development model is neither complete economic isolation nor uncontrolled liberalization. It is strategic integration: an approach that uses foreign capital and trade to strengthen domestic productive capacity. Through transparent institutions, skilled human resources, modern infrastructure, strong local enterprises, and carefully designed public policies, Asian countries can transform international economic integration into sustainable, resilient, and inclusive development.

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